JONES DAY®

VOL. 20 • NO. 5
SEPTEMBER–OCTOBER
2021

ONE FIRM WORLDWIDE®

BUSINESS RESTRUCTURING REVIEW

SECURED LENDER'S CREDIT BID RIGHT IN BANKRUPTCY SALE DENIED

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A secured creditor's right to "credit bid" the amount of its allowed claim in a bankruptcy sale of its collateral is an important creditor protection codified in section 363(k) of the Bankruptcy Code. Even so, a ruling recently issued by the U.S. Bankruptcy Court for the Central District of California reaffirms the principle that the right to credit bid a claim is not absolute and may be limited or denied altogether "for cause." Because the determination of whether (and to what extent) a secured claim should be allowed often "cannot be adjudicated before there is a sale of the Debtor's assets," the court in *In re Figueroa Mountain Brewing, LLC*, 2021 WL 2787880 (Bankr. C.D. Cal. July 2, 2021), ruled in an unpublished decision that it "would be unfair to limit or deny [a lender] a credit bid simply because the Debtor has filed an objection." However, without adjudicating the claim objection, the court found that "cause" existed to deny a secured lender the right to credit bid its disputed claim in a bankruptcy sale of its collateral because there was a sufficient objective basis to support the debtor's allegations that, among other things, its loan agreement and all payments made by the debtor under it were fraudulent transfers and the lender had dominated and controlled the debtor in an effort to take control of its assets.

CREDIT BIDDING

Section 363(k) of the Bankruptcy Code provides that a creditor with a lien on assets to be sold outside the ordinary course of business under section 363(b) may credit bid its "allowed claim" at the sale, "unless the court for cause orders otherwise." A credit bid is an offset of a secured claim against the collateral's purchase price. The U.S. Supreme Court explained in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 644 n.2 (2012), that "[t]he ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price" and "enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan."

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

In the aftermath of *RadLAX*, the debate shifted largely to the circumstances that constitute "cause" under section 363(k) to prohibit or limit a secured creditor's right to credit bid its claim. Because "cause" is not defined in the Bankruptcy Code, whether it exists has been

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left for the courts to determine. *See In re Olde Prairie Block, LLC*, 464 B.R. 337, 348 (Bankr. N.D. Ill. 2011) (citing cases).

In *In re Fisker Automotive Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del. 2014), the court limited the amount of a credit bid to the discounted purchase price actually paid by the credit bidder to purchase the secured debt it was credit bidding. The court held that limiting the amount of the credit bid was warranted because an unrestricted credit bid would chill bidding and because the full scope of the underlying lien was as yet undetermined. The court also expressed concern as to the expedited nature of the proposed sale under section 363(b), which in the court's view was never satisfactorily explained.

Since *Fisker*, a handful of courts have addressed the issue, with mixed outcomes. Some courts have denied motions to limit credit bidding rights. *See, e.g., In re Empire Generating Co, LLC*, 2020 WL 1330285 (S.D.N.Y. Mar. 23, 2020) (denying certain minority lenders' motion for leave to appeal a bankruptcy court order approving bid procedures and finding no cause to limit a collateral agent's right, in accordance with the terms of an intercreditor agreement, to credit bid the full amount of an undersecured claim in a bankruptcy sale despite allegations that the credit bid was tantamount to a *sub rosa* chapter 11 plan, the collateral agent had no "claim" against the debtors, and the credit bid would contravene the duty of the collateral agent under the intercreditor agreement to act in the best interest of all secured lenders); *In re Aéropostale, Inc.*, 555 B.R. 369 (Bankr. S.D.N.Y. 2016) (denying a motion to limit lenders' ability to credit bid their secured claim in a bankruptcy sale of the company in the absence of inequitable conduct, such as collusion, undisclosed agreements, or any other actions designed to chill bidding or unfairly distort the sale process and where no party challenged the validity or extent of the lenders' liens); *In re Tempnology, LLC*, 542 B.R. 50, 69 (Bankr. D.N.H. 2015) (denying a challenge to a secured creditor's right to credit bid its claim in the absence of any evidence of inequitable conduct or that the secured claim was subject to *bona fide* dispute), *aff'd*, 558 B.R. 500 (B.A.P. 1st Cir. 2016), *aff'd*, 879 F.3d 376 (1st Cir. 2018); *In re Charles Street African Methodist Episcopal Church of Boston*, 510 B.R. 453 (Bankr. D. Mass. 2014) (denying in part a motion to limit a credit bid where the debtor's counterclaims did not relate to the validity of the secured creditor's claims or liens, but requiring the secured creditor to include in its bid cash in an amount equal to a breakup fee payable to the stalking-horse bidder); *see also In re Aerogroup Int'l, Inc.*, 620 B.R. 517 (D. Del. 2020) (a secured creditor does not cap its secured claim in amount of its credit bid by making a credit bid at auction sale of its collateral, unless its credit bid is the winning bid at auction); *In re Murray Metallurgical Coal Holdings, LLC*, 614 B.R. 819, 835 (Bankr. S.D. Ohio 2020) (noting in *dicta* that "cause exists to reduce the amount of a credit bid only if there is 'specific evidence' demonstrating the allegation of bid chilling 'to be true in th[e] [particular] case'" (citations omitted)).

Other courts have found "cause" to limit or deny such rights. *SEC v. Capital Cove Bancorp LLC*, 2015 BL 449611 (C.D. Cal. Oct. 13, 2015) (finding cause to deny a creditor's request to credit bid at a sale due to, among other things, the existence of a prima facie case against the creditor for securities fraud, evidence of a Ponzi scheme involving the creditor, the creditor's other fraudulent acts, and the existence of a *bona fide* dispute regarding the validity of the creditor's liens); *In re Family Christian, LLC*, 533 B.R. 600 (Bankr. W.D. Mich. 2015) (refusing to approve a credit-bid sale to a party that, as a "consultation party" to the auction, had been privy to certain information that allowed it to gain an unfair advantage over other bidders, tantamount to insider trading); *In re The Free Lance-Star Publishing Co.*, 512 B.R. 798 (Bankr. E.D. Va.) (finding cause to limit a credit bid by an entity that purchased $39 million in face amount of debt at a discount where: (i) some of the creditor's liens had been improperly perfected; (ii) the creditor engaged in inequitable conduct by forcing the debtor into bankruptcy and an expedited section 363 sale process in pursuing a clearly identified loan-to-own strategy; and (iii) the creditor actively frustrated the competitive bidding process and

attempted to depress the sale price of the debtors' assets); *In re RML Dev., Inc.*, 528 B.R. 150, 155-56 (Bankr. W.D. Tenn. 2014) (limiting the amount of a secured creditor's credit bid to the undisputed portion of its claim and noting that "a modification or denial of credit bid rights should be the extraordinary exception and not the norm").

FIGUEROA MOUNTAIN

Buellton, California-based craft beer maker Figueroa Mountain Brewing LLC ("FMB") filed for chapter 11 protection in the Central District of California in October 2020. At the time of the filing, White Winston Select Asset Funds, LLC ("Winston") claimed that FMB owed approximately $9.5 million to Winston under a 2019 bridge loan. The original principal amount of the loan was $750,000, but the loan agreement was subsequently modified several times during 2019 and 2020 to increase the availability to $10.5 million. The loan was structured and treated as a revolving loan, under which FMB's revenues were generally collected by Winston through a lockbox account and then readvanced to FMB.

The Winston loan was secured by liens on substantially all of FMB's assets. However, with one exception, Winston's liens were junior to a lien granted to Montecito Bank and Trust ("MBT") securing MBT's claim in the amount of approximately $4.3 million. Pursuant to a subordination agreement, Winston held a first priority lien in FMB inventory and proceeds up to the amount of $1.5 million.

In January 2021, Winston commenced an adversary proceeding in the bankruptcy court seeking declaratory relief regarding the validity, extent, and priority of its liens and allowance of its claim. FMB asserted various affirmative defenses, counterclaims, and cross-claims in response, including: (i) the loan was unenforceable because Winston was not validly doing business in California due to its failure to register as a foreign limited liability company; (ii) Winston dominated and controlled FMB in an effort to seize control of FMB's assets; (iii) the loan was usurious; (iv) Winston would be unjustly enriched if its loan were repaid; and (v) recovery of the loan proceeds was barred by the doctrine of unclean hands.

The relief sought by FMB included a judgment disallowing Winston's claim under section 502(b)(1) of the Bankruptcy Code, recharacterizing the Winston debt as equity, equitably subordinating Winston's claim under section 510(c) of the Bankruptcy Code, avoiding the Winston loan and all payments made to Winston as preferential and fraudulent transfers under federal bankruptcy law and California law, and awarding FMB compensatory, statutory, and punitive damages due to Winston's conduct.

In March 2021 (and again in June), FMB sought court approval of bidding procedures governing an anticipated auction of substantially all of its assets under section 363(b) of the Bankruptcy Code. It also filed a motion seeking an order depriving Winston of the right to credit bid its claim under section 363(k), asserting, among other things, that the claim was subject to bona fide dispute and should be disallowed due to Winston's inequitable and domineering conduct.

THE BANKRUPTCY COURT'S RULING

Initially, U.S. Bankruptcy Judge Martin R. Barash noted that even though section 363(k) expressly endows the holder of an *allowed* secured claim with the right to credit bid, "[t]he filing of an objection [to the claim] containing allegations—without more—is not enough to limit or deny a credit bid." In this case, he explained, FMB's request for relief was "part of a complicated adversary proceeding that has not been adjudicated and cannot be adjudicated before there is a sale of [FMB's] assets." *Figueroa Mountain*, 2021 WL 2787880, at *6.

Judge Barash next rejected FMB's argument that Winston should not be permitted to credit bid its claim because the credit bid would chill the bidding at the anticipated auction. According to the judge, "the risk of chilling bids is [not] an independently adequate basis to limit or deny a credit bid." Instead, he noted, there must be "other reasons" why permitting a secured creditor to credit bid the entirety of its claim is inequitable.

Judge Barash also rejected FMB's argument that Winston should not be permitted to credit bid because it allegedly engaged in inequitable conduct, including using its contractual rights and position of power to exercise financial and operational control over FMB, exacerbating FMB's financial difficulties, and increasing FMB's debt to Winston by adding millions of dollars of fraudulent, unreasonable, and/or unnecessary amounts to the loan, with the ultimate objective of acquiring ownership of FMB's assets. According to Judge Barash, although these allegations might be proven at trial, "the evidentiary record presently is not adequate to establish definitively that . . . Winston is responsible for the inequitable conduct of which it has been accused." *Id.* at *7.

However, Judge Barash concluded that Winston's right to credit bid should be denied because its claim was subject to genuine dispute based on an objective evidentiary record. He explained that other courts that have limited credit bidding rights where the allowance of a disputed secured claim has not been adjudicated have required a showing that a "sufficient dispute exists regarding the lien forming the basis for a credit bid," rather than demonstration that the party seeking to limit or deny credit bidding "is likely to succeed on its challenges." *Id.* at *8 (citing cases).

Judge Barash then applied the test for whether a dispute is a "bona fide dispute" under section 363(f)(4) of the Bankruptcy Code, which permits a sale of estate property free and clear of an interest in the property if the "interest is in bona fide dispute." Under that test, he explained, the court must "determine whether there is an objective basis for either a factual or a legal dispute as to the validity of the claim." *Id.* (citations and internal quotation marks omitted).

Judge Barash found that there was an objective basis in fact and law to conclude that Winston's claim was subject to a

genuine dispute. He accordingly ruled that "cause" existed under section 363(k) to deny Winston the right to credit bid its disputed claim "in any amount."

Specifically, Judge Barash determined that a genuine dispute existed as to whether the Winston loan and all payments made under it by FMB should be avoided as constructive fraudulent transfers under section 548(a) of the Bankruptcy Code because "[t]he evidence presented provide[d] an objective basis for [FMB's] cause of action to avoid the Bridge Loan and related transactions." *Id.* at *11. Among other things, he found that the evidence supported the conclusion that FMB was insolvent at the time the loan agreement was signed and amended and that FMB did not receive reasonably equivalent value in exchange for the obligations it assumed due to exorbitant interest, fees, and other charges. He also found that Winston had not established that any value it conferred on FMB was given in good faith.

Finally, Judge Barash noted that "the evidence suggest[s] an ulterior motive on the part of" Winston and its representative who handled the relationship with FMB because there was "an objective basis to conclude that [Winston and its representative] were using their roles as a lender and 'consultant' to exacerbate the [FMB's] distress and position [Winston] to acquire [FMB's] assets." *Id.* at *12 n.5.

OUTLOOK

Figueroa Mountain is an unusual case because it involved the outright denial, rather than limitation, of a secured creditor's right to credit bid in a bankruptcy sale. The outcome appears to have been influenced significantly by the court's perception that allegations of the lender's egregious misconduct, even though not yet adjudicated in a pending adversary proceeding, were sufficiently colorable to rise to the level of "cause" under section 363(k). Other cases might present a more nuanced fact pattern. The ruling, however, reinforces the rubric that credit-bidding rights in bankruptcy are not absolute, but qualified.

STRUCTURED DISMISSAL OF CHAPTER 11 CASES DID NOT VIOLATE *JEVIC*

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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 chapter 11 case that violate the Bankruptcy Code's ordinary priority rules without the consent of creditors. However, because the Court declined to express any "view about the legality of structured dismissals in general," the impact of the ruling on such relief remains an open question. The U.S. Bankruptcy Court for the Southern District of New York recently examined this issue in *In re KG Winddown, LLC*, 628 B.R. 739 (Bankr. S.D.N.Y. 2021). According to the court, "[*Jevic*] left the door open where such dismissals do not violate the absolute priority rule and otherwise comply with the applicable provisions of the Bankruptcy Code.... [and] [h]ere, the Debtors' request for structured dismissals fits neatly through that open door."

STRUCTURED DISMISSALS

In a typical successful chapter 11 case, a plan of reorganization or liquidation is proposed, the plan is confirmed by the bankruptcy court, the plan becomes effective, and, after the plan has been substantially consummated and the case has been fully administered, the court enters a final decree closing the case. Because chapter 11 cases can be prolonged and costly, prepackaged or prenegotiated plans and expedited asset sales under section 363(b) of the Bankruptcy Code have been increasingly used as methods to short-circuit the process, minimize expenses, and maximize creditor recoveries.

After a bankruptcy court approves the sale of substantially all of a chapter 11 debtor's assets under section 363(b), a number of options are available to deal with the debtor's vestigial property and claims against the bankruptcy estate, and to wind up the bankruptcy case. Namely, the debtor can propose and seek confirmation of a liquidating chapter 11 plan, the case can be converted to a chapter 7 liquidation, or the case can be dismissed. The first two options commonly require significant time and administrative costs.

Yet outright dismissal of a chapter 11 case may not be the best course of action either, for several reasons. Section 349(b) of the Bankruptcy Code provides that, "[u]nless the court, for cause, orders otherwise," the dismissal of a bankruptcy case (other than a case filed under the Securities Investor Protection Act) reinstates the status quo ante by, among other things, reinstating any prebankruptcy custodianship, vacating any bankruptcy court order avoiding a transfer or lien, and revesting property of the estate in the debtor. Dismissal of a case is intended to "undo the Bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case." H.R. Rep. No. 95-595, 338 (1977).

However, because conditions may have changed such that a complete restoration of the status quo is difficult or impossible, section 349(b) permits the bankruptcy court, "for cause," to modify the ordinary "restorative consequences" of unconditional dismissal of the chapter 11 case. *Jevic*, 137 S. Ct. at 979. This power is particularly relevant in cases where the debtor's assets have been sold in a section 363(b) sale. *See* H.R. Rep. No. 95-595, 338 (1977) (the intent "to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case . . . does not necessarily encompass undoing sales of property from the estate to a good faith purchaser").

Such a conditional dismissal—or "dismissal with strings"—is commonly referred to as a "structured dismissal," which has been defined by the American Bankruptcy Institute ("ABI") as follows:

> a hybrid dismissal and confirmation order in that it typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third party-releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case. These additional provisions—often deemed "bells and whistles"—are usually the result of a negotiated and detailed settlement arrangement between the debtor and key stakeholders in the case.

Final Report and Recommendations of the ABI Commission to Study the Reform of Chapter 11 (2014), p. 270.

TYPICAL TERMS

Among the provisions commonly included in bankruptcy court orders approving structured dismissals are:

- Expedited procedures to resolve claims objections.
- Provisions specifying the manner and amount of distributions to creditors.
- Releases and exculpation provisions that might ordinarily be approved as part of a confirmed chapter 11 plan.
- Senior creditor carve-outs and "gifting" provisions, whereby, as a *quid pro quo* for a consensual structured dismissal, a senior secured lender or creditor group agrees to carve out a portion of its collateral from the sale proceeds and then "gift" it to unsecured creditors.
- Provisions that, notwithstanding section 349(b), prior bankruptcy court orders survive dismissal and the court retains jurisdiction to implement the structured dismissal order; to resolve certain disputes; and to adjudicate certain matters, such as professional fee applications.

SOURCES OF AUTHORITY

The Bankruptcy Code does not expressly authorize or contemplate structured dismissals. Even so, sections 105(a), 305(a)(1), 349(b), and 1112(b) are commonly cited as authority for the remedy. *See, e.g., In re Olympic 1401 Elm Assocs., LLC*, 2016 WL

4530602 (Bankr. N.D. Tex. Aug. 29, 2016); *In re Naartjie Custom Kids, Inc.*, 534 B.R. 416 (Bankr. D. Utah 2015); *see generally* Amir Shachmurove, *Another Way Out: Structured Dismissals in* Jevic's *Wake*, Norton Bankr. L. Adviser (November 2015) (referencing use of sections 105, 305, 349, and 1112 as authority).

Section 1112(b)(1) directs a bankruptcy court, on request of a party in interest and after notice and a hearing, to convert a chapter 11 case to a chapter 7 liquidation or to dismiss the chapter 11 case, "whichever is in the best interests of creditors and the estate, for cause." "Cause" is defined in section 1112(b)(4) to include, among other things, "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" and "inability to effectuate substantial consummation of a confirmed plan."

Section 305(a)(1) of the Bankruptcy Code provides that a bankruptcy court may dismiss or suspend all proceedings in a bankruptcy case under any chapter if "the interests of creditors and the debtor would be better served by such dismissal or suspension." Section 305(a)(1) has traditionally been used to dismiss involuntary cases where recalcitrant creditors involved in an out-of-court restructuring file an involuntary bankruptcy petition to extract more favorable treatment from the debtor. However, the provision has also been applied to dismiss voluntary cases, albeit on a more limited basis. Because an order dismissing a case under section 305(a) may be reviewed on appeal only by a district court or a bankruptcy appellate panel, rather than by a court of appeals or the U.S. Supreme Court (*see* 11 U.S.C. § 305(c)), section 305(a) dismissal is an "extraordinary remedy." *See In re Kennedy*, 504 B.R. 815, 828 (Bankr. S.D. Miss. 2014). Section 305(a) has been cited as authority for approving a structured dismissal. *See, e.g., Olympic 1401*, 2016 WL 4530602, at *3; *Naartjie*, 534 B.R. at 425-26.

As noted above, section 349(b) authorizes a bankruptcy court to alter the ordinary consequences of dismissal "for cause." *See In re Johnson*, 565 B.R. 417, 425 (Bankr. C.D. Cal. 2017) ("Although not explicitly authorized by the Bankruptcy Code, structured dismissals (under § 1112(b) and/or § 305(a)) have been found to be implicitly authorized under § 349(b)").

Section 105(a) of the Bankruptcy Code provides that a bankruptcy court "may issue any order, process, or judgment that

is necessary or appropriate to carry out the provisions" of the Bankruptcy Code. However, section 105(a) "'does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.'" *Law v. Siegel*, 134 S. Ct. 1188, 1194 (2014) (quoting COLLIER ON BANKRUPTCY ("COLLIER") ¶ 105.01[2] (16th ed. 2013)).

THE BANKRUPTCY CODE'S PRIORITY SCHEME

The Bankruptcy Code sets forth certain priority rules governing distributions to creditors in both chapter 7 and chapter 11 cases. Secured claims enjoy the highest priority under the Bankruptcy Code. The Bankruptcy Code then recognizes certain priority unsecured claims, including claims for administrative expenses, wages, and certain taxes. *See* 11 U.S.C. § 507(a). General unsecured claims come next in the priority scheme, followed by any subordinated claims and the interests of equity holders.

In a chapter 7 case, the order of priority for the distribution of unencumbered assets is determined by section 726 of the Bankruptcy Code. The order of distribution ranges from payments on claims in the order of priority specified in section 507(a), which have the highest priority, to payment of any residual assets to the debtor, which has the lowest priority. Distributions are to be made pro rata to parties of equal priority within each of the six categories specified in section 726. If claimants in a higher category of distribution do not receive full payment of their claims, no distributions can be made to parties in lower categories.

In a chapter 11 case, the chapter 11 plan usually determines the treatment of secured and unsecured claims (as well as equity interests), subject to the requirements of the Bankruptcy Code. If a creditor does not agree to "impairment" of its claim under the plan—such as by agreeing to receive less than payment in full—and votes to reject the plan, the plan can be confirmed only under certain specified conditions. Among these conditions are the following: (i) the creditor must receive at least as much under the plan as it would receive in a chapter 7 liquidation (11 U.S.C. § 1129(a)(7)); and (ii) the plan must be "fair and equitable" (11 U.S.C. § 1129(b)(1)).

Section 1129(b)(2) of the Bankruptcy Code provides that a plan is "fair and equitable" with respect to a dissenting impaired class of unsecured claims if the creditors in the class receive or retain property of a value equal to the allowed amount of their claims or, failing that, if no creditor or equity holder of lesser priority receives any distribution under the plan. This is known as the "absolute priority rule."

The Bankruptcy Code does not expressly state whether these priority rules apply to structured dismissals, and until *Jevic*, precedent concerning this issue was sparse and inconsistent.

JEVIC

In *Jevic*, the Supreme Court held that bankruptcy courts may not deviate from the Bankruptcy Code's priority scheme when approving structured dismissals absent the consent of affected creditors (without, however, offering any "view about the legality of structured dismissals in general"). *Jevic*, 137 S. Ct. at 985.

The Court distinguished *Jevic* from 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 6–2 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." *Jevic*, 137 S. Ct. at 985. 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. *Id.*

The Court further explained that "in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve." *Id.* By contrast, it 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 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). *Id.* at 986.

JEVIC'S IMPACT

Based on *Jevic*, many courts have refused to approve structured dismissals, settlements, and related transactions that appeared to fit within the scope of *Jevic*'s prohibition of nonconsensual final distributions to creditors that violate the Bankruptcy Code's distribution scheme. *See, e.g.*, *In re Micron Devices, LLC*, 2021 WL 2021468, *10 (Bankr. S.D. Fla. May 20, 2021) (in approving a proposed settlement agreement, noting that "the 'structured dismissals' the Debtor has asked for, first directly and then indirectly—would not pass muster" under *Jevic* because, among other things, administrative claimants would not be paid in full); *In re Bluefield Women's Ctr., P.C.*, 2021 WL 1245949, *5 (Bankr. S.D.W. Va. Mar. 30, 2021) ("[Certain unsecured creditors] plead, in the alternative, that the 'cause' provision of § 349(b) would allow this Court to approve the structured dismissal. . . . This Court does not agree. Harkening back to the Supreme Court's decision in *Jevic*, 'cause' is too slender a reed for this Court to approve disbursement of funds in contravention to the Code's priority scheme."); *In re Fleetstar LLC*, 614 B.R. 767, 786–87 (Bankr. E.D. La. 2020) ("[T]o the extent the proposed 'dismissal with terms' provides for distributions that disturb the absolute priority rule designated in the Bankruptcy Code without the consent of all affected creditors, this Court is prohibited by the Supreme Court's holding in *Jevic* from approving such proposal.").

However, other courts have approved such dismissals or transactions by strictly limiting *Jevic* to its facts or by finding that the relief sought fell within one of the permitted exceptions articulated by the Court in its ruling. *See, e.g.*, *In re Veg Liquidation, Inc.*, 931 F.3d 730, 739 (8th Cir. 2019) (unequal distribution of the proceeds from a section 363 sale to unsecured creditors with equal priority was not prohibited by *Jevic*); *In re Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018) (refusing to apply *Jevic* to disturb an asset sale under section 363(b) and ruling that section 363(m) rendered statutorily moot an appellate challenge to a sale to a good faith purchaser); *In re Goodrich Quality Theaters, Inc.*, 616 B.R. 514, 521 (Bankr. W.D. Mich. 2020) (relying on the "competing bankruptcy principles" identified in *Jevic*, namely preservation of going concern value and prospects for reorganization, to approve critical vendor payments), *as supplemented*, 2020 WL 1180534 (Bankr. W.D. Mich. Mar. 9, 2020); *In re Claar Cellars, LLC*, 2020 WL 1238924 (Bankr. E.D. Wash. Mar. 13, 2020) (holding that the debtor's use of cash collateral to pay in part a prepetition, allegedly secured debt owed to an affiliated debtor did not violate *Jevic*); *In re ACI Concrete Placement of Kansas, LLC*, 604 B.R. 400, 407 (Bankr. D. Kan. 2019) (holding that enforcing a "carve out" from a secured creditor's collateral for payment of professional fees did not violate *Jevic*); *In re Daily Gazette Co.*, 584 B.R. 540, 546 (Bankr. S.D.W. Va. 2018) (a proposed disbursement following a section 363 sale that would result in an orderly payment of administrative claims, such as attorneys' fees and U.S. Trustee fees, followed by payment to an undisputed secured creditor with essentially a blanket lien covering in excess of the net sale proceeds "neither runs afoul of *Jevic* nor the Code generally").

KG WINDDOWN

In July 2020, former "Kona Grill" restaurant chain companies KG Winddown, LLC and certain affiliates (collectively, "debtors") filed for chapter 11 protection in the Southern District of New York for the second time in two years. On December 22, 2020, the bankruptcy court approved a sale of substantially all of the debtors' assets to secured creditor BSP Agency, LLC and related entities (collectively, "BSP"). The purchase price consisted of, among other things, a credit bid in the amount of the debtors' liability under pre- and postpetition credit facilities ($18 million), a $100,000 cash payment reserved for distribution to general unsecured creditors, cash in an amount sufficient to cover all cure amounts under assumed executory contracts, and the assumption of certain liabilities. The order approving the sale exculpated BSP for acts taken in connection with the sale.

The sale transaction included transition services agreements providing for the transfer of liquor licenses and other permits to BSP for certain restaurants located in Florida, New York, and New Jersey. On May 14, 2021, the debtors filed a motion seeking a structured dismissal of the chapter 11 cases of all debtors except two for which liquor licenses had not yet been transferred. On the filing date of the motion, the debtors' cash balance was approximately $1.14 million, but that decreased to approximately $940,000 two weeks later. In connection with the motion, the debtors' counsel agreed to discount its fees and expenses to the extent necessary to pay other administrative claims in full, but no cash remained to make any distributions to unsecured creditors.

The debtors' motion sought approval of various procedures to implement dismissal, including: (i) notice to all creditors and interest holders; (ii) authorization to pay allowed administrative claims, including U.S. Trustee fees, in full or as agreed otherwise; and (iii) authorization to file a certification requesting dismissal of the remaining debtors' cases once their liquor licenses had been transferred. The debtors also requested an order that, notwithstanding section 349, all prior court orders issued in the chapter 11 cases would remain in full force and effect after dismissal and the court would retain jurisdiction to: (i) resolve any disputes regarding the implementation of its orders; and (ii) adjudicate an adversary proceeding ("Katzoff AP") filed during the case by BSP alleging certain defendants impermissibly interfered in the sale transaction by preventing certain liquor license and domain name transfers.

The U.S. Trustee objected to the dismissal motion, arguing that the motion was: (i) premature because the debtors were not seeking immediate dismissal, but instead asking for approval of a two-step dismissal process conditioned on the liquor license transfers; (ii) unnecessary with respect to the payment of administrative claims; and (iii) improper because the debtors sought a "blanket reservation" of all orders in the case.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court granted the debtors' motion to approve the structured dismissals.

Bankruptcy Judge Martin Glenn acknowledged that a bankruptcy court's authority to order a structured dismissal "is the subject of some debate." However, he explained, although *Jevic* limited the potential scope of structured dismissals, it "'did not entirely close the door,'" provided the proposed dismissal contemplates distributions that do not the violate the Bankruptcy Code's priorities or the parties consent to nonconforming distributions, and dismissal otherwise complies with the applicable provisions of the Bankruptcy Code. *KG Winddown*, 628 B.R. at 745 (quoting COLLIER at ¶ 1129.09).

Here, Judge Glenn noted, the U.S. Trustee did not argue that the distributions proposed by the debtors as part of dismissal violated the statute's priority scheme, but merely that the contemplated distribution to administrative claimants was already dictated by the Bankruptcy Code, making court approval an unnecessary "comfort order." Judge Glenn disagreed, writing that, "[w]hile perhaps not required, approval would provide certainty to the Debtors and the creditors, and promote the orderly winding-up of the estates, which is precisely the purpose of the contemplated structured dismissal." *Id.* at 747.

He also rejected the U.S. Trustee's argument that dismissal was premature. According to Judge Glenn, "[t]he U.S. Trustee has not identified any concrete reason that the proposed two-step

process should not be approved, or why [non-pending liquor license transfer] Debtors' cases should not be dismissed before [the remaining] Debtors' cases are dismissed." *Id*.

In accordance with *In re Porges*, 44 F.3d 159 (2d Cir. 1995), Judge Glenn concluded that he could dismiss the debtors' chapter 11 cases, yet retain jurisdiction over the Katzoff AP pursuant to section 349.

Finally, Judge Glenn held that, pursuant to section 349, the court had the power to direct that orders entered during the debtors' chapter 11 cases, including the sale order containing the BSP exculpation provision, would survive dismissal. That provision, he noted, was negotiated in reliance that the sale order would survive dismissal under any circumstances and "appears to be precisely the kind of right that should be protected through section 349." Moreover, he emphasized, the U.S. Trustee raised this objection too late, having failed to object to exculpation at the time the court approved the sale.

OUTLOOK

Like many other rulings issued in the aftermath of *Jevic*, *KG Winddown* indicates that rumors of the demise of structured dismissals are an exaggeration. To be sure, *Jevic* clearly prohibits nonconsensual distributions that violate the Bankruptcy Code's priority scheme as part of a structured chapter 11 dismissal. However, priority-scheme-conforming or consensual distributions in connection with a structured dismissal are valid, and interim nonconforming distributions, such as settlement or critical vendor payments (whether or not consensual), may still be authorized provided they serve a recognized bankruptcy purpose.

Bankruptcy courts in the Southern District of New York have been prominent proponents of the continued vitality of structured dismissals post-*Jevic*. In addition to *KG Winddown*, Bankruptcy Judge Robert Drain recently approved a structured dismissal of the chapter 11 cases of grocery store chain Great Atlantic & Pacific Tea Co. and certain affiliates (collectively, "A&P") after A&P liquidated substantially all of its assets, leaving it with insufficient funds to confirm a plan. *See In re Atlantic & Pacific Tea Co. Inc.*, No. 15-23007 (RDD) (Bankr. S.D.N.Y. May 15, 2021) [Doc. No. 4810]. The structured dismissal order distributed A&P's assets in accordance with the Bankruptcy Code's priority scheme—after distribution of collateral to secured creditors, administrative claimants received an approximately 20% recovery and junior creditors received nothing. Judge Drain rejected arguments that the cases should instead be converted to chapter 7 liquidations and that *Jevic* should be interpreted broadly to preclude any proposed plan-like relief that circumvents the Bankruptcy Code's procedural safeguards. According to Judge Drain, the structured dismissal did not violate *Jevic* because, among other things, the provisions governing the wind-down of A&P's remaining assets did not constitute "plan relief" or an end-run around the Bankruptcy Code's creditor protections.

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"WORK-FOR-HIRE" FILM PRODUCTION AGREEMENT NOT EXECUTORY CONTRACT IN BANKRUPTCY DUE TO LACK OF MUTUAL CONTINUING MATERIAL OBLIGATIONS

Daniel J. Merrett • Mark G. Douglas

Whether a contract is "executory" such that it can be assumed, rejected, or assigned in bankruptcy is a question infrequently addressed by the circuit courts of appeals. The U.S. Court of Appeals for the Third Circuit provided some rare appellate court-level guidance on the question in *Spyglass Media Group, LLC v. Bruce Cohen Productions (In re Weinstein Company Holdings LLC)*, 997 F.3d 497 (3d Cir. 2021). The Third Circuit affirmed lower court rulings holding that a "work-made-for-hire" contract between a film company debtor and the producer of a motion picture was not an executory contract because the producer lacked any remaining "material obligations." In so ruling, the court noted that the parties to a contract can override the Bankruptcy Code's intended protections for a debtor in connection with certain contracts, but only by clearly and unambiguously providing that continuing obligations are material in the text of the agreement and thereby ensuring to the maximum extent possible that the contract will be found to be executory.

ASSUMPTION AND REJECTION OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES

Section 365(a) of the Bankruptcy Code provides that, with certain exceptions delineated elsewhere in the statute, "the trustee, subject to the court's approval, may assume or reject any executory

contract or unexpired lease of the debtor." The trustee's power to assume or reject is conferred upon a chapter 11 debtor-in-possession ("DIP") under section 1107(a) of the Bankruptcy Code. Rejection results in a court-authorized breach of the contract, with any claim for damages treated as a prepetition claim against the estate on a par with the claims of other general unsecured creditors (unless the debtor has posted security). 11 U.S.C. § 365(g). Assumption of a contract requires, among other things, that the trustee or DIP cure all existing monetary defaults and provide adequate assurance of its future performance. 11 U.S.C. § 365(b).

Bankruptcy courts will generally approve assumption or rejection of an executory contract if presented with evidence that either course of action is a good business decision. *See Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019) ("The bankruptcy court will generally approve [the] choice [to assume or reject], under the deferential 'business judgment' rule."). Upon assumption, most kinds of executory contracts may also be assigned by the trustee or DIP to third parties under the circumstances specified in sections 365(c) and 365(f). In chapter 11 cases, except with respect to certain kinds of contracts (such as nonresidential real property leases, aircraft lease agreements, and commitments to a federal depository institutions regulatory agency), the trustee or DIP may decide to assume or reject at any time up to confirmation of a chapter 11 plan. However, any nondebtor party to a contract may seek to compel the trustee or DIP to assume or reject the contract prior to confirmation, in which case the bankruptcy court must decide what period of time is reasonable to make the decision. 11 U.S.C. §§ 365(d)(2), (d)(4), and (o). Pending the decision to assume or reject, the trustee or DIP is generally obligated to keep current on most obligations that become due under the contract postpetition. 11 U.S.C. §§ 365(d)(3) and (d)(5).

DEFINITION OF "EXECUTORY"

The Bankruptcy Code does not define "executory." Based on the legislative history of section 365, the U.S. Supreme Court concluded in a 1984 decision that "Congress intended the term to mean a contract 'on which performance is due to some extent on both sides.'" *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 522 n.6 (1984) (quoting H.R. Rep. No. 95-595, 347 (1977); S. Rep. No. 95-989, 58 (1978)).

However, because nearly all contracts involve some unperformed obligations on both sides as of the bankruptcy petition date, many courts have adopted the more restrictive definition proposed by Professor Vern Countryman, who in 1973 defined an "executory" contract as "[a] contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." *See* V. Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973); *see also* V. Countryman, *Executory Contracts in Bankruptcy: Part II*, 57 Minn. L. Rev. 479 (1974); *see generally* COLLIER ON BANKRUPTCY ("COLLIER") ¶ 365.02 (16th ed. 2021) (citing cases).

Thus, according to this approach, unless both parties have unperformed obligations as of the bankruptcy petition date that would constitute a material breach if not performed, the contract is not executory. *See In re Columbia Gas Sys. Inc.*, 50 F.3d 233, 239 (3d Cir. 1995); *accord In re Bennett Enterprises, Inc.*, 628 B.R. 481 (Bankr. D.N.J. 2021) (a contract for the sale of a debtor's liquor license did not remain executory after the purchaser obtained a state court order for specific performance because, under New Jersey law, neither party had any remaining material obligations to the other under the sale contract, and to the extent either party failed to fulfill its obligations under the state court order, the state court had authority to complete, or appoint a third party to complete, those obligations); *see also In re Brick House Properties LLC*, 2021 WL 3502914, *6 (Bankr. D. Utah June 11, 2021) (noting that, in accordance with the Tenth Circuit's ruling in *In re Baird*, 567 F.3d 1207 (10th Cir. 2009), the Countryman definition applies, but with the caveat that the remaining obligations must be "significant").

State law determines what constitutes a material unperformed obligation. *Columbia Gas*, 50 F.3d at 239 n.10; *In re Houston*, 2009 WL 3762257, at *2 (Bankr. W.D. Ky. Nov. 9, 2009) ("Whether a party's nonperformance of the remaining obligations under a contract would constitute a material breach is a factual question resolved through application of state law.") (citing *In re Teligent, Inc.*, 268 B.R. 723, 730 (Bankr. S.D.N.Y. 2001)); *Seitz v. Paul T. Freund Corp.*, 2009 WL 1011617, at *2 (W.D.N.Y. Apr. 15, 2009) ("Determination of whether a breach is material is a factual question resolved by resort to state law. . . . In New York, a material breach is one which substantially defeats the purpose of the contract, and if uncured, will operate to excuse the other party from further performance.").

Some courts have eschewed the traditional Countryman test in favor of a result-oriented or "functional" approach examining whether the bankruptcy estate will benefit from assumption or rejection of the contract instead of looking at the mutuality of unperformed material obligations. *See In re Fin. Oversight & Mgmt. Bd. for Puerto Rico*, 2021 WL 2676983, *4 (D.P.R. June 29, 2021) (noting that the functional approach works "'backward from an examination of the purposes to be accomplished by rejection, and if they have already been accomplished then the contract cannot be executory'" (citation omitted) and ruling that a prebankruptcy settlement agreement was executory and could be assumed under either the Countryman or the functional test); *see generally* COLLIER at ¶ 365.02 (citing cases).

Yet another approach is a "modern contract analysis" proposed by Professor Jay L. Westbrook and Kelsi S. White in their article titled "The Demystification of Contracts in Bankruptcy," 91 Am. Bankr. L.J. 481 (Summer 2017), which is premised on the notion that the Countryman test is outmoded and confusing. This approach would abolish the "material breach" rule that embodies executoriness as a prerequisite to application of section 365.

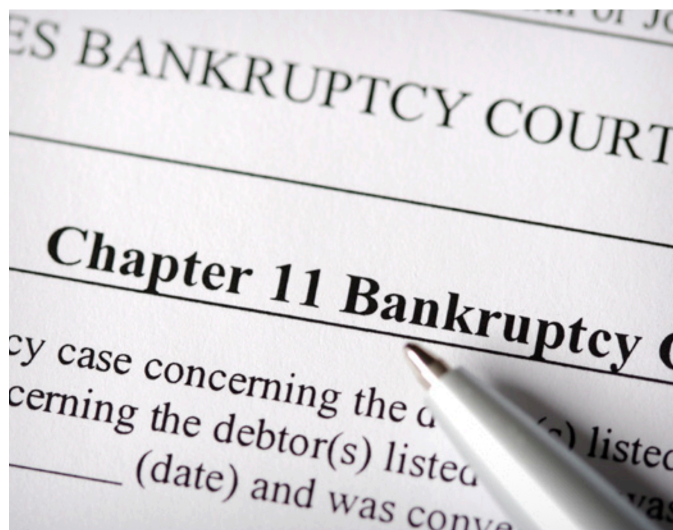
Instead, the court would engage in the following analysis to determine whether a contract should be assumed or rejected:

(1) Determine under state contract law if the contract contains some obligations that remain to be performed. If not, it cannot be assumed or rejected;
(2) If there is nothing remaining under the contract except obligations owed by the debtor (*e.g.*, payment), assumption or rejection is not necessary because there is nothing left to do except payment and discharge through the bankruptcy process;
(3) If some obligations remain other than mere payment, consider whether the net benefit to the estate from performance by both parties (assumption) exceeds the net benefit from the estate's breach of the contract and payment of the breach (rejection) claim; and
(4) The court should approve the course of action resulting in net benefit to the estate, unless some other specific provision in section 365 requires a different conclusion.

Id. at 489.

If a contract or agreement is not executory, it may be neither assumed nor rejected. Instead, the contract may give rise to either an estate asset or a liability—in the latter case, a claim that may be asserted against the estate by the non-debtor party. Thus, for example, if the non-debtor party has fully performed under the contract and "the only remaining obligation is the [debtors'] duty to pay," the contract is not executory. *Teligent*, 268 B.R. at 732; *accord Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1046 (4th Cir. 1985) ("It is true that a contract is not executory as to a party simply because the party is obligated to make payments of money to the other party.").

However, like other assets of a bankruptcy estate, a contract that is not executory may be sold by the trustee or DIP as part of a chapter 11 plan or in a sale under section 363 of the Bankruptcy Code. In the event of a sale "free and clear" under section 363(f), the trustee or DIP need not cure any defaults under the contract,



and, unless the parties agree otherwise, the buyer would not assume any prepetition liabilities under the contract. *See In re Am. Home Mortg. Holdings, Inc.*, 402 B.R. 87, 94 (Bankr. D. Del. 2009) ("[S]ection 363 of the Bankruptcy Code permits a debtor to transfer its rights and obligations under a non-executory contract . . . [and] section 363(f)(5) permits the rights and obligations under one non-executory contract to be transferred free and clear of claims arising under other contracts."); *accord In re Badlands Energy, Inc.*, 608 B.R. 854, 874 (Bankr. D. Colo. 2019).

WEINSTEIN

In 2011, Bruce Cohen ("Cohen") and his production company entered into an agreement ("Cohen agreement") with the predecessor-in-interest of The Weinstein Company ("TWC") to make the film *Silver Linings Playbook*. The contract was structured as a "work-made-for-hire," meaning that Cohen owned none of the intellectual property in the picture but was paid $250,000 in fixed initial compensation and had the right to contingent future compensation equal to approximately 5% of the picture's future profits. The contingent compensation provision stated that, if the film was produced by Cohen, and Cohen and his production company fully performed all required services and obligations under the agreement, "and are not otherwise in breach or default hereof," Cohen was entitled to the specified contingent compensation.

The film was successfully released in 2012.

In March 2018, TWC filed for chapter 11 protection in the District of Delaware for the purpose of selling its assets under section 363 of the Bankruptcy Code to Spyglass Media Group, LLC ("Spyglass"). At the time of the bankruptcy filing, Cohen was owed approximately $400,000 in profits from the film. The sale closed in July 2018. Under the asset purchase agreement, Spyglass agreed to pay any cure amounts necessary under assumed executory contracts. However, Spyglass had until November 2018 to designate which TWC executory contracts it wanted to assume as part of the transaction. In October 2018, Spyglass sought a declaratory judgment from the bankruptcy court that the Cohen agreement was not executory and, therefore, could not be assumed and assigned (with an attendant cure obligation) but was part of the section 363 sale.

Cohen objected. Other writers, producers, and actors with similar work-made-for-hire contracts similarly asserted that their contracts were executory and that Spyglass owed them millions of dollars in contingent compensation incident to TWC's cure obligations under section 365(b).

In a test case for these disputes, the bankruptcy court ruled that the Cohen agreement was not executory and thus could be sold under section 363 to Spyglass without triggering a cure payment obligation. The district court affirmed, and Cohen appealed to the Third Circuit.

THE THIRD CIRCUIT'S RULING

At the outset of its opinion, the Third Circuit explained that, if the Cohen agreement was executory, Spyglass had to cure existing defaults and pay approximately $400,000 in contingent compensation to Cohen. If the contract was not executory, Spyglass needed to comply only with post-closing obligations coming due under the agreement.

Writing for the three-judge panel, Circuit Judge Thomas L. Ambro noted that New York law governed the Cohen agreement. This meant that the court was required to analyze whether the agreement "contained at least one obligation for both [TWC] and [Cohen] that would constitute a material breach under New York law if not performed." *Weinstein*, 997 F.3d at 503 (citation and internal quotation marks omitted). Under New York law, Judge Ambro explained: (i) "[a] material breach is a failure to do something that is so fundamental to a contract that the failure to perform that obligation defeats the essential purpose of the contract"; and (ii) in accordance with the substantial performance doctrine, if the defaulting party has substantially performed, the other party is not excused from performing. *Id.*

According to Judge Ambro, TWC's obligation to pay contingent compensation to Cohen was "clearly material" because it far exceeded Cohen's fixed compensation under the Cohen agreement. However, Cohen's remaining obligations, including his agreement to refrain from seeking injunctive relief about the exploitation of the film, his obligation to indemnify TWC against third-party claims arising from any breaches committed by him, and restrictions on his ability to assign the contract, were "all ancillary after-thoughts in a production agreement." *Id.* at 507.

Judge Ambro rejected Cohen's argument that the court could not substitute its own judgment because Cohen and TWC expressly agreed that all of Cohen's obligations under the Cohen agreement were material in the provision requiring TWC to pay his contingent compensation if he was "not otherwise in breach or default." Judge Ambro acknowledged that parties can contract around a default rule such as the substantial performance rule—i.e., "they can agree that what to the ordinary person is immaterial is nonetheless not so"—and that if a contract "makes plain that certain unperformed obligations are material, we can conclude that the contract is executory without further analysis." *Id.* (citations omitted). However, he concluded that the parties to the Cohen agreement did not "clearly and unambiguously avoid the substantial performance rule for evaluating executory contracts." *Id.* at 508.

Among other reasons, Judge Ambro explained: (i) the language relied on by Cohen for the materiality of his remaining obligations was "buried in a long covenant provision" rather than being part of the remedies or termination section of the contract; and (ii) the requirement that Cohen not be in breach or default "may be better viewed as a condition precedent to TWC's payment obligation" than a duty or an obligation, indicating that the contract was not executory. *Id.*

Finally, Judge Ambro noted that, if accepted, Cohen's position would permit the contract parties to override debtor protections in the Bankruptcy Code:

> [T]he Code's treatment of contracts facilitates the debtor's rehabilitation by treating non-executory contracts where only the debtor has material obligations to perform as liabilities of the estate, so the debtor does not accidentally assume them without good reason. Here, the logical implication of Cohen's position is that the Cohen Agreement would be an executory contract forever, no matter how much he has already performed.... That would be a highly unusual result and would contravene the protections created for the Debtors by the Bankruptcy Code....
>
> To be clear, we recognize that parties can contract around a state's default contract rule regarding substantial performance, and by doing so they can also override the Bankruptcy Code's intended protections for the debtor. However, that result can only be accomplished clearly and unambiguously in the text of the agreement.

Id. at 509. The Third Circuit accordingly affirmed the lower courts' determinations that the Cohen agreement was not an executory contract.

OUTLOOK

Weinstein does not break any new ground on the definition of an executory contract that may be rejected, assumed, or assumed and assigned in a bankruptcy case. Even so, the ruling is notable because it provides rare appellate court-level guidance on the issue. It also highlights that parties may, through clearly drafted provisions, specify those obligations that they intend to be material under an agreement that may end up as part of a bankruptcy estate.

STALKING HORSE BIDDER MAY BE ENTITLED TO ADMINISTRATIVE PRIORITY FOR EXPENSES DESPITE FAILURE TO CLOSE BANKRUPTCY SALE

Brad B. Erens • Mark G. Douglas

In *In re Energy Future Holdings Corp.*, 990 F.3d 728 (3d Cir. 2021), the U.S. Court of Appeals for the Third Circuit ruled that even though a "stalking horse" bidder failed to obtain necessary regulatory approvals to close an anticipated bankruptcy asset sale, the bidder potentially could receive an administrative claim for a break-up fee and expenses if it could demonstrate that its efforts provided value to the estate. The ruling represents an expansive view on this issue and may provide bidders with enhanced protection for their bids. In so ruling, the Third Circuit reversed lower court rulings, directing the bankruptcy court on remand to determine whether the bidder's actions conferred an actual benefit on the estate. The parties ultimately entered into a settlement that, if approved by the bankruptcy court, would result in the bidder receiving $4 million.

ALLOWANCE OF ADMINISTRATIVE EXPENSES IN BANKRUPTCY

Section 503 of the Bankruptcy Code provides that, "[a]fter notice and a hearing, there shall be allowed, administrative expenses, . . . including—(1)(A) the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b). According to the Third Circuit, for a claim to be entitled to administrative expense status under this provision, it must "arise from a [postpetition] transaction with the debtor-in-possession," and "be beneficial to the debtor-in-possession in the operation of the business." *Calpine Corp. v. O'Brien Envtl. Energy, Inc. (In re O'Brien Envtl. Energy, Inc.)*, 181 F.3d 527, 532–33 (3d Cir. 1999); *accord In re Philadelphia Newspapers, LLC*, 690 F.3d 161, 172–73 (3d Cir. 2012). The party asserting an administrative expense claim bears the burden of demonstrating that it is entitled to administrative expense status. *O'Brien*, 181 F.3d at 533.

The U.S. Supreme Court has ruled that postpetition tort claims may also be allowed as administrative expenses if those claims arise from actions related to the preservation of a bankruptcy estate, even if those claims have no discernable benefit to the estate. *Reading Co. v. Brown*, 391 U.S. 471, 477, 88 S.Ct. 1759 (1968) (holding that fire damage costs resulting from the negligent actions of a bankruptcy receiver acting in the scope of his authority are an "actual and necessary" expense of reorganization). Although *Reading* involved interpretation of the former Bankruptcy Act, subsequent decisions have recognized that its analysis applies to section 503(b) of the Bankruptcy Code. *See, e.g., Philadelphia Newspapers*, 690 F.3d at 173-74; *In re B. Cohen & Sons Caterers, Inc.*, 143 B.R. 27 (E.D. Pa. 1992); *In re Hayes Lemmerz Int'l, Inc.*, 340 B.R. 461 (Bankr. D. Del. 2006); *In re Brooke Corp.*, 485 B.R. 650 (Bankr. D. Kan. 2013); *In re Women First Healthcare, Inc.*, 332 B.R. 115 (Bankr. D. Del. 2005).

STALKING HORSES AND BREAK-UP FEES

Section 363(b)(1) of the Bankruptcy Code authorizes a bankruptcy trustee or chapter 11 debtor in possession, "after notice and a hearing," to use, sell, or lease property of the estate outside the ordinary course of business. While a sale under section 363(b)(1) is most frequently undertaken by means of a public auction, in which assets are generally sold to the highest bidder, the bankruptcy court may also approve a private sale entered into between the debtor and a purchaser.

Generally speaking, the initial bidder in a public auction held under section 363—the "stalking-horse bidder"—sets the minimum price and other terms of the transaction. Because of the time and effort expended by the stalking-horse bidder in performing due diligence and engaging in the negotiations necessary to arrive at the initial bid, bankruptcy courts generally will allow reasonable bid protections for the bidder in the event the stalking-horse bidder does not prevail at the auction. Those bid protections, which are typically the subject of extensive negotiations, often include reimbursement of expenses incurred by the bidder in connection with the transaction, a "break-up" fee equal to a specified percentage of the bidder's purchase price, auction procedures, and certain other rights related to the stalking-horse bid.

Outside of bankruptcy, a seller's decision to give such protections are typically accorded deference under the "business judgment" rule. In the bankruptcy context, however, several different approaches have been applied by courts in assessing the propriety of bid protections. *See generally* COLLIER ON BANKRUPTCY ¶ 363.02[7] (16th ed. 2021). Some courts apply a business judgment standard to the issue, which involves the highest degree of deference to the debtor's decision to commit to the bidding protections under scrutiny. Other courts apply stricter scrutiny, requiring evidence that proposed bid protections are in the "best interests of the estate." *Id.*

Finally, some courts, and in particular the Third Circuit, have generally allowed or disallowed bid protections, including break-up fees, according to the standards governing the allowance of administrative expenses under section 503(b). *See In re Reliant Energy Channelview LP,* 594 F.3d 200 (3d Cir. 2010) (reaffirming that section 503(b) administrative expense treatment is the only appropriate standard for ruling on break-up fees); *O'Brien*, 181 F.3d at 535 ("[T]he allowability of break-up fees, like that of other administrative expenses, depends upon the requesting party's ability to show that the fees were actually necessary to preserve the value of the estate. Therefore, we conclude that the business judgment rule should not be applied as such in the bankruptcy context. Nonetheless, the considerations that underlie the debtor's judgment may be relevant to the Bankruptcy Court's determination on a request for break-up fees and expenses."); *accord In re Acis Cap. Mgmt., L.P.,* 604 B.R. 484, 517 (N.D. Tex. 2019); *In re President Casinos, Inc.*, 314 B.R. 786, 788 (Bankr. E.D. Mo. 2004).

ENERGY FUTURE

Energy Future Holdings Corp. and its affiliates (collectively, "EFH") filed for chapter 11 protection on April 29, 2014, in the District of Delaware. Subject to bankruptcy court approval, EFH negotiated a merger agreement with NextEra Energy, Inc. ("NextEra") under which NextEra would pay off a significant portion of EFH's debt ($9.8 billion) in exchange for EFH's 80% indirect economic interest in Oncor Electric Delivery Company LLC ("Oncor"), Texas's largest electric power transmission and distribution company. NextEra made consummation of the merger agreement subject to the removal of a regulatory "ring fence" around Oncor put in place by the Public Utility Commission of Texas ("PUCT") in 2007. The ring fence prohibited NextEra from appointing or replacing Oncor board members and prevented Oncor from making distributions to NextEra.

The merger agreement provided that a $275 million termination fee would be payable to NextEra if EFH terminated the agreement. Specifically, under the agreement: (i) if NextEra terminated the merger following a failure to obtain PUCT approval to remove the ring fence, that would not trigger the termination fee; but (ii) if EFH terminated the merger following a failure to obtain PUCT approval, the termination fee would be payable as an administrative expense.

Section 6.7 of the merger agreement further provided for the parties to bear their own costs and expenses, as follows:

> Except as otherwise provided in Section 6.3, Section 6.18, Section 6.19, Section 6.20 and Section 6.22 or any administrative expenses of [EFH's estate] addressed in the Plan of Reorganization, whether or not the Merger is consummated, all costs and expenses incurred in connection with this Agreement and the Closing Date Transactions and the other transactions contemplated by this Agreement shall be paid by the party incurring such expense.

The bankruptcy court approved the merger agreement, including the termination fee.

The PUCT ultimately denied NextEra's request to remove the ring fence. It also denied two motions filed by NextEra for reconsideration of that decision. NextEra then appealed the PUCT's decision to a Texas state court, but EFH terminated the merger agreement while the appeal was pending. Shortly afterward, the bankruptcy court approved a merger between EFH and another entity—Sempra Energy ("Sempra"). Sempra paid $9.45 billion in connection with the transaction—several hundred million dollars less than the $9.8 billion NextEra had agreed to pay—but the Sempra merger agreement contemplated that the ring fence would remain undisturbed.

Thereafter, an EFH creditor moved the bankruptcy court to reconsider its approval of the NextEra termination fee. The creditor argued that, in approving the merger agreement, the court had not realized that NextEra had no incentive to terminate the agreement if PUCT did not approve the Oncor deal. Rather, NextEra had every incentive not to terminate because doing so would mean that it would not receive the termination fee, whereas NextEra would receive the fee if it waited for EFH to terminate the agreement. NextEra opposed the creditor's motion and filed an application for payment of the fee.

The bankruptcy court granted the motion for reconsideration and modified the termination fee provision in the merger agreement to preclude NextEra from receiving it. In so ruling, the court wrote:

> The Court had a fundamental misunderstanding of the critical facts when it approved the Termination Fee. Despite the Court's direct question as to whether the Termination Fee would be payable if the PUCT declined to approve the NextEra Transaction, the record is incomplete and confusing on that fundamental point. The Court simply did not understand that if the PUCT declined to approve the NextEra Transaction and the [EFH] (as opposed to NextEra) terminated the Merger Agreement the Termination Fee would be payable to NextEra.... The confusing record was critical because in combination with another fact that was not mentioned, i.e., the Merger Agreement had no time limit, the reality was that ***under no foreseeable circumstances***

would NextEra terminate the Merger Agreement if the PUCT declined to approve the NextEra Transaction. Why? Because NextEra had the ability to hold out and to pursue numerous motions for reconsideration and a fruitless appeal until [EFH was] forced by economic circumstances to terminate the Merger Agreement, which is exactly what occurred. If the Court had understood these critical facts it would not have approved this provision of the Termination Fee.

In re Energy Future Holdings Corp., 575 B.R. 616, 632-33 (Bankr. D. Del. 2017), *aff'd*, 904 F.3d 298 (3d Cir. 2018). However, the court held that NextEra could seek allowance of an administrative claim "on a ground other than the grounds on which the Termination Fee was denied." The Third Circuit affirmed the bankruptcy court's ruling on direct appeal. *See In re Energy Future Holdings Corp.*, 904 F.3d 298 (3d Cir. 2018), *cert. denied sub nom. NextEra Energy, Inc. v. Elliott Assocs., L.P.*, 139 S. Ct. 1620 (2019) ("*EFH I*"). NextEra's request for rehearing *en banc* by the Third Circuit and a petition seeking U.S. Supreme Court review were both denied.

NextEra then filed an application in the bankruptcy court under section 503(b)(1)(A) to recover costs "incurred in its efforts to complete the transaction, obtain the requisite regulatory approvals, and complete the acquisition of [EFH's] Oncor assets from the time the Merger Agreement was executed until [EFH] gave notice of termination." Certain EFH creditors objected to the application and moved to dismiss it or, in the alternative, for summary judgment.

The bankruptcy court granted the motion to dismiss NextEra's application. The court reasoned that there was no "competitive bidding process" in connection with the NextEra transaction and that EFH "eventually closed a transaction with Sempra for substantially less value." The court rejected NextEra's argument that its efforts provided a "roadmap" for the Sempra deal, emphasizing that there was no benefit to the bankruptcy estate because EFH "[was] forced . . . to find an alternative transaction at far less value."

The bankruptcy court also concluded that NextEra was not entitled to payment of the requested costs under the express language of the merger agreement, cited above. The district court affirmed the ruling, and NextEra appealed to the Third Circuit.

THE THIRD CIRCUIT'S RULING

A three-judge panel of the Third Circuit reversed and remanded the case below. The Third Circuit did reject NextEra's argument that it benefited the estate by acting as a stalking horse. NextEra's bid was the sole offer and did not attract higher offers, but in fact resulted in an alternate merger transaction with Sempra at a significantly lower price.

However, writing for the panel, District Judge Wendy Beetlestone (sitting by designation) concluded that section 6.7 of the merger agreement did not bar NextEra's request for payment of fees as an administrative expense claim. According to Judge Beetlestone:

> The unambiguous meaning of Section 6.7, then, is that except as specified in certain sections of the Merger Agreement, "administrative expenses of [EFH's estate]" are allowed . . . if determined by the Bankruptcy Court to be expenses that were "actual and necessary" to preserving [EFH's estate] . . . . Only costs that do not meet the requirements of § 503(b)(1)(A) or are not otherwise enumerated in the Merger Agreement are barred by Section 6.7. Appellees' argument that NextEra waived its right to claim general administrative expenses pursuant to § 503(b)(1)(A) is contrary to the plain language of Section 6.7.

Energy Future, 990 F.3d at 740. Next, Judge Beetlestone determined that NextEra "plausibly alleged" that its expenses conferred an actual benefit on the estate "by providing valuable information, and accepting certain risks, that paved the way for the later Sempra deal." In reversing the lower courts on this point, she explained that, in the context of a motion to dismiss, the inquiry "is not whether NextEra actually benefitted the estate, but whether it plausibly alleged that it did so." *Id.* at 747.

According to Judge Beetlestone, benefit to the estate "does not have to be substantial" and "less readily calculable benefits, such as the ability to conduct business as usual, can qualify." She further noted that promoting more competitive bidding by inducing an initial bid, along with encouraging prospective bidders to do their due diligence and "research[ing] the value of the debtor and convert[ing] that value to a dollar figure on which other bidders can rely" can qualify as a "benefit." *Id.* at 742 (citations and internal quotation marks omitted).

Judge Beetlestone agreed that NextEra plausibly alleged that its efforts in drafting the merger agreement and the chapter 11 plan, settling creditor objections to the proposed merger, and "proving to future bidders that [EFH's] interest would necessarily have the [ring fence] attached saved [EFH] from reinventing the wheel even after the deal with NextEra fell through." *Id.* at 745. Even though the Sempra merger involved a substantially lower price, the Sempra bid "was for Oncor with the undesirable ring fence intact and was, therefore, a bid on a different bag of goods." *Id.* at 744. Moreover, NextEra's unsuccessful efforts toward consummating the merger without the ring fence "provided future bidders with the necessary information to place informed bids, with the understanding that the ring fence would remain." *Id.* at 745.

The Third Circuit concluded that NextEra plausibly alleged it benefited the estate through its "due diligence" attempting to obtain PUCT approval of the transaction without the ring fence because NextEra's actions "'increase[d] the likelihood that the price at which the debtor['s asset] is sold will reflect its true worth.'" *Id.* (quoting *O'Brien*, 181 F.3d at 535, 537). It accordingly reversed the lower courts' dismissal of NextEra's application and remanded the case below.

OUTLOOK

Because *Energy Future* involved reversal of an order granting a motion to dismiss, the Third Circuit directed the bankruptcy court to consider whether NextEra's efforts "actually benefitted" the estate. On remand, the Third Circuit wrote, the bankruptcy court should "consider the equities to NextEra as part of its balancing of the benefit and costs to the estate," including "the fairness—or lack thereof—of NextEra being induced by the assurance of a Termination Fee to make the substantial outlays it did, only, when all was said and done, to lose out not only on the deal but also on the Termination Fee." *Id.* at 742 n.8.

However, the Third Circuit cautioned, because Termination Fees are "meant to account for the risk of mergers rather than be an accurate valuation of merger-related services, . . . the size of the Termination Fee is not, absent more, an appropriate guide to the value of the benefits to the estate." *Id.* at 746 n.13. It also emphasized that the question of "whether [a] Termination Fee, if correctly understood at the time it was approved, produced a benefit to the estate" does not govern the bankruptcy court's inquiry on remand. Rather, the bankruptcy court must determine whether actions taken by NextEra to consummate the merger "provided a benefit worthy of administrative expense reimbursement wholly apart from any Termination Fee." *Id.* at 743 n.9.

On September 1, 2021, NextEra, EFH, and certain other parties reached a settlement regarding NextEra's application for the allowance of an administrative expense claim. Under the proposed settlement, which is subject to bankruptcy court approval, NextEra's administrative expense claim would be allowed in the amount of $15 million, but NextEra would be paid only $4 million on that claim with funds contributed by a third party, the parties would grant mutual releases, and the litigation would be dismissed.

Despite its complicated and unusual procedural posture, *Energy Future* is significant. The Third Circuit adopted a potentially broad view of what can qualify as a plausible administrative expense claim under section 503(b)(1)(A) of the Bankruptcy Code in the context of a proposed transaction under section 363(b) of the Bankruptcy Code. Under this ruling, even unsuccessful efforts to consummate a transaction can potentially benefit the estate and render related expenses eligible for administrative claim status. As a result, parties documenting bidding protections may wish to include language specifically identifying the scope of recoverable administrative expense claims or specific waivers of the right to cover such expenses from the estate in the event of an unsuccessful bid.

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N.Y. DISTRICT COURT RULES THAT CHAPTER 15 RECOGNITION NOT REQUIRED TO ENFORCE FOREIGN BANKRUPTCY INJUNCTION

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U.S. courts have a long-standing tradition of recognizing or enforcing the laws and court rulings of other nations as an exercise of international "comity." It has been generally understood that recognition of a foreign bankruptcy proceeding under chapter 15 is a prerequisite to a U.S. court enforcing, under the doctrine of comity, an order or judgment entered in a foreign bankruptcy proceeding or a provision in foreign bankruptcy law applicable to a debtor in such a proceeding.

A ruling recently handed down by the U.S. District Court for the Southern District of New York directly challenges this principle, which has existed since chapter 15 was enacted in 2005. In *Moyal v. Munsterland Gruppe GmbH & Co.*, 2021 WL 1963899 (S.D.N.Y. May 17, 2021), the court dismissed litigation against a German company, finding that, under principles of comity, the lawsuit was stayed by operation of German law when the company filed for bankruptcy in Germany. The district court did so despite the absence of any order issued by a U.S. bankruptcy court recognizing the German bankruptcy proceeding under chapter 15.

COMITY

"Comity" is "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 164 (1895). International comity has been interpreted to include two distinct doctrines: (i) "legislative," or "prescriptive," comity; and (ii) "adjudicative comity." *Maxwell Comm'n Corp. v. Société Générale (In re Maxwell Comm'n Corp.)*, 93 F.3d 1036, 1047 (2d Cir. 1996).

The former "shorten[s] the reach of a statute"—one nation will normally "refrain from prescribing laws that govern activities connected with another state when the exercise of such jurisdiction is unreasonable." *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, 237 (Bankr. S.D.N.Y. 2017).

"Adjudicative comity," or "comity among courts," is an act of deference whereby the court of one nation declines to exercise jurisdiction in a case that is properly adjudicated in a foreign court. Because a foreign nation's interest in the equitable and orderly distribution of a foreign debtor's assets is an interest deserving respect and deference, U.S. courts generally defer to foreign bankruptcy proceedings and decline to adjudicate creditor claims that are the subject of such proceedings. *See Canada*

Southern Railway Co. v. Gebhard, 109 U.S. 527, 548 (1883) (“the true spirit of international comity requires that [foreign schemes of arrangement], legalized at home, should be recognized in other countries”); *accord In re Int’l Banking Corp. B.S.C.*, 439 B.R. 614, 624 (Bankr. S.D.N.Y. 2010) (citing cases).

Prior to 2005, as an exercise of comity, U.S. courts regularly enforced stays of creditor collection efforts against a foreign debtor or its U.S. assets issued in connection with foreign bankruptcy proceedings. *See, e.g., Philadelphia Gear Corp. v. Philadelphia Gear de Mexico, S.A.*, 44 F.3d 187 (3d Cir. 1994) (deferring to Mexican bankruptcy proceeding); *Badalament, Inc. v. Mel-O-Ripe Banana Brands, Ltd.*, 265 B.R. 732 (E.D. Mich. 2001) (deferring to Canadian bankruptcy proceeding); *Lindner Fund, Inc. v. Polly Peck Int’l PLC*, 143 B.R. 807 (S.D.N.Y. 1992) (citing cases and dismissing litigation brought in U.S. against UK company that was debtor in UK insolvency proceedings); *Cornfeld v. Investors Overseas Services, Ltd.*, 471 F. Supp. 1255 (S.D.N.Y. 1979) (deferring to Canadian bankruptcy proceeding), *aff’d*, 614 F.2d 1286 (2d Cir. 1979).

In many such cases, U.S. courts recognized and enforced the stays of foreign courts in granting relief in an “ancillary proceeding” brought by the representative of a foreign debtor under section 304 of the Bankruptcy Code—the repealed precursor to chapter 15 of the Bankruptcy Code. Section 304 expressly authorized a U.S. bankruptcy court to enjoin the commencement or continuation of any action against a foreign debtor with respect to property involved in a foreign bankruptcy case. *See, e.g., JP Morgan Chase Bank v. Altos Hornos de Mexico S.A. de C.V.*, 412 F.3d 418 (2d Cir. 2005); *Cunard S.S. Co. v. Salen Reefer Servs. AB*, 773 F.2d 452 (2d Cir. 1985); *Hoffman v. Joint Official Liquidators (In re Nat’l Warranty Ins. Risk Retention Grp.)*, 306 B.R. 614 (B.A.P. 8th Cir.), *aff’d*, 384 F.3d 959 (8th Cir. 2004).

However, an ancillary proceeding under section 304 was “not the exclusive remedy for foreign debtors opposing actions by local creditors against assets located in the United States.” *Hembach v. Quikpak Corp.*, 1998 WL 54737, *4 (E.D. Pa. Jan. 8, 1998). The foreign representative could request that the U.S. court recognize foreign bankruptcy proceedings as a matter of international comity, without seeking relief under section 304. *See Interpool, Limited v. Certain Freights of the M/VS Venture Star, Mosman Star, Fjord Star, Lakes Star, Lily Star*, 878 F.2d 111 (3d Cir. 1989); *Remington Rand Corporation–Delaware v. Business Sys. Inc.*, 830 F.2d 1260, 1267–68 (3d Cir. 1987) (section 304 “expresse[d] Congressional recognition of an American policy favoring comity for foreign bankruptcy proceedings . . . [and was] not the exclusive source of comity”); *In re Enercons Virginia, Inc.*, 812 F.2d 1469, 1471–72 (4th Cir. 1987); *see generally* COLLIER ON BANKRUPTCY (“COLLIER”) ¶ 1509.02 (16th ed. 2021) (“Thus, foreign representatives could, theoretically at least, try their luck in a variety of courts, with failure in one not precluding a second try in another.”).

Prior to the enactment of chapter 15, many courts examined whether a foreign proceeding was “procedurally fair” and did not violate U.S. law or public policy in assessing whether a U.S. court should defer to the proceeding under principles of comity. *See, e.g., JP Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V.*, 412 F.3d 418, 428 (2d Cir. 2005); *In re Artimm, S.r.L.*, 335 B.R. 149, 161 (Bankr. C.D. Cal. 2005).

CHAPTER 15 ALTERS THE LANDSCAPE

The enactment of chapter 15 in 2005 changed the requirements for seeking recognition and enforcement in the United States of foreign bankruptcy court orders or laws impacting a foreign debtor or its U.S. assets.

Under section 1515 of the Bankruptcy Code, a “foreign representative” 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.

A “foreign proceeding” is defined in section 101(23) of the Bankruptcy Code as:

> [A] collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. Chapter 15 therefore contemplates recognition in the United States of both a “foreign main proceeding”—a case pending in the country where the debtor’s center of main interests (“COMI”) is located (*see* 11 U.S.C. § 1502(4))—and “foreign

nonmain proceedings" pending in countries where the debtor merely has an "establishment" (*see* 11 U.S.C. § 1502(5)).

Upon recognition of a foreign main proceeding, section 1520(a) provides that certain provisions of the Bankruptcy Code automatically come into force, including section 362, which imposes an automatic stay preventing creditor collection efforts with respect to the debtor or its U.S. assets. 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 proceeding.

Section 1509(b) provides that, if a U.S. bankruptcy court recognizes a foreign proceeding, the foreign representative may apply directly to another U.S. court for appropriate relief, and a U.S. court "shall grant comity or cooperation to the foreign representative." Section 1509(c) accordingly specifies that a foreign representative's request for comity or cooperation from another U.S. court "shall be accompanied by a certified copy of an order granting recognition" under chapter 15.

If a U.S. bankruptcy court denies a petition for recognition of a foreign proceeding, section 1509(d) authorizes the court to "issue any appropriate order necessary to prevent the foreign representative from obtaining comity or cooperation" from other U.S. courts. However, a foreign representative's failure to commence a chapter 15 case or to obtain recognition does not prevent the foreign representative from suing in a U.S. court "to collect or recover a claim which is the property of the debtor." 11 U.S.C. § 1509(f). Indeed, section 1509's "requirement of prior permission by way of recognition by a bankruptcy court deals only with acts by a foreign representative who needs the assistance of a court in the United States. Nothing in the statute requires prior judicial permission for acts that do not implicate matters of comity or cooperation by courts." *In re Iida*, 377 B.R. 243, 258 (B.A.P. 9th Cir. 2007).

These provisions reflects lawmakers' intention that chapter 15 be the "exclusive door to ancillary assistance to foreign [restructuring or insolvency] proceedings," with the goal of controlling such cases in a single court. COLLIER at ¶ 1509.03 (quoting H.R. Rep. No. 109-31(I), 110 (2005) ("Parties would be free to avoid the requirements of [chapter 15] and the expert scrutiny of the bankruptcy court by applying directly to a state or Federal court unfamiliar with the statutory requirements.... This section concentrates the recognition and deference process in one United States court, ensures against abuse, and empowers a court that will be fully informed of the current status of all foreign proceedings involving the debtor.").

Therefore, unlike practice before the enactment of chapter 15, the vast majority of courts have held that a foreign representative must comply with the requirements of chapter 15 to obtain the various forms of relief or assistance contemplated by the chapter, including a stay or dismissal of U.S. court proceedings against a foreign debtor or its assets. *See Halo Creative Design Ltd. v. Comptoir Des Indes Inc.*, 2018 WL 4742066 (N.D. Ill. Oct. 2, 2018); *Oak Point Partners, Inc. v. Lessing,* 2013 WL 1703382 (N.D. Cal. Apr. 19, 2013); *Orchard Enter. NY, Inc. v. Megabop Records Ltd.*, 2011 WL 832881 (S.D.N.Y. Mar. 4, 2011); *Econ. Premier Assurance Co. v. CPI Plastics Grp., Ltd.*, 2010 WL 11561369 (W.D. Ark. June 7, 2010); *Reserve Int'l Liquidity Fund, Ltd. v. Caxton Int'l Ltd.*, 2010 WL 1779282 (S.D.N.Y. Apr. 29, 2010); *Andrus v. Digital Fairway Corp.*, 2009 WL 1849981 (N.D. Tex. June 26, 2009); *U.S. v. J.A. Jones Const. Grp., LLC*, 333 B.R. 637 (E.D.N.Y. 2005); *Iida v. Kitahara (In re Iida)*, 377 B.R. 243 (B.A.P. 9th Cir. 2007); *In re Loy*, 380 B.R. 154 (Bankr. E.D. Va. 2007).

However, a handful of U.S. courts have determined that chapter 15 recognition is not necessary to enforce foreign bankruptcy or insolvency court orders. For example, in *In EMA Garp Fund v. Banro Corp.*, 2019 WL 773988 (S.D.N.Y. Feb. 21, 2019), the court dismissed litigation against a Canadian company and its former CEO, finding that, under principles of comity, the lawsuit was barred by Canadian court orders approving the company's Canadian bankruptcy proceeding and releasing all claims against the defendants. The district court did so despite the absence of any order issued by a U.S. bankruptcy court recognizing the Canadian bankruptcy proceeding under chapter 15.

Notably, the district court wrote that "the fact that Defendants did not file a recognition proceeding in [a] U.S. court" was "irrelevant" to its comity determination. 2019 WL 773988, at *5 (citing *Allstate Life Ins. Co. v. Linger Group Ltd.*, 994 F.2d 996, 999 (2d Cir. 1993); *Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B.*, 825 F.2d 709, 714 (2d Cir. 1987)). According to the district court, the defendants "were under no obligation to file anything in U.S. courts in order to earn [comity] for the Canadian courts." *Id.* (citing *Hilton*, 159 U.S. at 164); *see also Oui Financing v. Dellar*, 2013 WL 5568732 (S.D.N.Y. Oct. 9, 2013) (enforcing as a matter of comity a stay entered in a French safeguard proceeding with no mention of chapter 15); *Bickerton v. Bozel S.A. (In re Bozel S.A.)*, 434 B.R. 86 (Bankr. S.D.N.Y. 2010) (without mentioning section 1509(b), allowing a liquidator appointed in the British Virgin Islands ("BVI") liquidation proceedings of a BVI company to seek relief in the chapter 11 case of its subsidiary).

As noted, if there is no foreign representative seeking the assistance of a U.S. court in enforcing an order entered in a non-U.S. bankruptcy proceeding, chapter 15 recognition is not necessary. *See generally* COLLIER at ¶ 1509.02 (noting that "courts regularly rule that chapter 15 recognition is not a prerequisite to grant comity to foreign proceedings on the request of a party other than a foreign representative"). For example, in *Trikona Advisers Ltd. v. Chugh*, 846 F.3d 22 (2d Cir. 2017), the U.S. Court of Appeals for the Second Circuit affirmed a district court ruling giving collateral estoppel effect to the findings of a foreign insolvency court, even though no chapter 15 petition had been filed in the United States on behalf of the foreign debtor seeking recognition of its Cayman Islands winding-up proceeding. According to the Second Circuit, because the party seeking such relief was not a "foreign representative" under chapter 15, the provisions of chapter 15 simply did not apply, but the district court nonetheless

did not err in granting comity to the foreign insolvency court's factual findings. *Accord Barclays Bank PLC v. Kemsley*, 44 Misc. 3d 773 (N.Y. Sup. 2014) (chapter 15 recognition was not necessary to enforce, at the request of an individual debtor, a discharge order in a UK bankruptcy proceeding, even though a U.S. bankruptcy court previously denied the UK bankruptcy trustee's petition for chapter 15 recognition of the bankruptcy, because chapter 15's plain language applies only to a "foreign representative" such as a trustee).

MOYAL

In February 2019, David Moyal ("Moyal") sued Münster, Germany-based Münsterland Gruppe GmbH & Co. KG ("MGKG") in N.Y. state court for breach of a distribution agreement. After the litigation was removed to federal district court, MGKG agreed to the entry of a default judgment because it lacked the resources to defend the U.S. action as well as anticipated litigation to enforce the judgment in Germany. However, MGKG reserved the right to contest the amount of the damages.

In March 2021, MGKG and its general partner filed a bankruptcy proceeding in a German court, which appointed an insolvency administrator for the debtors. The filing triggered an automatic stay of all litigation against MGKG under German law.

MGKG then filed a motion to dismiss or stay the U.S. district court litigation due to the pending German bankruptcy proceeding. Moyal opposed the motion, arguing that, among other things: (i) MGKG's attorney lacked the authority to file the motion because he was stripped of any such authority upon the company's bankruptcy filing; (ii) MGKG's insolvency administrator should have filed a chapter 15 petition for the purpose of seeking injunctive relief on the company's behalf; and (iii) Moyal did not receive "formal notice" of the Germany bankruptcy proceeding.

THE DISTRICT COURT'S RULING

The district court dismissed the litigation based upon principles of comity. In so ruling, Magistrate Judge Stewart D. Aaron applied the "procedural fairness" analysis commonly used by U.S. courts prior to the enactment of chapter 15 in 2005. For support, he cited several pre-chapter 15 decisions addressing comity.

Judge Aaron found that German insolvency laws "comport with due process and fairly treat claims of [U.S.] creditors" (quoting *Victrix*, 825 F.2d at 714) because: (i) the German court shared the U.S. policy of equal distribution of assets; (ii) German law mandated the issuance of a stay; and (iii) German law "makes no distinction between, and gives no preference to, claims by foreign or German creditors based on their nationality." In addition, Judge Aaron rejected Moyal's arguments that he received inadequate notice of the German bankruptcy proceeding and that MGKG's counsel lacked the authority to file the motion. According to the judge, the facts belied Moyal's inadequate notice claim, and MGKG's attorney was still counsel of record at the time he filed the motion.

Notably, in a footnote, Judge Aaron wrote that "[Moyal's] suggestion that the insolvency [administrator] should have commenced a proceeding in U.S. bankruptcy court under Chapter 15 of the Bankruptcy Code to seek a stay of this action in the District Court is absurd and would fly in the face of comity principles." *Moyal*, 2021 WL 1963899, at *3 n.1 (citing COLLIER at ¶ 1509.02 ("[C]ourts regularly rule that chapter 15 recognition is not a prerequisite to grant comity to foreign proceedings on the request of a party other than a foreign representative.").

OUTLOOK

The district court's ruling in *Moyal* cuts against the grain on the question of whether chapter 15 recognition is a prerequisite for relief from U.S. courts on the basis of comity in cases involving a foreign bankruptcy proceeding. As noted, the vast majority of courts considering the question have ruled to the contrary in keeping with the plain language and purpose of chapter 15.

Interestingly, the cases relied upon by the district court in *Moyal* in concluding that chapter 15 recognition was unnecessary were decided prior to the enactment of chapter 15. By contrast, the court does not discuss any of the plethora of post-enactment court rulings requiring chapter 15 recognition as a prerequisite to comity. Instead, Judge Aaron reasoned that recognition was unnecessary because no "foreign representative" was seeking relief in connection with a foreign bankruptcy case.

The problem with this rationale is that MGKG was a debtor in a foreign bankruptcy proceeding and the relief sought—dismissal or an injunction—was in furtherance of German law and the German bankruptcy. Like its attorney, who the court permitted to withdraw as counsel because he lost the authority to represent the company as of the date it filed for bankruptcy, MGKG lacked the authority to continue prosecuting the U.S. litigation notwithstanding the fact that MGKG filed the motion to dismiss or stay after the German proceeding was commenced. The German court vested sole authority to represent MGKG in the insolvency administrator after MGKG's bankruptcy filing. Accordingly, any relief as a form of assistance to the German bankruptcy proceeding should have been sought by the insolvency administrator, who was MGKG's "foreign representative" within the meaning of section 101(24) of the Bankruptcy Code and the only person with authority to represent the debtor in the United States.

SECOND CIRCUIT APPLIES *TAGGART* STANDARD TO ORDERS DECLARING HOME MORTGAGE LOANS CURRENT

Charles M. Oellermann • Mark G. Douglas

In a decision that may have significant ramifications in bankruptcy cases, a divided panel of the U.S. Court of Appeals for the Second Circuit ruled in *PHH Mortgage Corp. v. Sensenich (In re Gravel)*, 2021 WL 3277211 (2d Cir. Aug. 2, 2021), that the standard articulated by the U.S. Supreme Court in *Taggart v. Lorenzen*, 139 S. Ct. 1795 (2019), for the imposition of contempt sanctions due to a violation of the bankruptcy discharge injunction also applied to contempt sanctions imposed for repeated violations of bankruptcy court orders declaring a home mortgage current. In *Gravel*, the mortgage lender repeatedly sent statements to borrowers that listed (but did not include in the balance owed) fees that were no longer due. The Second Circuit also held that a bankruptcy court may not impose contempt sanctions for a violation of Rule 3002.1 of the Federal Rules of Bankruptcy Procedure ("Bankruptcy Rules"), which requires home mortgage lenders to give notice within 180 days of fees or expenses being charged against a chapter 13 debtor. According to the majority, sanctions for even repeated violations of Bankruptcy Rule 3002.1 are limited to economic, rather than punitive, damages.

BANKRUPTCY RULE 3002.1

Bankruptcy Rule 3002.1 was implemented in 2011 to avoid situations where chapter 13 debtors have received a discharge but face foreclosure due to undisclosed post-bankruptcy charges imposed by home mortgage lenders prior to the expiration of the automatic stay. The rule was also designed to help mortgage servicers that might otherwise be deemed to have violated the automatic stay by notifying chapter 13 debtors about mortgage defaults. Bankruptcy Rule 3002.1(c) requires a mortgage lender to file a notice itemizing all fees, expenses, or charges incurred in connection with the mortgage during the bankruptcy case within 180 days after the charges were incurred. Under Bankruptcy Rule 3002.1(i), if the mortgage lender fails to file a required notice of such fees, the bankruptcy court may preclude the lender from presenting the omitted information as evidence in the court, "unless the failure is substantially justified or is harmless." Alternatively, the court may "award other appropriate relief, including reasonable expenses and attorneys' fees caused by the failure."

TAGGART

In *Taggart*, the Supreme Court ruled that a bankruptcy court may hold a creditor in civil contempt for attempting to collect on a debt that has been discharged in bankruptcy "if there is no fair ground of doubt as to whether the [discharge] order barred the creditor's conduct." *Taggart*, 139 S. Ct. at 1801.

Taggart left open the question of whether the "fair ground of doubt" standard should apply to violations of other bankruptcy court orders or provisions of the Bankruptcy Code, such a chapter 11 plan confirmation order, or the automatic stay. Several courts have weighed in on the issue, with mixed outcomes. *See, e.g., Deutsche Bank Trust Co. Americas v. Gymboree Group, Inc.*, 2021 WL 3618229, *11 (E.D. Va. Aug. 16, 2021) ("Because there is fair ground for doubt concerning the requirements of the 2017 Plan and related disbursements, the record does not warrant a finding of contempt."); *In re Jeong*, 2020 WL 1277575 (B.A.P. 9th Cir. Mar. 16, 2020) (applying the *Taggart* standard in upholding a bankruptcy court order granting a chapter 7 trustee's request for contempt sanctions for a willful violation of the stay); *Tate v. Fairfax Village I Condominium*, 2020 WL 634293 (Bankr. D.D.C. Feb. 10, 2020) (citing *Taggart* in finding a willful violation of the stay in a chapter 13 case and imposing sanctions under section 362(k)(1) of the Bankruptcy Code); *In re Franklin*, 614 B.R. 534, 546 n.19 (Bankr. M.D.N.C. Jan. 24, 2020) (in a chapter 13 case involving a request for automatic stay violation sanctions under section 362(k), noting the distinction between a discharge injunction and the automatic stay and stating that "[e]ven if the standard in *Taggart* applied to § 362(k), no reasonable creditor objectively could have believed [the creditor's] actions in this case did not violate the automatic stay"); *In re Spiech Farms, LLC*, 603 B.R. 395, 408 n.22 (Bankr. W.D. Mich. 2019) (in a chapter 7 case, stating that "[t]his court does not read *Taggart* to change the Sixth Circuit's standard for determining whether a creditor can be held in contempt for violating the automatic stay").

GRAVEL

Gravel involved debtors in three separate chapter 13 cases filed in the U.S. Bankruptcy Court for the District of Vermont and the company originating and servicing the home mortgages ("servicer") for all of those debtors. The servicer violated Bankruptcy Rule 3002.1 some 25 times in each of the Vermont cases as well as violating the rule in cases filed in courts. In one of the cases before the Vermont bankruptcy court, the servicer previously agreed to pay a $9,000 sanction for sending erroneous mortgage statements for three years.

In two of the three Vermont cases, the bankruptcy court had entered an order (a "current order") declaring that the debtors were current on all pre- and post-filing payments, fees, and charges. Less than a month after the court issued the current orders, however, the servicer began listing in the debtors' statements fees allegedly incurred during the periods encompassed by the orders, but did not include those fees in the amounts due. In those two cases, the servicer had not filed the notices required by Bankruptcy Rule 3002.1(c). There was no current order in the third case, but the servicer listed fees in that debtor's statements (but did not include the fees in the amount due), without filing a Bankruptcy Rule 3002.1(c) notice.

For violating the rule, the bankruptcy court imposed $75,000 (i.e., $1,000 for each of the 25 violations in all three cases) in sanctions under Bankruptcy Rule 3002.1(i). In addition, invoking its

"authority . . . to impose punitive sanctions on parties who violate court orders," the court imposed a total of $300,000 in sanctions for violation of the two current orders. Reasoning that it "may hold a creditor in contempt for that party's violation of an injunction order," the court applied the *Taggart* contempt standard and "impos[ed] punitive sanctions" on the servicer for its violation of the orders.

The district court reversed on appeal, ruling that the $375,000 in sanctions exceeded the bankruptcy court's "statutory and inherent powers." The district court remanded the case to the bankruptcy court, which later imposed the same $75,000 in sanctions for violating Bankruptcy Rule 3002.1, but reduced the punitive sanctions for violating the current orders to $225,000.

The Second Circuit granted the servicer's request for a direct appeal of the second sanctions order.

THE SECOND CIRCUIT'S RULING

A divided three-judge panel of the Second Circuit vacated and reversed the second sanctions order.

Initially, Circuit Judge Dennis Jacobs, writing for the majority, explained that a bankruptcy court's "narrowly circumscribed" contempt power derives from a court injunction—an equitable remedy—and section 105(a) of the Bankruptcy Code, which authorizes the court to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."

The majority concluded that the servicer "did not, as a matter of law, violate" the current orders because those orders specifically prohibited the servicer "from disputing that the debtors are current (as set forth herein) in any other proceeding," but "did not enjoin the recording of expired fees on the statements" sent to the debtors. *Gravel*, 2021 WL 3277211, at **4-5.

In so ruling, the majority applied the contempt standard established in *Taggart*. "Without an express injunction [barring the servicer from sending out statements contrary to the current order]," the majority wrote, there was a "fair ground of doubt as to whether the listed fees can form the basis for contempt." *Id.* at *4. According to the majority, the bankruptcy court "could have crafted an order that would have forbidden the conduct" at issue. *Id.* at *6.

Addressing the $75,000 sanction for failure to file Bankruptcy Rule 3002.1(c) notices, the majority acknowledged that monetary sanctions are permitted by Bankruptcy Rule 3002.1(i). According to the majority, however, "'other appropriate relief' is limited to non-punitive sanctions, as that would cabin it to the most general attribute shared with an award of expenses and fees." *Id.* at *7. The majority explained that various provisions of the Bankruptcy Code, such as section 362(k)(1), expressly authorize punitive sanctions. In addition, it noted, Bankruptcy Rule 3002.1, unlike Fed. R. Civ. P. 37, which authorizes the imposition of sanctions for failure to comply with discovery orders, does not include provision for "further just orders," indicating that punitive sanctions cannot be imposed for violations of Bankruptcy Rule 3002.1

The majority declined to decide whether the $75,000 sanction was authorized under the bankruptcy court's inherent power, writing that "[t]he sanction was imposed under Rule 3002.1(i), and our holding is that the sanction went beyond the relief authorized by that rule." The majority noted, however, that given the absence of any finding of bad faith below, it was "dubious" whether the bankruptcy court "could exercise its inherent power to do that which is unavailable under powers expressly defined" in Bankruptcy Rule 3002.1(i). Even so, the majority emphasized, if the bankruptcy court had found bad faith, it would be within its inherent power to sanction the offender.

Circuit Judge Joseph Bianco concurred in part and dissented in part. Judge Bianco agreed with the majority's holding that the current orders "did not clearly and unambiguously prohibit" the servicer's conduct for which the bankruptcy court imposed $225,000 in sanctions. *Id.* at *10 (dissenting opinion). However, the judge vigorously disputed vacatur of the $75,000 sanction imposed under Bankruptcy Rule 3002.1(i), reasoning that the "'other appropriate relief' language in [Bankruptcy Rule 3002.1(i)(2)] conferred upon bankruptcy courts . . . a proper basis to impose the $75,000 punitive sanction against [the servicer] based upon its flagrant and repeated violations of the Rule." *Id*. Limiting "other appropriate relief" for a rule violation to reimbursement of costs to a debtor, the judge wrote, "does little to prevent future violations and therefore falls far short of safeguarding the Chapter 13 'fresh start' process for all such debtors." *Id.* at *16.

Finally, according to Judge Bianco, even if Bankruptcy Rule 3002.1(i) itself did not permit the imposition of sanctions, the bankruptcy court had "independent authority under its inherent powers to impose this $75,000 sanction against [the servicer] for its egregious conduct in violation of the Rule." *Id.* at *11.

OUTLOOK

In *Gravel*, the Second Circuit appears to have definitively answered a major question left unanswered by *Taggart*—namely, whether the "fair ground of doubt" standard applies to contempt for violation of bankruptcy court orders other than orders discharging debtors. Whether other courts will adopt this expansive interpretation of *Taggart* remains to be seen. The Second Circuit's approach places the burden on parties drafting orders to specify clearly which actions are prohibited to foreclose a "fair ground of doubt" defense.

On September 15, 2021, the chapter 13 trustee filed a petition for rehearing *en banc* of the Second Circuit's ruling. Given Judge Bianco's vigorous dissent and the potential far-reaching implications of the decision in bankruptcy cases, the court may be inclined to grant the petition.

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U.S. SUPREME COURT UPDATE: PETITIONS SEEK REVIEW OF NOTABLE BANKRUPTCY LAW RULINGS

Charles M. Oellermann • Mark G. Douglas

At a conference to be held at the end of the summer recess on September 27, 2021, the U.S. Supreme Court will consider whether to grant petitions seeking review during the new Term that begins on October 4 of three notable appeals involving issues of bankruptcy law. Two of those appeals address the doctrine of "equitable mootness." The third concerns federal preemption of a non-debtor third party's tortious interference claims against other non-debtor third parties.

The court-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.

The equitable mootness doctrine has been criticized as an abrogation of federal courts' "virtually unflagging obligation" to hear appeals within their jurisdiction. *In re One2One Commc'ns, LLC*, 805 F.3d 428, 433 (3d Cir. 2015); *In re Charter Commc'ns, Inc.*, 691 F.3d 476, 481 (2d Cir. 2012). According to this view, dismissing an appeal on equitable mootness grounds "should be the rare exception." *In re Tribune Media Co.*, 799 F.3d 272, 288 (3d Cir. 2015); *accord In re VeroBlue Farms USA, Inc.*, 2021 WL 3411834, *1 (8th Cir. Aug. 5, 2021) (as in decisions by the Third, Tenth, and numerous other Circuits, "we conclude that the district court did not apply a sufficiently rigorous test to determine when bankruptcy equities and pragmatics justify foregoing Article III judicial review of a bankruptcy court order confirming a Chapter 11 plan"); *In re Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009) (equitable mootness should be applied "with a scalpel rather than an axe"). In *VeroBlue*, the Eighth Circuit even went so far as "banish 'equitable mootness' from the (local) lexicon" because it is "misleading," holding that, in accordance with the Supreme Court's decision in *Mission Prod. Holdings Inc. v. Tempnology LLC*, 139 S. Ct. 1652 (2019), an appeal is "moot, that is, beyond a federal court's Article III jurisdiction, only if 'it is impossible for a court to grant any effectual relief whatsoever.'" *VeroBlue*, 2021 WL 3411834, at *5 (quoting *Mission Prod.*, 139 S. Ct. at 1660).

Substantially similar tests (briefly discussed here) have been applied by most circuit courts of appeals in assessing whether an appeal of a chapter 11 confirmation order should be dismissed under the doctrine. Those tests, a common element of which is whether a chapter 11 plan has been substantially consummated, generally focus on whether the appellate court can fashion effective and equitable relief.

Some courts, including the Third and Fifth Circuits, have taken the position that equitable mootness does not apply outside the context of appeals of chapter 11 plan confirmation orders. *See, e.g., In re LCI Holding Company, Inc.*, 802 F.3d 547, 554 (3d Cir. 2015); *In re Sneed Shipbuilding, Inc.*, 916 F.3d 405, 409 (5th Cir. 2019).

Other courts, including the Fourth, Ninth, Tenth, and Eleventh Circuits, have been less constrained in relying on the doctrine to dismiss appeals. *See Myers v. Offit Kurman, P.A.*, 773 F. App'x 161, 162 (4th Cir. 2019) (finding that an appeal from a bankruptcy court order granting a chapter 7 trustee's motion for approval of a settlement agreement was equitably moot given that the agreement had been fully consummated and funds had been distributed accordingly); *Stokes v. Gardner*, 483 F. App'x 345, 346 (9th Cir. 2012) (finding that an appeal of an order approving a settlement agreement in a chapter 7 case was equitably moot); *Ordonez v. ABM Aviation, Inc.*, 787 F. App'x 533 (10th Cir. 2019) (appeals from a bankruptcy court order relating to a chapter 7 trustee's settlement of the debtor's employment discrimination claims were equitably moot, since the debtor did not diligently seek a stay, the settlement agreement had been fully consummated, the funds had been distributed, the estate had been fully administered, and the debtor's challenges were neither legally meritorious nor equitably compelling); *In re JMC Memphis, LLC*, 655 F. App'x 802 (11th Cir. 2016) (dismissing as equitably moot an appeal from an unstayed order approving a settlement between the chapter 7 trustee and the debtor's property insurer).

The Second Circuit recently joined this group in *In re Windstream Holdings, Inc.*, 838 Fed. App'x. 634 (2d Cir. 2021), ruling in a non-precedential summary order that an appeal of a "critical vendor" order directing the payment of the prebankruptcy claims of vendors deemed essential to the success of a chapter 11 debtor's reorganization before the claims of other unsecured creditors was equitably moot after confirmation of the debtor's chapter 11 plan. In so ruling, the Second Circuit noted that: "Our precedent is clear that equitable mootness can be applied 'in a range of contexts,' including appeals involving all manner of bankruptcy court orders. . . . [A]n appeal does not need to directly challenge a reorganization plan to impact that plan." *Id.* at 637.

One of the *Windstream* debtor's general unsecured creditors filed a petition seeking Supreme Court review of the ruling on

July 21, 2021. *See GLM DFW, Inc. v. Windstream Holdings, Inc.*, No. 21-78 (U.S.) (petition for cert. filed July 21, 2021).

In *In re Nuverra Environmental Solutions, Inc.*, 834 Fed. App'x 729 (3d Cir. 2021) (discussed here), a divided panel of the Third Circuit handed down a long-awaited ruling that could have addressed, but ultimately did not address, the validity of "gifting" chapter 11 plans under which a senior creditor class gives a portion of its statutorily entitled recovery to one or more junior classes as a means of achieving consensual confirmation. By avoiding the merits and holding that an appeal of an order confirming a "horizontal gifting" plan was equitably moot, the Third Circuit skirted a question that continues to linger in the aftermath of *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), which invalidated final distributions to creditors departing from the Bankruptcy Code's priority scheme as part of a nonconsensual "structured dismissal" of a chapter 11 case.

A creditor who objected to the *Nuverra* debtor's chapter 11 plan filed a petition seeking review of the decision on July 6, 2021. *See Hargreaves v. Nuverra Environmental Solutions Inc.*, No. 21-17 (U.S.) (petition for cert. filed July 6, 2021).

In *Sutton 58 Associates LLC v. Pilevsky*, 164 N.E.3d 984 (N.Y. 2020), New York's highest court decided by a 4–3 margin that the doctrine of federal preemption does not bar a non-debtor third party's tortious interference claims against other non-debtor third parties for actions taken in anticipation of a debtor's chapter 11 filing. In *Pilevsky*, a lender provided $150 million in financing for a housing project that was structured as a bankruptcy-remote single-asset real estate entity. However, at the behest of the project's advisors and in violation of the loan agreement, the project owner engaged in conduct, including selling an ownership interest in the project to another entity, that disqualified it as a "single-asset real estate debtor" in a subsequent chapter 11 case. After the bankruptcy court confirmed the owner's chapter 11 plan, the lender sued the advisors in New York state court, arguing that their actions amounted to tortious interference with contract by causing the project owner to breach its agreements with the lender. A trial court decided that the claims were not preempted by federal bankruptcy law and an intermediate state appellate court reversed, concluding that the claims were preempted.

The New York Court of Appeals reversed the intermediate appellate court, holding that "[p]laintiff's tortious interference claims—asserted against defendants who were not debtors in the bankruptcy proceedings and which are premised upon conduct that occurred prior to those proceedings—are peripheral to, and do not impugn, the bankruptcy process." *Id.* at 994. In a dissenting opinion, three of the court's judges expressed "fear [that] state litigation may disincentivize lawyers and potential secondary lenders from assisting debtors who wish to file for bankruptcy but need legal counsel and financial assistance to do so." *Id.* at 1014.

The defendants asked the Supreme Court to review the decision on April 20, 2021. *See Pilevsky v. Sutton 58 Associates LLC*, 20-1483 (U.S.) (petition for cert. filed Apr. 20, 2021).

In a conference later in the upcoming Term, the Court will consider whether to grant a petition seeking review of a ruling by the U.S. Court of Appeals for the Third Circuit in *In re Venoco LLC*, 998 F.3d 94 (3d Cir. 2021). In that case, before filing for chapter 11 protection, the debtors leased an offshore oil and gas drilling rig from the State of California and its Lands Commission (collectively, the "State"). After the debtors abandoned the leased rig, the State took over decommissioning the rig and plugged the abandoned wells. The liquidating trustee appointed under the debtors' confirmed chapter 11 plan filed an adversary proceeding in the bankruptcy court seeking to recover, on an inverse condemnation theory, compensation from the State for the alleged taking of the debtors' refinery without any compensation. The State moved to dismiss on the basis of, among other things, state sovereign immunity conferred by the Eleventh Amendment to the U.S. Constitution.

The bankruptcy court denied the motion to dismiss, and a district court affirmed on appeal. A three-judge panel of the Third Circuit also affirmed. Among other things, the Third Circuit panel ruled that the liquidating trustee's claims were brought to effectuate the bankruptcy court's *in rem* jurisdiction and, in accordance with the Supreme Court's decision in *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006), were therefore claims as to which the State had waived its sovereign immunity from suit by ratifying the Bankruptcy Clause of the U.S. Constitution (Art. I § 8 cl. 4).

The State asked the Supreme Court to review the decision on July 23, 2021. *See Cal. State Lands Comm'n v. Davis*, No. 21-109 (petition for cert. filed July 23, 2021). It its petition, the State argues, among other things, that the "limited consent" to a waiver of state sovereign immunity found in *Katz* should not apply in a case involving claims that do not arise under federal bankruptcy law.

NEWSWORTHY

In July 2021, ***Jones Day*** was given a "Most Recommended" law firm status by BTI Consulting Group for the 19th consecutive year. The honor is based on unprompted responses from in-depth interviews with more than 350 top legal decision-makers conducted by BTI Consulting Group for its annual survey, "The Firms Top Legal Decision Makers Recommend Above All Others."

The National Law Journal ("NLJ") recognized ***Kevyn D. Orr (Washington)*** by including him in its list of Crisis Trailblazers for 2021. Through the various Trailblazers special supplements, the NLJ recognizes agents of change—movers and shakers in the legal industry who have made significant contributions to, and innovations in, their area of practice.

Thomas A. Wilson (Cleveland), ***Jeffrey B. Ellman (Atlanta)***, ***Kevyn D. Orr (Washington)***, ***Thomas M. Wearsch (Cleveland)***, ***Caitlin K. Cahow (Chicago)***, ***Anna Kordas (New York)***, ***Oliver S. Zeltner (Cleveland)***, ***James O. Johnston (Los Angeles)***, ***Aldo L. LaFiandra (Atlanta and New York)***, ***Heather Lennox (Cleveland and New York)***, ***T. Daniel Reynolds (Cleveland)***, ***Gregory M. Gordon (Dallas)***, ***Corinne Ball (New York)***, ***Carl E. Black (Cleveland)***, ***Bruce Bennett (Los Angeles and New York)***, and ***Brad B. Erens (Chicago)*** were recognized in *The Best Lawyers in America* (2022) in the fields of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law and/or Litigation—Bankruptcy.

Fabienne Beuzit (Paris), ***Isabelle Maury (Paris)***, and ***Rodolphe Carrière (Paris)*** were recognized in the 2022 edition of *The Best Lawyers in France*™/*Les Echos* in the practice area Insolvency and Reorganization Law.

Michèle Grégoire (Brussels; Financial Markets and Global Disputes) was recognized in the 2022 edition of *The Best Lawyers in Belgium*™ in the practice area Insolvency and Reorganization Law.

An article written by ***Daniel J. Merrett (Atlanta)*** and ***Mark G. Douglas (New York)*** titled "Another Bankruptcy Court Adopts Majority View in Approving Bankruptcy Trustee's Use of Tax Code Look-Back Period in Avoidance Actions" was published in *AIRA Journal* Vol. 34 No. 3 (2021).

An article written by ***Corinne Ball (New York)***, ***Dan T. Moss (Washington)***, and ***Michael C. Schneidereit (New York)*** titled "Bankruptcy Ruling Highlights Growing Use of Chapter 15" was published on Law360 on July 27, 2021. The article was prepared with the assistance of ***Isel M. Perez (Miami)*** and ***Mark G. Douglas (New York)***.

An article written by ***Corinne Ball (New York)***, ***Dan T. Moss (Washington)***, ***Michael C. Schneidereit (New York)***, ***Isel M. Perez (Miami)***, and ***Mark G. Douglas (New York)*** titled "Illinois Bankruptcy Court Examines Statutory Authority For Enforcing Foreign Bankruptcy Court Orders in Chapter 15 Cases" was published in the September 2021 *INSOL News Update*.

An article written by ***Corinne Ball (New York)*** titled "Fifth Circuit Sends Clear Message that Bankruptcy Sales Are Final" was published in the August 25, 2021, issue of the *New York Law Journal*.

BUSINESS RESTRUCTURING REVIEW

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

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