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SINGAPORE INTERNATIONAL COMMERCIAL COURT ISSUES FIRST DECISION ON RECOGNITION OF CROSS-BORDER BANKRUPTCY CASES UNDER MODEL LAW

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Established in 2015 as a trusted neutral forum to meet increasing demand for effective transnational dispute resolution, the Singapore International Commercial Court (the "SICC") is a division of the General Division of the High Court and part of the Supreme Court of Singapore. On January 18, 2024, the SICC handed down its first insolvency-related ruling. In *Re PT Garuda Indonesia (Persero) Tbk* [2024] SGHC(I) 1 ("*PT Garuda*"), the SICC granted recognition in Singapore of an Indonesian debtor-airline's "suspension of payments" proceeding under Singapore's version of the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"). The SICC also recognized and enforced the terms of a composition plan approved by creditors and confirmed by an Indonesian court. In so ruling, the SICC overruled objections to recognition interposed by disgruntled aircraft lessors asserting, among other things, that recognition of the Indonesian proceeding would violate Singapore's public policy because creditors were treated unfairly in the debtor's composition plan.

The decision provides a wealth of guidance regarding practice, procedure, and judicial standards governing the recognition of cross-border insolvency proceedings in the aftermath of Singapore's adoption of the Model Law in 2017.

THE MODEL LAW

In 1997, the United Nations Commission on International Trade Law ("UNCITRAL") adopted the Model Law as a common framework of rules and procedures governing bankruptcy and insolvency proceedings involving debtors that do business or have creditors or other stakeholders in more than one country. The Model Law is premised on "comity," or cooperation among courts, court functionaries, and professionals of different nations for the efficient administration of debtors and their assets in bankruptcy and restructuring proceedings. If a bankruptcy or insolvency proceeding has been filed in one country, the debtor's accredited representative can seek "recognition" of that proceeding under the Model Law in the courts of other nations for the purpose of, among other things, protecting the debtor's assets against collection efforts by local creditors or repatriating the debtor's assets to the home forum.

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As of 2024, the Model Law had been implemented by nearly 60 nations or territories, including the United States (in chapter 15 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 1501 *et seq.*), the United Kingdom, Japan, and Singapore (discussed below). In discussing the provisions of the Model Law below, we have included citations to the corresponding provisions of chapter 15 for ease of reference.

Under the Model Law, the "foreign representative" of a foreign debtor may file a petition in a bankruptcy or insolvency court in a Model Law jurisdiction seeking recognition of the debtor's "foreign proceeding" in another jurisdiction (Model Law or otherwise). *See* Model Law Art. 2; Art. 11 (11 U.S.C. § 1515(a)). Article 15.2 of the Model Law specifies the information required in an application for recognition, which includes documentary (or other acceptable) evidence of the commencement of the debtor's foreign proceeding and the appointment of the foreign representative. *Id.* at Art. 15.2 (11 U.S.C. § 1515(b)).

A "foreign representative" is defined as "a person or body, including one 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 the foreign proceeding." *Id.* at Art. 2(d) (11 U.S.C. § 101(24)).

The Model Law defines a "foreign proceeding" as:

> [A] collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency 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.

Id. at Art. 2(a) (11 U.S.C. § 101(23)).

More than one bankruptcy or insolvency proceeding may be pending with respect to the same foreign debtor in different countries. The Model Law therefore contemplates recognition in a Model Law jurisdiction of both a foreign "main" proceeding—a case pending in the country where the debtor's "centre of main interests" ("COMI") is located—and foreign "non-main" proceedings, which may be pending in countries where the debtor merely has an "establishment." *Id.* at Art. 2(b) and (c) (11 U.S.C. § 1502).

In the absence of evidence to the contrary, "the debtor's registered office, or habitual residence in the case of an individual, is presumed to be" the debtor's COMI. *Id.* at Art. 16.3 (11 U.S.C. § 1516(c)). In comparison, an establishment is defined as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services. *Id.* at Art. 2(f) (11 U.S.C. § 1502(2)).

If an application for recognition satisfies the requirements set forth in the Model Law, it is mandatory for the court presiding over the case to recognize the debtor's foreign proceeding as either a foreign main proceeding (if pending in a COMI jurisdiction) or a foreign non-main proceeding (if pending in an establishment jurisdiction). *Id.* at Art. 17 (11 U.S.C. § 1517(a)).

LAWYER SPOTLIGHT: DAN B. PRIETO

Dan Prieto, a partner in the Business Restructuring & Reorganization Practice in the Dallas Office, has represented high-profile companies in successful chapter 11 reorganizations, out-of-court restructurings, and distressed M&A transactions.

In recent years, Dan has assisted clients in achieving permanent resolutions of mass tort liabilities, including asbestos and talc liabilities. Dan is currently representing LLT Management, an affiliate of Johnson & Johnson, to resolve its talc liability. He has represented Bondex, Kaiser Aluminum, and USG Corporation in their respective section 524(g) chapter 11 reorganizations that fully resolved their asbestos liabilities; and RadioShack in its successful chapter 11 reorganization and a going concern sale of a substantial portion of its business. Dan also played a lead role in representing the owners of the Vogtle nuclear plant in connection with Westinghouse's chapter 11 case and a guarantee provided by Toshiba and Hanson Permanente Cement and Kaiser Gypsum in chapter 11 cases they filed to resolve their asbestos and environmental liabilities.

He has been recognized by *The Best Lawyers in America*, as a "Rising Star" by *Texas Monthly*, as an "Outstanding Young Restructuring Lawyer" by *Turnarounds & Workouts*, and among the "Best Lawyers in Dallas" by *D Magazine*.

Certain kinds of provisional relief, including injunctive relief, may be granted by the presiding court in the interim between the filing of a recognition application and the issuance of the court's decision on the application. *Id.* at Art. 19 (11 U.S.C. § 1509).

Upon recognition of a foreign main proceeding, an automatic stay or moratorium is triggered to prevent creditor collection efforts against the debtor or its assets. *Id.* at Art. 20 (11 U.S.C. § 1520). Absent evidence to the contrary, recognition as a foreign proceeding is deemed to be proof that the debtor is insolvent. *Id.* at Art. 31. (11 U.S.C. § 1531, but only for purposes of an involuntary chapter 7 or 11 case filed against the debtor).

In addition, after recognition of a foreign proceeding, the court, "where necessary to protect the assets of the debtor or the interests of the creditors," has the discretion to order a wide variety of relief to the foreign representative. This includes injunctive relief, restrictions on the transfer or other disposition of the debtor's assets, discovery, entrusting the debtor's property located in the jurisdiction to the foreign representative or a party designated by the court (provided that local creditors' rights are adequately protected), and any "additional relief that may be available [to the foreign representative] under the laws of the [recognizing jurisdiction]." *Id.* at Art. 21 (11 U.S.C. § 1521).

Article 23 of the Model Law provides that, upon recognition of a foreign proceeding, the foreign representative has standing to commence litigation to redress pre-recognition actions that are detrimental to creditors, such as avoidance actions. *Id*. at Art. 23 (11 U.S.C. § 1523, but only in a case commenced by or against the debtor under another chapter of the Bankruptcy Code).

The Model Law includes a "public policy" exception to the granting of any relief (recognition or otherwise) under its provisions. It states that "[n]othing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of this State." *Id.* at Art. 6 (11 U.S.C. § 1506). In addition, Article 22 of the Model Law provides that, "[i]n granting or denying [pre- or post-recognition] relief . . . or in modifying or terminating relief . . ., the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected." *Id.* at Art. 22 (11 U.S.C. § 1522).

Guidelines and procedures for cooperation, coordination, and communication among the courts and foreign representatives, a key aspect of the Model Law, are set forth in Chapters IV and V (Arts. 25 through 30) (11 U.S.C. §§ 1525–1530).

OTHER CROSS-BORDER INSOLVENCY MODEL LAWS

Since 1997, the explosion of cross-border bankruptcy and insolvency cases prompted UNCITRAL to formulate other model laws designed to provide a framework for recognizing and enforcing insolvency-related judgments (the Model Law on Recognition and Enforcement of Insolvency-Related Judgments (2018) (the "IRJ Model Law")) and to equip implementing nations with legislation addressing domestic and cross-border bankruptcies or insolvencies of enterprise groups (the Model Law on Enterprise Group Insolvency (2019) (the "EGI Model Law")). In addition, the increasing need for cooperation and coordination in cross-border cases prompted the Judicial Insolvency Network to develop Guidelines for Communication and Cooperation Between Courts in Cross-Border Insolvency Matters (2016) (the "JIN Guidelines") and to adopt Modalities of Court-to-Court Communication (2019) (the "Modalities").

These guidelines and modalities have since been adopted and implemented by many courts overseeing cross-border bankruptcy cases. Prior to the creation of the JIN Guidelines, communication between courts involved in "parallel" bankruptcy or insolvency proceedings was often nonexistent or poorly coordinated, in many cases achieved by means of ad hoc protocols. This created significant delay and uncertainty and sometimes resulted in conflicting rulings from the courts involved.

THE MODEL LAW IN SINGAPORE AND INDONESIA

In Singapore, the Model Law was introduced by way of an amendment to the Companies Act that became effective in 2017. As enacted in Singapore, the Model Law is the Third Schedule to the Insolvency, Dissolution, and Restructuring Act 2018 (2020 rev. ed) (the "Singapore Model Law"). At the time it was introduced, the Model Law was part of significant substantive changes to Singapore's insolvency and restructuring regime, including the introduction of an automatic stay of creditor collection efforts, super-priority financing, and mechanisms to confirm restructuring plans over the objections of creditors. The Singapore Model Law applies only to corporate entities.

In February 2017, Singapore also adopted the JIN Guidelines and, effective June 2020, the Modalities. As of the beginning of 2024, Singapore had not adopted the IRJ Model Law or the EGI Model Law but is studying the advisability of doing so.

Indonesia has not enacted the Model Law, nor has it ratified an international treaty that would enable Indonesian courts to recognize restructuring or insolvency proceedings commenced outside of Indonesia or to enforce the rulings of foreign insolvency courts. Its bankruptcy regime is still premised on the concept of "territoriality," a principle that limits bankruptcy subject matter jurisdiction to property located within its territory. Law No. 37 of 2004 on Bankruptcy and Suspension of Payments (the "IBL") is the principal source of insolvency law in Indonesia, although it is complemented by other laws. The IBL provides for both bankruptcy proceedings and proceedings involving the suspension of debt payment obligations (*Penundaan Kewajiban Pembayaran Utang* or "PKPU"). Indonesia has also not adopted the JIN Guidelines or the Modalities.

PT GARUDA

PT Garuda Indonesia (Persero) Tbk (the "debtor") is the state-owned national airline of Indonesia. It is registered, domiciled, and has a registered office in Jakarta, with a principal place of business located at the Soekarno-Hatta International Airport, Jakarta's main international airport. Key business decisions are made from the Jakarta office, and all of the debtor's directors and a majority of its employees are Indonesian nationals.

The debtor is registered in Singapore as a foreign company. It has an office in Singapore as well as aircraft assets and bank accounts.

In October 2021, one of the debtor's creditors commenced a PKPU (suspension of payments) proceeding against the debtor in the Jakarta Commercial Court. On June 27, 2022, the court confirmed ("homologated") a "composition plan" for the debtor that had been approved by the holders of more than 97% of the debtor's $8 billion in debt. In addition to specifying distributions to various classes of creditors, the plan included provisions to discharge the debts of various non-debtor affiliates, including Garuda Indonesia Holiday France ("Garuda France").

The debtor sublet certain aircraft leased by Garuda France from two aircraft-lessors (collectively, "Greylag"). Greylag actively participated in the PKPU proceeding and voted against the composition plan. It appealed the order confirming the plan, but the Indonesia Supreme Court dismissed the appeal. In addition, the Jakarta Commercial Court dismissed Greylag's motion to nullify the confirmation order. Greylag also appealed that ruling to the Indonesia Supreme Court (the "nullification appeal").

Greylag and certain other creditors also filed winding-up, liquidation, or enforcement proceedings against the debtor in Australia and France, but the cases were dismissed or, in the case of a French court order of attachment, overturned. Greylag also initiated two arbitration proceedings in Singapore against the debtor and Garuda France.

The debtor's CEO and its finance director, as board-appointed joint foreign representatives (the "FRs"), filed a petition on September 23, 2022, in the U.S. Bankruptcy Court for the Southern District of New York seeking recognition of the PKPU proceeding under the U.S. version of the Model Law—chapter 15 of the Bankruptcy Code. The U.S. bankruptcy court, with the consent of the parties (including Greylag), entered an order recognizing the PKPU proceeding as a foreign main proceeding on October 26, 2022. In November 2022, the FRs filed an application for an order recognizing and enforcing the debtor's composition plan in the United States. However, Greylag objected on various grounds, and the FRs withdrew the application in May 2023.

On November 22, 2022, the FRs filed a petition in the SICC seeking, among other things, recognition of the PKPU proceeding under the Singapore Model Law and enforcement of the composition plan in Singapore.

Greylag did not contend that the PKPU proceeding did not qualify as a "foreign main proceeding." Greylag instead opposed the recognition application on two main grounds. First, Greylag argued that the petition was filed prematurely in light of the pending nullification appeal in Indonesia, which may lead to the annulment of the composition plan, as well as the pending petition seeking recognition and enforcement of the composition plan in the United States under chapter 15 of the U.S. Bankruptcy Code.

Second, Greylag also argued that recognition of the PKPU proceeding would be contrary to the public policy of Singapore under Article 6 of the Singapore Model Law (which tracks the language of Article 6 of the Model Law, with one exception discussed below) because the PKPU proceeding and voting on the composition plan were conducted: (i) without equitable treatment

of unsecured creditors by offering different terms to each creditor such that there was dissimilarity in treatment; and (ii) without adequate disclosure of information regarding the release of claims against non-debtor Garuda France. Greylag also sought discovery of documents related to the aircraft lease arrangement with Garuda France, the rationale for releasing claims against Garuda France in the composition plan, and financial statements of the debtor and its affiliates.

THE SINGAPORE COURT'S DECISION

A three-judge panel of the SICC granted the petition for recognition of the PKPU proceeding to be recognized as a foreign main proceeding in Singapore and dismissed Greylag's discovery request.

Writing for the SICC panel, former U.S. Bankruptcy Judge Christopher S. Sontchi first addressed Greylag's discovery request. Justice Sontchi denied the motion because Greylag had not demonstrated that the requested documents were material or relevant to its assertion that enforcement of the composition plan in Singapore was contrary to public policy. *PT Garuda*, ¶¶ 41–44.

Next, the court concluded that the PKPU proceeding should be recognized as a "foreign main proceeding" under the Singapore Model Law. According to Justice Sontchi, the PKPU proceeding satisfied all of the requirements for recognition prescribed in Article 17 of the Singapore Model Law, and Greylag "did not take issue with any of the formal and substantive requirements for recognition." *Id.* at ¶¶ 45, 51–59. Therefore, the SICC determined, recognition was mandatory under Article 17 of the Singapore Model Law.

The court made certain key observations relating to the approach to hearing a recognition proceeding. Justice Sontchi explained that the Singapore Model Law "gives effect to the principle of modified universalism through a procedural framework which not only permits but encourages cooperation and coordination between jurisdictions in cases of cross-border insolvencies." *Id.* at ¶ 67.

The concept of modified universalism, he noted, recognizes that the insolvency laws and procedures of each nation may be different "but takes the view that such differences should not stand in the way of the recognition of foreign insolvency proceedings and the benefits that would accrue to creditors as a collective whole through a global effort to coordinate the distribution of assets in a cross-border collapse." *Id.* at ¶¶ 63–69. Justice Sontchi further explained that the principles of modified universalism and comity are closely related, stating that "a key aspect of comity requires that courts eschew an inquiry into the substantive merits of foreign law and the findings made by the foreign court in the foreign proceedings. *Id.* at ¶ 71.

Addressing a threshold issue, the court also explained that the "*Gibbs* Rule," whereby the discharge of a debt is not effective unless it is in accordance with the law governing the debt, did not apply in this case. *See Antony Gibbs & Sons v. La Société Industrielle et Commerciale des Métaux* [1890] LR 25 QBD 399. According to Justice Sontchi, although the *Gibbs* Rule can preclude recognition of a foreign proceeding, restructuring plan, or judgment where such proceeding involves the compromise or discharge of a debt governed by foreign law (which was the case here, as the aircraft lease agreements were governed by New York law), "the present case falls squarely within the exception to that rule, namely that the *Gibbs* Rule does not apply where a creditor submits to the jurisdiction of a foreign court, either by submitting its claims in the foreign insolvency proceeding or otherwise agreeing to be bound thereby." *Id.* at ¶ 61.

He also expressed skepticism regarding "the soundness of this rule in the context of modern cross-border insolvency." *Id.* at ¶ 62; *see also Re Pacific Andes Resources Development Ltd and other matters* [2018] 5 SLR 125 (doubting the soundness of the *Gibbs* Rule).

The court then went on to consider the objections raised by Greylag under Article 6 of the Singapore Model Law and rejected Greylag's arguments regarding both the premature nature of the recognition application and public policy. Initially, Justice Sontchi noted that because the FRs had withdrawn their motion seeking enforcement of the composition plan in the United States under chapter 15, only the pendency of the nullification appeal before the Indonesia Supreme Court was relevant to the court's inquiry. The prematurity of the application was also not seriously pursued at the hearing.

According to the court, Greylag failed to cite any provision in the Singapore Model Law to support its objection, and Greylag's argument "runs counter to the mandatory effect of giving recognition to a foreign proceeding once the requirements in Article 17 of [the Singapore Model Law] are satisfied." *Id.* at ¶ 76. Furthermore, Justice Sontchi explained, Article 17 of the Singapore Model Law "does not require a foreign proceeding to be concluded, or that all avenues of appeal and review must be exhausted in the foreign jurisdiction before an application for recognition of the foreign proceeding is brought." *Id.* at ¶ 77.

He also emphasized that the Singapore Model Law expressly contemplates that a recognition order can be modified or terminated if circumstances change that would invalidate the "substratum" for recognition, such as reversal on appeal of an order confirming a compromise or reorganization plan. *Id.* at ¶¶ 78–80. The court observed that it is open to Greylag to apply to the Singapore courts under Article 17(4) to request termination of both the recognition of the PKPU proceeding and any ancillary reliefs granted in support of recognition. *Id.* at ¶ 80.

Next, the court turned to Greylag's public policy argument. Given the purpose of advancing the goal of modified universalism and principles of comity, it flows that a high threshold is required to find that the recognition of a foreign proceeding is in breach of Singapore public policy under Article 6 of the Singapore Model Law. *Id.* at ¶ 89, 94.

After surveying court decisions among Model Law countries, the SICC concluded that the public policy exception in Article 6 is "to be applied restrictively," and "a challenge brought under Article 6 of the [Singapore Model Law] on the ground of public policy will succeed only in limited circumstances." *Id.* at ¶ 92.

Justice Sontchi acknowledged that a court must be sensitive to the differences among the bankruptcy and insolvency laws of different countries. Even so, he wrote, "[t]he fact that foreign insolvency laws and procedures operate differently from what is normally expected and experienced in the domestic insolvency regime cannot, without more, give rise to a finding that the foreign proceeding is abhorrent and contrary to Singapore public policy." *Id.* at ¶ 95.

The SICC noted that the public policy exception stated in Article 6 of the Singapore Model Law differs from the exception set forth in Article 6 of the Model Law because the latter provides that the court can refuse to grant relief that is "manifestly contrary" to public policy rather than merely "contrary" to public policy. Regardless of the distinction, Justice Sontchi reasoned, the public policy exception in the Singapore Model Law does not establish a lower threshold for finding a breach of public policy (*id.* at ¶¶ 84–94). Instead, "any successful challenge against recognition on the basis of [the public policy exception in the Singapore Model Law] must be narrow in scope; such a challenge will succeed only if the recognition and the grant of relief is contrary to the fundamental public policy of Singapore." *Id.* at ¶ 95. "[A]pplying a low threshold under Article 6 of the [Singapore Model Law]," Justice Sontchi wrote, "would permit creditors to stultify recognition proceedings on the basis of alleged breaches of public policy, however insignificant." *Id.* at ¶ 94.

According to the SICC, based upon relevant case law, challenges brought under the public policy exception are likely to succeed when: (i) recognition is sought of a foreign proceeding commenced in violation of a moratorium; (ii) relief is sought in the "receiving" court that is prohibited by the civil or criminal laws of the country in which the foreign proceeding is pending; (iii) the foreign representative acted in bad faith or failed to make full and frank disclosure of material facts to the receiving court; (iv) recognition is sought of a foreign proceeding commenced in breach of the receiving court's order granted in a prior proceeding; (v) "there is a failure to accord due process to the creditors and other relevant stakeholders in the foreign insolvency process"; or (vi) "the insolvency proceedings or foreign court orders are tainted by fraud." *Id.* at ¶¶ 96–98.

In relation to Greylag's objections, the SICC explained that due process is "a fundamental tenet of Singapore public policy" and requires that creditors be notified of, and permitted to participate in, insolvency proceedings that impact their claims and rights. *Id.* at ¶¶ 99, 101. Due process also requires disclosure to creditors of adequate information for them to make an informed decision regarding their rights in the insolvency proceeding. In addition, Justice Sontchi noted, upholding due process is a component of the "broader requirement that creditors participating in foreign proceedings must be treated fairly and equitably." *Id.* at ¶ 102.

The SICC ruled that the facts before it did not raise any concerns regarding due process, noting that Greylag's public policy objection was "directed at the content of substantive Indonesian insolvency laws and the merits of the [order approving the composition plan]." According to Justice Sontchi, "the challenges raised are primarily on the merits disguised as public policy objections." *Id.* at ¶ 103.

The SICC rejected Greylag's argument that the debtor's creditors were treated unfairly in the PKPU proceeding because: (i) creditors were classified improperly for purposes of voting on the composition plan; (ii) the debtors negotiated with some but not all unsecured creditors regarding the terms of alternative aircraft leasing arrangements; and (iii) the composition plan released claims against non-debtor Garuda France, thereby discharging Greylag's right to pursue Garuda France for payment of its claims.

Justice Sontchi explained that the classification scheme sought by Greylag—involving subclassification of creditors rather than classifying them all together—is authorized under Singapore law, but not Indonesia law, which provides for classification only of preferred, secured and unsecured claims. This argument, he wrote, is an impermissible "criticism of the structure of the Indonesian insolvency scheme, as opposed to an issue of fair and equitable treatment of creditors." *Id.* at ¶¶ 118, 120.

According to the SICC, the division of creditors into subclasses is not "a fundamental tenet of the fair and equitable treatment of creditors recognised as part of Singapore public policy such that these requirements must be met *before a foreign restructuring or insolvency procedure may be recognised*." *Id.* at ¶ 117. Moreover, Justice Sontchi explained, merely providing some unsecured creditors with different repayment terms than others under a composition plan is not so unfair or prejudicial that it offends Singapore public policy. Instead, he wrote that, "[f]or a restructuring plan to be commercially viable and successful, some aspect of differentiated creditor treatment must be expected." *Id.* at ¶ 121.

The SICC found that all of the debtor's creditors, including Greylag and other aircraft lessors, were provided with adequate information regarding the course of the restructuring proceeding and the terms of the composition plan, and there was therefore "no issue regarding the transparency and openness of the PKPU Proceeding." *Id.* at ¶ 124. Greylag's complaint, the court explained, did not concern the fair and equitable treatment of creditors overall but, rather, the debtor's commercial decision not to continue its aircraft leasing relationship with Greylag entities on terms acceptable to them. *Id.* at ¶ 123.

The SICC rejected Greylag's assertion that the composition plan's third-party release violated Singapore public policy because creditors were not provided with adequate information regarding the Garuda France release to exercise their voting rights meaningfully. According to Justice Sontchi, adequate information concerning the terms of the composition plan (including the release) was disclosed to all creditors before they voted on the plan, and Greylag never requested disclosure of financial information regarding Garuda France until it filed its written submissions with the SICC in connection with the recognition application. *Id.* at ¶¶ 130–32.

The court emphasized that Greylag never raised its public policy argument in the PKPU proceeding. Moreover, the SICC noted that Greylag's assertion that the terms of the modification plan were unfair and prejudicial to creditors was belied by the fact that creditors overwhelming voted to accept the plan. *Id.* at ¶¶ 135, 136.

Finally, the SICC concluded that, following the court's recognition of a foreign proceeding, Article 21(1) of the Singapore Model Law authorizes the court to recognize and enforce a foreign insolvency court's orders under the "chapeau" of "any appropriate relief," rather than "any additional relief that may be available" under Singapore law within the meaning of Article 21(1)(g). The SICC reached that conclusion because, among other things, "[n]othing in the IRDA confers on Singapore insolvency officeholders the power to apply for the recognition and enforcement of such plans and orders." *Id.* at ¶¶ 143–51.

Because it was satisfied that the interests of the debtor, its creditors, and other stakeholders were sufficiently protected by the composition plan (as required by Article 22 of the Singapore Model Law), the SICC ruled that the PKPU proceeding should be recognized as a foreign main proceeding under the Singapore Model Law, and that the order confirming the composition plan should be recognized and enforced in Singapore. However, because the release in the composition plan of non-debtor Garuda France might have an impact on the issues arising in the Singapore arbitration proceedings and "were more appropriately dealt with" in those proceedings, the court held that the arbitrations involving Greylag and Garuda France should not be prejudiced by recognition of the PKPU proceeding or enforcement of the order approving the composition plan in Singapore. As such, it ordered a carve-out in respect of such recognition and enforcement. *Id.* at ¶ 161. The SICC also directed that the automatic stay triggered by recognition of the PKPU proceeding did not preclude Greylag from prosecuting claims in the arbitration against the debtor that were originally denied by the debtor's administrators in the PKPU proceeding because Indonesian law permits a creditor to pursue collection of a claim rejected in a PKPU proceeding in a foreign jurisdiction. *Id.* at ¶ 162.

OUTLOOK

Singapore has made great strides during the last decade to establish itself as a go-to jurisdiction for the resolution of international commercial disputes. A major part of its efforts in that regard include the creation of the SICC in 2015 and the adoption of the Model Law in 2017.

The SICC's initial foray into cross-border bankruptcy recognition under the Singapore Model Law is notable for several reasons, particularly because the case before it was complex and nuanced. Key takeaways from the court's ruling include:

- Once the statutory requirements for recognition have been satisfied under the Singapore Model Law, recognition is mandatory, unless recognition or other relief sought in the petition are contrary to public policy.
- The public policy exception to recognition under the Singapore Model law is "restrictively" construed, and a challenge based on the exception will succeed "only if the recognition and the grant of relief is contrary to the fundamental public policy of Singapore."
- The Singapore Model Law "does not require a foreign proceeding to be concluded, or that all avenues of appeal and review must be exhausted in the foreign jurisdiction before an application for recognition of the foreign proceeding is brought."
- Principles of comity will be adhered to whereby a light threshold should be imposed for recognition, although the court may impose appropriate conditions and carve-outs in the circumstances.
- Under the Singapore Model Law, a court can recognize and enforce the terms of both a foreign insolvency proceeding and a plan of compromise or reorganization sanctioned by the foreign insolvency court.
- A court should not refuse to recognize a foreign insolvency proceeding merely because the restructuring laws of the foreign court and the recognizing court differ. The appropriate inquiry is whether the treatment of stakeholders is fundamentally fair and provides creditors with substantive due process.

The SICC's analysis tracks much of the analysis that has been developed over the last 24 years in jurisdictions that have adopted the Model Law, including the United States (since 2005 in chapter 15 cases). This robust jurisprudence and the volume of cases filed under the Model Law is demonstrable evidence that cross-border restructurings and the successful coordination of such cases benefit from Model Law procedures as well as guidelines and procedures established under related Model Laws, which, by extension, will benefit the capital markets by providing consistency, reliability, and predictability to investors, creditors, and borrowers.

TEXAS BANKRUPTCY COURT: DEBTOR'S NON-ECONOMIC RIGHTS UNDER LLC AGREEMENT ARE ESTATE PROPERTY PROTECTED BY AUTOMATIC STAY

Dan B. Prieto • Richard H. Howell

The Bankruptcy Code invalidates "*ipso facto*" clauses in executory contracts or unexpired leases that purport to modify or terminate the contract or lease (or the debtor's rights or obligations under the contract or lease) based solely on the debtor's financial condition or the commencement of a bankruptcy case for the debtor. It also invalidates state law, rather than a contract, that purports to alter the property interests of the debtor. A more difficult situation arises when those interests are on the outer bounds of "property of the estate."

The U.S. Bankruptcy Court for the Southern District of Texas examined the extent to which non-bankruptcy law can modify or terminate the voting and managerial interests that a debtor holds in a limited liability company ("LLC") in *In re Envision Healthcare Corp.*, 655 B.R. 701 (Bankr. S.D. Tex. 2023). The court held that managerial and voting interests become property of the estate on the bankruptcy petition date. It also ruled that the non-debtor members of an LLC who acted postpetition to cancel the debtor's rights under an LLC agreement, based on a state law purporting to terminate such rights upon a bankruptcy filing, violated the automatic stay. Finally, the court denied a motion to compel arbitration of the dispute over the cancellation. According to the court, the determination of what qualifies as property of the estate is within the court's "core" jurisdiction, and permitting arbitration in the case would run against the purposes of the Bankruptcy Code.

THE BANKRUPTCY ESTATE AND THE AUTOMATIC STAY

An estate is created upon the commencement of a bankruptcy case. The estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). The scope of the estate is "broad," and it includes tangible and intangible property, causes of action, and property the debtor did not have a possessory interest in, among other things. *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 (1983).

The bankruptcy estate also includes any of the debtor's prepetition property interests (except for certain beneficial interests in trusts) notwithstanding any agreement or applicable non-bankruptcy law to the contrary that: (i) restricts or conditions a transfer of the debtor's interest; or (ii) is conditioned on the debtor's financial condition or the appointment of a trustee or custodian for the debtor; and (iii) effects "a forfeiture, modification, or termination of the debtor's interest in property." 11 U.S.C. § 541(c). Such forfeiture, termination, or modification provisions are commonly referred to as "*ipso facto*" clauses.

Although the Bankruptcy Code outlines the broad scope of property interests brought into the estate, it lacks guidance on determining what interests in property the debtor had prepetition. Instead, non-bankruptcy (generally state) law defines a debtor's property interests. *Butner v. United States*, 440 U.S. 48, 54–55 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding."). Where state law and federal law conflict, however, state law yields, especially in circumstances where a private party cannot comply with both laws or where state law stands as an obstacle to the purpose of Congress. *See Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000).

The aggregation of estate property is an essential step before assets can be administered and equitably distributed in bankruptcy. For this reason, estate property is protected from creditor collection efforts by an "automatic stay" upon the commencement of a bankruptcy case. The automatic stay precludes "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). One purpose of the stay is to give debtors a "breathing spell" by stopping collection efforts, foreclosure

actions, and other harassment. *See* H.R. Rep. No. 95-595, 340 (1978). The stay also serves to protect creditors, helping to provide "an orderly [reorganization or] liquidation procedure under which all creditors are treated equally." *Id.*

For most courts, violations of the stay are treated as void. *See generally* COLLIER ON BANKRUPTCY ¶ 362.12[1] (16th ed. 2023). However, some courts, including the U.S. Court of Appeals for the Fifth Circuit, have concluded that actions violating the stay are merely voidable rather than void. *See In re Jones*, 63 F.3d 411 (5th Cir. 1995). The Fifth Circuit reads section 362(d) of the Bankruptcy Code, which permits a court to retroactively annul the automatic stay, together with section 549(a)(1), which authorizes a bankruptcy trustee to avoid unauthorized postpetition transfers, to mean that certain postpetition actions are valid if not voided. *See Sikes v. Glob. Marine, Inc.*, 881 F.2d 176, 179 (5th Cir. 1989).

ARBITRATION IN BANKRUPTCY

Courts generally enforce arbitration agreements. The Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* (the "FAA"), manifests a "liberal policy favoring arbitration agreements" and marks a Congressionally led departure in the law from prior "judicial suspicion of the desirability and of the competence" of arbitrators. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625, 626–27 (1985). Arbitration agreements, with certain exceptions, are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." FAA § 2.

Once a court determines that a valid arbitration agreement exists, however, the court must next consider whether any federal statute or policy forecloses arbitration of the particular claim. *Mitsubishi*, 473 U.S. at 628. A party opposing arbitration bears the burden to show that "Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue." *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220, 226 (1987). A party can do so by pointing to the statute's text, legislative history, or, importantly, "an inherent conflict between arbitration and the statute's underlying purposes." *Id.* at 227.

Whether a bankruptcy court is bound to enforce an arbitration clause or demand depends in part on whether the dispute is within the court's statutorily defined "core" jurisdiction. Twenty-eight U.S.C. § 157(b)(2) sets forth a non-exhaustive list of "core proceedings" in bankruptcy. Generally, a proceeding in bankruptcy qualifies as "core" if it "derives exclusively from the provisions of the Bankruptcy Code." *In re Nat'l Gypsum Co.*, 118 F.3d 1056, 1067 (5th Cir. 1997). That is, core proceedings are those that "would arise only in bankruptcy" or that involve "a right created by the federal bankruptcy law." *In re Wood*, 825 F.2d 90, 97 (5th Cir. 1987). Proceedings that are merely otherwise "related" to the bankruptcy, and therefore could have been brought in another court absent the bankruptcy petition, are non-core proceedings. *Id.* at 96.

As a rule, bankruptcy courts must uphold arbitration agreements in "non-core" proceedings. *Nat'l Gypsum*, 118 F.3d at 1066 ("With respect to derivative, non-core matters, the Third Circuit's opinion [that non-core proceedings are arbitrable] . . . has been universally accepted.") (discussing *Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149 (3d Cir. 1989). Courts in the Second, Third, Fourth, Fifth, and Eleventh Circuits have held that, even for "core" proceedings, the relevant inquiry is whether arbitration would conflict with the underlying purposes of the Bankruptcy Code. *See, e.g., Nat'l Gypsum*, 118 F.3d at 1067 (refusing to find that the arbitration of core bankruptcy proceedings inherently conflicted with the Bankruptcy Code).

Thus, despite the mandate of the FAA, a bankruptcy court may refuse to enforce an arbitration agreement when: (i) "the underlying nature of a proceeding derives exclusively from the provisions of the Bankruptcy Code"; and (ii) "the arbitration of the proceeding conflicts with the purpose of the Code." *In re Gandy*, 299 F.3d 489, 495 (5th Cir. 2002).

ENVISION HEALTHCARE

AmSurg Holdings, LLC (the "debtor") is a nationwide operator of ambulatory surgery centers. In 2016, the debtor and Envision Healthcare Holdings, Inc. consummated a merger of equals, forming Envision Healthcare Corporation ("Envision"). On May 15, 2015, Envision and numerous affiliates, including the debtor, filed for chapter 11 protection in the Southern District of Texas.

At the time of filing, the debtor held a 25% interest in Folsom Endoscopy Center ("FEC"), a Delaware LLC that operated as an ambulatory surgery center. In accordance with the terms of the LLC agreement, the debtor's stake secured it voting and related managerial interests in FEC. The LLC agreement also included an arbitration clause.

Several months after the chapter 11 case began, the majority owner of FEC, Gastroenterology Medical Clinic, Inc., and another FEC member (collectively, "GMC") took steps to amend the LLC agreement to strip the debtor it of its prepetition voting and managerial rights. In doing so, they relied on a provision in the Delaware Limited Liability Company Act (the "Del. LLC Act "). Del. Code Ann. tit. 6, §§ 18-101 *et seq.* Section 18-304(1)(b) of the Del. LLC Act states that "[a] person ceases to be a member of a limited liability company" when, among other events, the person "files a voluntary petition in bankruptcy." The Del. LLC Act defines a "person" as "a natural person, partnership (whether general or limited), [or a] limited liability company." Del LLC Act. § 18-101(14).

The debtor filed a motion to enforce the automatic stay, alleging that GMC's attempt to terminate the debtor's interests under the LLC agreement was a plain violation of sections 362 and 541 of the Bankruptcy Code. GMC responded by demanding arbitration of the dispute.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court denied GMC's motion to compel arbitration and voided as barred by the automatic stay the amendment to the LLC agreement that stripped the debtor of its voting and management rights in FEC.

U.S. Bankruptcy Judge Christopher Lopez acknowledged that the LLC agreement contained a valid arbitration clause but rejected GMC's argument that the case involved nothing more than a contract dispute.

Judge Lopez emphasized that "[p]roperty of the estate is a quintessential part of the Bankruptcy Code," and that resolution of the dispute involving the cancellation of the debtor's voting and managerial interests under the LLC agreement was a core bankruptcy proceeding because it required a determination of whether those interests were estate property. *Envision*, 655 B.R. at 709. Because the Del. LLC Act purported to terminate the debtor's interests, he explained, the question of whether those interests were estate property could be determined only after resolving the "direct conflict" arising between the Bankruptcy Code and the Del. LLC Act. Judge Lopez further concluded that permitting arbitration in this instance would not be consistent with the purposes of the Bankruptcy Code. According to Judge Lopez, "[t]here is nothing in the LLC Agreement to interpret" and the "conflict must be resolved by this Court, not an arbitrator." *Id.*

Judge Lopez concluded that the debtor's managerial and voting rights under the LLC agreement qualified as legal and equitable interests that are property of the estate. He relied on the Supreme Court's "broad" construction of the estate in *Whiting Pools*. According to Judge Lopez, the phrase "all legal or equitable interests" in section 541(a)(1) of the Bankruptcy Code is not ambiguous, writing that "[w]e all know what 'all' means." *Id.* at 709. This plain reading of section 541(a), Judge Lopez reasoned, is bolstered by section 541(c)(1)(B), which provides that estate property includes interests of the debtor that were purportedly terminated because of the commencement of a bankruptcy case.

"[S]tates," Judge Lopez wrote, "cannot legislate estate property away." *Id.* at 710. A bankruptcy filing, he emphasized, both creates an estate and triggers the automatic stay. These events "occur simultaneously and instantaneously," and "[t]here is no metaphysical moment in time for state law to alter or modify any prepetition rights between the filing of the petition and creation of the estate." *Id.* at 711. The bankruptcy court accordingly held that, once the debtor filed for chapter 11 protection, its managerial and voting interests under the LLC agreement became part of the estate and were protected by the automatic stay.

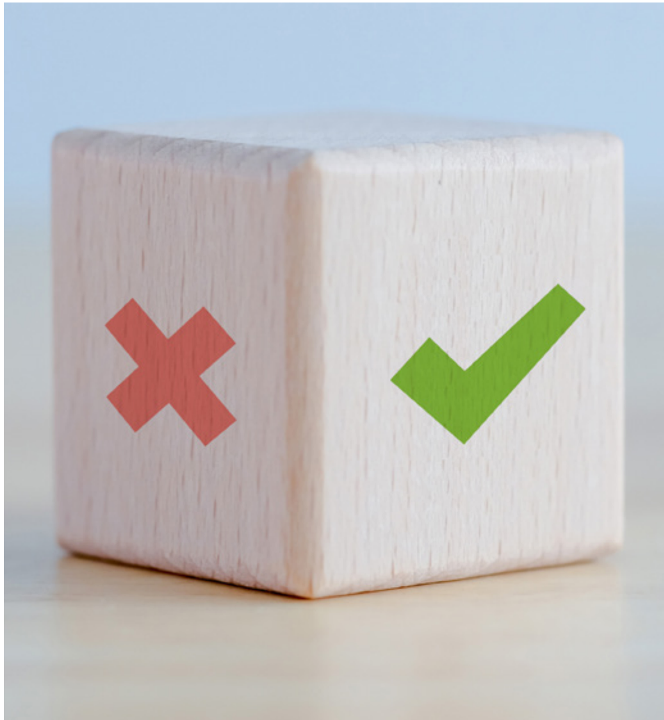
Examining the Del. LLC Act and relevant case law interpreting it, Judge Lopez acknowledged that various Delaware courts have upheld either section 18-304 of the Del. LLC Act or other similar *ipso facto* provisions on the ground that such provisions deprive LLC members merely of management, but not economic, rights. *Id.* (citing *Zachman v. Real Time Cloud Servs. LLC*, 2021 WL 1561430, at *2 (Del. Apr. 20, 2021); *Milford Power Co., LLC v. PDC Milford Power, LLC*, 866 A.2d 738, 740 (Del. Ch. 2004)). For Judge Lopez, however, the distinction drawn by these courts was irrelevant. He determined that section 18-304 of the Del. LLC Act directly conflicts with federal bankruptcy law by purporting to alter property rights included in the bankruptcy estate, thereby violating the automatic stay.

The bankruptcy court noted that its conclusion comports not only with the text of the Bankruptcy Code, but also with other court decisions interpreting similar state laws in this context. *Id.* at 711–712 (citing *Weiss v. All Year Holdings Ltd. (In re All Year Holdings Ltd.)*, 648 B.R. 434, 456 (S.D.N.Y. 2022), *appeal withdrawn*, 2023 WL 2944995 (2d Cir. Feb. 1, 2023); *Pearce v. Woodfield (In re Woodfield)*, 602 B.R. 747, 756 (Bankr. D. Or. 2019); *Sheehan v. Warner (In re Warner)*, 480 B.R. 641, 647, 656 (Bankr. N.D. W. Va. 2012)).

The court accordingly declared the amendment to the LLC agreement to be void and restored the debtor's pre-existing voting and managerial rights.

OUTLOOK

There are several takeaways from the bankruptcy court's decision in *Envision Healthcare*. First, in keeping with the Bankruptcy Code's purpose in administering all of a debtor's interests in property, "wherever located and by whomever held," for the benefit of all stakeholders, "property of the estate" is construed broadly and includes non-economic assets such as management or voting rights under an LLC agreement. Second, the ruling reinforces the supremacy of federal bankruptcy law over non-bankruptcy laws that purport to modify or terminate a debtor's property rights based upon its financial condition or a bankruptcy filing. Finally, *Envision Healthcare* illustrates that a bankruptcy court has the discretion to deny arbitration of a dispute that is a core proceeding if arbitration would conflict inherently with the purposes of the Bankruptcy Code.



CHANGES TO CONFIRMED "TOGGLE" CHAPTER 11 PLAN REQUIRED NO ADDITIONAL DISCLOSURE AND VOTING WHERE CREDITORS' RIGHTS NOT MATERIALLY AND ADVERSELY AFFECTED

Mark A. Cody

Even after a bankruptcy court has confirmed a chapter 11 plan, changed circumstances prior to the plan's implementation and "substantial consummation" might make alterations to the plan necessary. If a proposed change is significant enough, it may be deemed a plan "modification," in which case the Bankruptcy Code may require that stakeholders be provided with additional disclosure regarding the alteration and an opportunity to vote on the plan as modified. The U.S. Bankruptcy Court for the Southern District of New York addressed the procedures governing post-confirmation modification of a chapter 11 plan in *In re Celsius Network LLC*, 2023 WL 8931299 (Bankr. S.D.N.Y. Dec. 27, 2023). In a case where the debtors' "toggle" chapter 11 plan expressly contemplated two alternative transactions, but the debtors proposed certain changes prior to the plan's implementation, the court held that, even if the alterations qualified as a plan "modification," no additional disclosure or voting was necessary because the changes did not materially and adversely impact creditors.

SOLICITATION OF VOTES ON A CHAPTER 11 PLAN

Generally, holders of allowed claims and interests have the right to vote to accept or reject a chapter 11 plan. *See* 11 U.S.C. § 1126(a). A class of claims accepts a plan if creditors (other than creditors whose votes are disallowed under section 1126(e)) holding at least two-thirds in amount and more than one-half in number of the allowed claims in the class (again, not counting disallowed claims) vote in favor of the plan. *See* 11 U.S.C. § 1126(c). For a class of equity interests to accept a plan, the holders of at least two-thirds of the interests voting must vote to accept it. *See* 11 U.S.C. § 1126(d). Creditors or interest holders whose claims or interests are not "impaired" under the plan (as defined in 11 U.S.C. § 1124), however, are conclusively deemed to accept the plan, "and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required." *See* 11 U.S.C. § 1126(f). Creditors and interest holders that would receive or retain nothing under the plan are deemed to reject it. *See* 11 U.S.C. § 1126(g).

Section 1125(b) of the Bankruptcy Code provides that votes in favor of a chapter 11 plan can be solicited postpetition only after creditors and interest holders receive a court-approved disclosure document containing "adequate information," a concept defined in section 1125(a). *See* 11 U.S.C. § 1125; Fed. R. Bankr. P. 3016(b). This provision is "designed to 'discourage the undesirable practice of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests.'" *In re Heritage Org., LLC*, 376 B.R. 783, 794 (Bankr. N.D. Tex. 2007) (quoting *In re Clamp-All Corp.*, 233 B.R. 198, 208 (Bankr. D. Mass. 1999)).

MODIFICATION OF A CHAPTER 11 PLAN

Section 1127(a) of the Bankruptcy Code states that the proponent of a chapter 11 plan on which votes have been solicited from creditors or interest holders "may modify such plan at any time *before confirmation*," unless the proposed modification violates the Bankruptcy Code's requirements regarding the classification of claims and interests or the contents of a plan. 11 U.S.C. § 1127(a) (emphasis added).

Section 1127(b) provides that the proponent of a plan or the reorganized debtor "may modify such plan at any time *after confirmation* of such plan *and before substantial consummation* of such plan," again unless the proposed modification violates the Bankruptcy Code's requirements regarding the classification of claims and interests or the contents of a plan. 11 U.S.C. § 1127(b) (emphasis added). It further states that "[s]uch plan as modified . . . becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, under section 1129 of [the Bankruptcy Code]."

Section 1127(c) of the Bankruptcy Code provides that any modification must comply with the requirement in section 1125 that the holders of claims and interests be given "adequate information" about the contents of a chapter 11 plan.

Under section 1127(d), a creditor or interest holder who accepts or rejects a chapter 11 plan prior to its modification is deemed to accept or reject, "as the case may be, such plan as modified, unless within the time frame fixed by the court, such holder changes such holder's previous acceptance or rejection."

Section 1141(a) of the Bankruptcy Code provides that the terms of a confirmed chapter 11 plan are binding on all parties.

Under section 1101(2), "substantial consummation" of a chapter 11 plan occurs when: (i) substantially all of the property to be transferred under the plan has been transferred; (ii) the debtor or its successor has assumed the business or management of substantially all of the property dealt with by the plan; and (iii) distributions under the plan have commenced.

Special rules regarding post-confirmation plan modifications apply to individual chapter 11 debtors under section 1127(e).

Section 1127 does not apply in small business debtor reorganization cases filed under subchapter V of chapter 11. Instead, in subchapter V cases, section 1193 of the Bankruptcy Code sets forth substantially similar requirements for pre- and post-confirmation, pre-substantial consummation modification of a chapter 11 plan. *See generally* COLLIER ON BANKRUPTCY ("COLLIER") ¶ 1127.06 (16th ed. 2023) (discussing differences between modification of subchapter V plans and ordinary chapter 11 plans).

Rule 3019(a) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") provides that, in a chapter 9 or chapter 11 case, the plan proponent may file with the court a modification of a chapter 11 plan after it has been accepted but prior to confirmation. It further states that:

> If the court finds after hearing on notice to the trustee, any committee appointed under the Code, and any other entity designated by the court *that the proposed modification does not adversely change the treatment of the claim of any creditor or the interest of any equity security holder who has not accepted in writing the modification,* it shall be deemed accepted by all creditors and equity security holders who have previously accepted the plan.

Fed. R. Bankr. P. 3019(a) (emphasis added). Bankruptcy Rule 3019(b) establishes the procedure for post-confirmation modifications to a plan in an individual chapter 11 case.

Sections 1127 and 1141, when taken together with other related provisions of the Bankruptcy Code, impose an important element of finality in chapter 11 cases that allows stakeholders to rely on the provisions of a confirmed chapter 11 plan. *See generally* COLLIER at ¶ 1127.03[2][a] ("In enacting section 1127(b), Congress intended to 'safeguard the finality of plan confirmation.'").

The term "modify" within the meaning of section 1127 is not defined in the Bankruptcy Code or the Bankruptcy Rules. Courts determine what constitutes a "modification" to a chapter 11 plan on a case-by-case basis. *See* COLLIER at ¶ 1127.03. Some courts have concluded that "modification" means "alter[ing] the legal relationships among the debtor and its creditors and other parties in interest." *See In re Ionosphere Clubs, Inc.*, 208 B.R. 812, 816 (S.D.N.Y. 1997); *accord Matter of Highland Capital Mgmt., L.P.*, 57 F.4th 494, 503 (5th Cir. 2023) (ruling that a change that "alters the parties' rights, obligations, and expectations" is a plan modification); *In re Oakhurst Lodge, Inc.*, 582 B.R. 784, 798 (Bankr. E.D. Cal. 2018) (a settlement that "alters the legal relationships among the debtor and its creditors" under a confirmed plan constitutes a plan modification).

The U.S. Court of Appeals for the Second Circuit has characterized a restructuring of a trust established under a chapter 11 plan for the payment of asbestos-related personal injury claims as a "modification" because the restructuring effectively altered a "payment right" under the plan. *See Findley v. Blinken (In re Johns-Manville Corp.)*, 982 F.2d 721, 747–48 (2d Cir. 1992) ("Even if the concept of 'modification' implies some distinction between significant changes of substance, which are prohibited, and minor changes of procedure, which might be allowed, the alterations accomplished [here] are both substantive and significant."), *modified on alternate grounds*, 993 F.2d 7 (2d Cir. 1993).

The Second Circuit has also concluded that "procedural" modifications of a chapter 11 plan may be permitted if the bankruptcy court's authority to make such modifications is expressly reserved in the plan and the modification does not affect the "substantive rights" of stakeholders. *See State Gov't Creditors' Committee for Property Damage Claims v. McKay (In re Johns-Manville Corp.)*, 920 F.2d 121, 128 (2d Cir. 1990); *accord Findley*, 982 F.2d at 746; *see also Ionosphere*, 208 B.R. at 816 (the requirements of section 1127 apply even when the plan or supporting documents expressly contemplate the possibility of amendments).

If a post-voting plan modification is substantive (i.e., it materially and adversely affects stakeholders), the plan proponent must provide creditors and interest holders with a new disclosure statement and another opportunity to vote on the plan. *See In re Am.-CV Station Group Inc.*, 56 F.4th 1302, 1309 (11th Cir. 2023); *In re Sentinel Mgmt. Grp., Inc.*, 395 B.R. 281, 301 (Bankr. N.D. Ill. 2008); *In re Am. Solar King Corp.*, 90 B.R. 808, 825 (Bankr. W.D. Tex. 1988).

Courts have rejected attempts to circumvent section 1127(b) by characterizing a proposed plan modification as a motion to modify, clarify, or reconsider the chapter 11 plan confirmation order or to modify a plan-related document. *See, e.g., Findley*, 982 F.2d at 748; *In re Rickel & Assocs.*, 260 B.R. 673, 677 (Bankr. S.D.N.Y. 2001); *In re United States Brass Corp.*, 255 B.R. 189, 194 (Bankr. E.D. Tex. 2000); *In re Planet Hollywood Int'l*, 274 B.R. 391, 399 (Bankr. D. Del. 2001); *In re U.S. Repeating Arms Co.*, 98 B.R. 138, 140 (Bankr. D. Conn. 1989); *In re Charterhouse, Inc.*, 84 B.R. 147, 150 (Bankr. D. Minn. 1988).

Absent modification of a chapter 11 plan or an order revoking confirmation (see 11 U.S.C. § 1144, which authorizes the court to revoke a confirmation order "only if such order was procured by fraud" within 180 days of confirmation), appeal of an order confirming a chapter 11 plan is the only recourse. However, such an appeal may be deemed moot absent a stay pending appeal if the plan has been substantially consummated before the appeal

can be heard. *See generally* COLLIER at ¶ 1129.09 (discussing the doctrine of "equitable mootness").

CELSIUS NETWORK

Cryptocurrency lender Celsius Network LLC and certain affiliates (collectively, the "debtors") filed for chapter 11 protection on June 12, 2022, in the Southern District of New York. In October 2022, the debtors began a marketing and sale process for substantially all of their assets. Following a May 2023 auction, Fahrenheit LLC ("Fahrenheit") emerged as the successful bidder, and the backup bidder was Blockchain Recovery Investment Consortium ("BRIC").

The bankruptcy court confirmed the debtors' chapter 11 plan on November 9, 2023. Various parties appealed the confirmation order, challenging discrete issues, including ownership of certain loan collateral and the scope of the plan's release and exculpation provisions, rather than the plan's overall structure or the transactions that it contemplated.

The plan contemplated two alternative transactions. The primary transaction (the "NewCo transaction") involved: (i) the creation of a new public company ("NewCo") managed by Fahrenheit, as plan sponsor, to monetize the debtors' illiquid assets, including the bitcoin mining and cryptocurrency staking operations; (ii) an initial distribution of NewCo stock and liquid cryptocurrency to creditors, funded in part by $450 million in liquid cryptocurrency "seed funding"; (iii) $39.5 million provided by digital asset mining company US Bitcoin Corp. ("US Bitcoin") to fund the buildout and energization of mining facilities; and (iv) Fahrenheit's commitment to provide $50 million as a "plan sponsor contribution."

If the NewCo transaction was not feasible, the plan provided that the debtors could "toggle" to an alternative transaction involving an orderly wind down (the "OWD"). If activated, the OWD would eliminate certain (then unnecessary) provisions of the NewCo transaction, substitute provisions governing a mining-only public company, and substitute BRIC for Fahrenheit as the plan sponsor. The plan and disclosure statement stated that the debtors could "select a different Backup Plan Sponsor if a different party provides terms superior to those provided by BRIC," and that the "different party" might be US Bitcoin.

In the disclosure statement, the debtors notified creditors and interest holders that a vote to accept the plan would be a vote "to accept both the NewCo Transaction and the [OWD]."

Shortly after confirmation of the debtors' chapter 11 plan, the SEC informed the debtors that it would not approve the NewCo transaction, but that it would not require pre-clearance for the debtors to pursue the registration of a mining-only company.

Accordingly, on November 30, 2023, the debtors sought bankruptcy court approval to implement the OWD, but with certain changes from the original transaction. Specifically, after performing a market check, the debtors determined that US Bitcoin offered better terms than BRIC and decided to change the backup plan sponsor to US Bitcoin. After BRIC objected, the debtors and BRIC reached a separate agreement whereby BRIC would instead serve as a litigation administrator entrusted with monetizing illiquid assets, causes of action, and claims. The plan expressly contemplated such an eventuality, providing that "one or more Liquidation Administrators" could be appointed by the creditors' committee "to prosecute, settle, or otherwise resolve any remaining Disputed Claims." BRIC's fees as litigation administrator, including a "recovery incentive fee," were to be funded by reductions in fees otherwise payable pursuant to the terms of the original OWD.

The Office of the U.S. Trustee (the "UST") and a borrower group objected to the OWD implementation motion. The UST argued that the new "MiningCo transaction" with US Bitcoin was a material modification of the plan that required a new disclosure statement and vote because: (i) it changed the legal relationships between the debtors and unsecured creditors, and changed the mining manager from BRIC to US Bitcoin; (ii) it materially altered the substantive rights of creditors by changing the amount and type of finds recoverable; (iii) the proposed funding under the transaction was dramatically different than that proposed under the plan; and (iv) the OWD implementation motion was missing critical details that should be provided to creditors in an amended disclosure statement. The borrower group echoed some of these concerns, adding that the bankruptcy court should implement the original OWD and that the court lacked jurisdiction to hear the motion because the plan confirmation order had been appealed.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court granted the debtors' motion to implement the MiningCo transaction without requiring a new disclosure statement and voting.

At the outset of his opinion, Chief U.S. Bankruptcy Judge Martin Glenn explained that the chapter 11 plan and the disclosure statement "explicitly provide for the possibility of an alternate Backup Plan Sponsor on terms superior to those negotiated with the BRIC," and the confirmation order authorized the debtors to make this toggle if they, the committee, and their advisors elected to do so in good faith and consistent with their fiduciary duties. *Celsius Network*, 2023 WL 8931299, at *8. As such, Judge Glenn noted, the inquiry before him was whether the terms of the deal with US Bitcoin were better than the terms of the deal with BRIC, and if so, "whether any of the modified terms are materially adverse to creditors such that the change (although contemplated) nevertheless constitutes a modification requiring solicitation." *Id.*

Judge Glenn found that the terms of the MiningCo transaction with US Bitcoin were superior to those negotiated with BRIC as part of the original OWD. However, he acknowledged that it was difficult to perform an "apples-to-apples comparison" of the two due to the many post-confirmation developments in the debtors' chapter 11 cases that rendered certain provisions in the original

deal with BRIC obsolete and replaced certain terms with other agreements involving a variety of parties. For this reason, Judge Glenn focused on "the more measurable and more salient impact on the *creditors*; namely, the recoveries they receive." *Id.* at *11.

Judge Glenn painstakingly compared the anticipated creditor recoveries under the MiningCo transaction and the original OWD. He concluded that, under the former, the debtors "are giving each creditor a *bigger* [recovery salad], which contains different proportions of each original ingredient; but crucially, the new salad contains *at least as much* of each ingredient as the original did." *Id.* at *13.

Judge Glenn emphasized that the debtors stated in the disclosure statement that a vote to accept the plan would be a vote to accept both the NewCo transaction and the OWD, and the OWD expressly permitted the selection of an alternate backup plan sponsor in a deal involving terms no worse than the terms of the OWD. Thus, he concluded, the substitution of US Bitcoin for BRIC was not a "modification" of the plan "and section 1127(b) is not *per se* triggered." *Id.* at *14.

Even so, the bankruptcy court explained, even a change expressly contemplated in a plan cannot violate section 1127(b). Any change that "materially and adversely changes the way that a claim or interest holder is treated," Judge Glenn noted, constitutes a modification entitling creditors and interest holders to a new disclosure statement and another opportunity to vote on the modified plan. *Id.* (citations omitted).

In this case, however, Judge Glenn found that the MiningCo transaction did not involve a material and adverse change from the terms of the original plan. Among other things, he reasoned: (i) creditors' legal relationships were not changed because the MiningCo transaction was "within the letter of the Plan"; and (ii) creditors' substantive rights were not affected because the transaction would provide creditors with their pro rata portion of the same kinds of distributions as the original OWD, and "no creditor's recovery would be reduced or augmented disproportionately with respect to other creditors." *Id.* (citation omitted). The bankruptcy court was highly critical of the borrower group's argument that the original OWD should be implemented despite the changed circumstances and that their rights or recoveries were harmed because cryptocurrency prices had inflated significantly since the court confirmed the debtors' chapter 11 plan.

Finally, the bankruptcy court rejected the argument that it lacked jurisdiction to rule on the debtors' motion due to the pending appeal of the plan confirmation order. According to Judge Glenn, "[b]ankruptcy courts commonly implement unstayed, confirmed plans while an appeal is pending." *Id.* at *15 (citations omitted). Moreover, he noted, even in cases involving a "modification" of a plan within the meaning of section 1127(b), a bankruptcy court is not divested of jurisdiction to decide issues collateral to those at issue in an appeal, which was the case here.

OUTLOOK

Celsius Networks is an interesting case study regarding the mechanics and requirements governing post-confirmation chapter 11 plan modifications. The court readily found that the plan, the disclosure statement, and the confirmation order expressly contemplated the NewCo transaction, the OWD, and the possibility that certain changes might be made to the OWD based on clearly identified future developments. In addition, after carefully examining the terms of the original OWD and the MiningCo transaction, the court concluded that, even if the MiningCo transaction qualified as a "modification" of the chapter 11 plan within the meaning of section 1127(b), no additional disclosure or voting was necessary because creditors' rights and recoveries were not materially and adversely affected by the modification.

The ruling also highlights the difficulty of comparing creditor recoveries and rights under complex chapter 11 transactions, particularly in cases involving fluctuating asset values.

Another key takeaway from *Celsius Networks* is that the proponents of a confirmed chapter 11 plan are understandably loathe to characterize a change to the plan as a "modification" because additional disclosure and resolicitation of the plan are costly in terms of time and money, particularly in large cases involving thousands of creditors.

THIRD CIRCUIT: BANKRUPTCY COURT LACKS DISCRETION TO DENY EXAMINER APPOINTMENT MOTION IN LARGE CHAPTER 11 CASES

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The Bankruptcy Code provides that, in chapter 11 cases where the court does not find "cause" for the appointment of a trustee, the court "shall" appoint an examiner, upon a request from the Office of the U.S. Trustee (the "UST") or any party-in-interest prior to confirmation of a chapter 11 plan. The examiner's role is to investigate the debtor's affairs or allegations of management misconduct, if either: (i) the court determines that the appointment would be in the best interests of stakeholders and the estate; or (ii) the debtor has qualifying unsecured debt exceeding $5 million. It is well recognized that a bankruptcy court has the discretion to determine whether the appointment of an examiner is in the best interests of stakeholders and the estate. However, courts sometimes disagree over whether the appointment of an examiner is mandatory if the debtor meets the statutory debt threshold.

The U.S. Court of Appeals for the Third Circuit addressed this issue as a matter of first impression in *In re FTX Trading Ltd.*, 91 F.4th 148 (3d Cir. 2024). The Third Circuit reversed a bankruptcy court order denying a motion by the UST to appoint an examiner in a cryptocurrency chapter 11 case to investigate allegations of pre-bankruptcy manager misconduct even though the debtor's unsecured debt far exceeded the $5 million threshold. In so ruling, the Third Circuit joined the Sixth Circuit in concluding that the appointment of an examiner is such cases is mandatory when requested by the UST or a party-in-interest, and that the bankruptcy court's discretion is limited to defining the scope of the examiner's investigation.

APPOINTMENT OF A TRUSTEE OR EXAMINER IN CHAPTER 11

Ordinarily, a chapter 11 debtor's pre-bankruptcy management continues to direct the debtor's affairs and control its assets as a debtor-in-possession ("DIP"). However, if management's misconduct or incompetence indicates that it should no longer be entrusted with that role, the Bankruptcy Code provides that the DIP can be supplanted with a chapter 11 trustee.

Specifically, section 1104(a) of the Bankruptcy Code provides that during the pendency of a chapter 11 case prior to confirmation of a plan, the court, upon the request of a party in interest or the UST, and after notice and a hearing, "shall" order the appointment of a trustee either "for cause" or "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate" (but excluding the number of the debtor's security holders or the amount of its assets or liabilities). "Cause" is defined non-exclusively to include "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management," either before or after the bankruptcy petition date. 11 U.S.C. § 1104(a)(1).

The Bankruptcy Code also contemplates a less drastic alternative—the appointment of an examiner—in cases where "cause" to appoint a trustee is absent, but where the input of an independent third party is deemed necessary to investigate the debtor's financial affairs or management's conduct. Section 1104(c) provides as follows:

> If the court does not order the appointment of a trustee under [section 1104(a)], then at any time before the confirmation of a plan, on request of a party in interest or the [UST], and after notice and a hearing, the court *shall* order the appointment of an examiner *to conduct such an investigation of the debtor as is appropriate*, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if—
>
> (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; *or*
> (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,000,000.

11 U.S.C. § 1104(c) (emphasis added).

Thus, under section 1104(c), the bankruptcy court "shall" appoint an examiner if a chapter 11 trustee has not been appointed, a plan has not been confirmed and either: (a) the court determines that the appointment is in the best interests of creditors, interest holders or the estate; or (b) the debtor's qualifying unsecured debt exceeds $5 million.

Unlike a chapter 11 trustee, an examiner does not replace the DIP and generally assumes no management authority over the debtor or the estate. Rather, the examiner's role is to investigate and report on matters of the type described in section 1104(c) within the investigative scope established by the bankruptcy court.

Specifically, an examiner appointed under section 1104(c) has the following duties: (i) unless the court orders otherwise, a duty to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan"; (ii) a duty to file with the court as soon as practicable a report detailing the examiner's findings regarding these issues and any appropriate remedies available to the estate, and to submit the report to any official committee, indenture trustee, or other entity designated by the court; and (iii) a duty to perform "any other duties of the trustee that the court orders the [DIP] not to perform." *See* 11 U.S.C. § 1106(b), (a)(3), and (a)(4).

Section 1104(c)(2) is a vestige of the "public company" exception that was included in the original U.S. Senate bill later enacted as the Bankruptcy Code in 1978. *See* S. 2266, 95th Cong. 2d Sess., §§ 1101(3), 1104(a), 1109(b), 1125(f), 1126(b)(3), 1128, 1130(a)(7), 1130(a)(8)(B), and 1130(b) (1978), reprinted in COLLIER ON BANKRUPTCY ("COLLIER") at App. Pt. 4(e). The Senate bill would have made the appointment of a *trustee* mandatory in a chapter 11 cases involving a "public company," which was defined as a company with at least $5 million in unsecured debt and at least 1,000 security holders. The inclusion of section 1104(c)(2) as a ground for the mandatory appointment of an *examiner* was a compromise after the public company provision was removed. *See* 124 Cong. Rec. H11,102 (daily ed. Sept. 28, 1978), reprinted in COLLIER at App. Pt. 4(f)(i); S17,419 (daily ed. Oct. 6, 1978), reprinted in COLLIER at App. Pt. 4(f)(iii)). The $5 million threshold in section 1104(c)(2) is typically satisfied "where there is outstanding unsecured bank debt or outstanding publicly issued debentures in an aggregate sum in excess of $5,000,000." COLLIER at ¶ 1104.03[2].

In examining section 1104(c)(2) and its legislative history, a majority of courts, including the U.S. Court of Appeals for the Sixth Circuit and many district and bankruptcy courts, have held that the statute's plain language requires the appointment of an examiner in cases satisfying the $5 million threshold. *See Morgenstern v. Revco D. S., Inc. (In re Revco, D. S., Inc.)*, 898 F.2d 498, 500–01 (6th Cir. 1990); *Walton v. Cornerstone Ministries Invs., Inc.*, 398 B.R. 77, 81 (N.D. Ga. 2008); *In re Dynegy Holdings, LLC*, 2013 WL 12568343, at *1 (Bankr. S.D.N.Y. Jan. 18, 2013); *In re Vision Dev. Grp. of Broward Cnty., LLC*, 2008 WL 2676827, at *3 (Bankr. S.D. Fla. June 30, 2008); *see also Loral Stockholders Protective Comm. v. Loral Space and Commc'ns, Ltd. (In re Loral Space and Commc'ns, Ltd.)*, 2004 WL 2979785, at *5 (S.D.N.Y. Dec. 23, 2004) (agreeing that the appointment of an examiner is mandatory if the debt threshold is satisfied and noting that "it is well-established that the bankruptcy court has considerable discretion in designing an examiner's role"); *In re Erickson Retirement Communities, LLC*, 2010 WL 881727, at *2 (Bankr. N.D. Tex. March 5, 2010) ("[If] the $5 million unsecured debt threshold is met, a bankruptcy court ordinarily has no discretion. The only judicial discretion that comes into play is in defining the scope of the examiner's role/duties."); *In re UAL Corp.*, 307 B.R. 80, 84 (Bankr. N.D. Ill. 2004) ("Although the question is not free from doubt, the best reading of the statute differs from that proposed by either of the parties: appointment of an examiner is mandatory if the four conditions are met, but the court retains the discretion to determine the nature and scope of the examiner's investigation.").

However, despite the mandatory language of section 1104(c), some courts have refused to appoint an examiner even though a chapter 11 debtor's fixed, liquidated, unsecured debt— other than debt for goods, services, or taxes—or debt owing to an insider, exceeds $5 million. These courts have reasoned that the phrase "conduct such an investigation of the debtor as is appropriate" in the provision modifies the term "shall," meaning that a bankruptcy court has the discretion to refuse to appoint an examiner under section 1104(c)(2) even if the debtor satisfies the debt threshold. *See, e.g., In re Residential Cap., LLC*, 474 B.R. 112, 121 (Bankr. S.D.N.Y. 2012) ("While section 1104(c) expresses a Congressional preference for appointment of an independent examiner to conduct a necessary investigation, the facts and circumstances of the case may permit a bankruptcy court to deny the request for appointment of an examiner even in cases with more than $5 million in fixed debts. Accordingly, section 1104(c)(2) requires that a court order the appointment of an examiner when (1) no plan has been confirmed; (2) no trustee has been appointed; (3) the debtor has in excess of $5 million in fixed debts; and (4) the facts and circumstances of a case do not render the appointment of an examiner inappropriate."); *In re Spansion, Inc.*, 426 B.R. 114, 126 (Bankr. D. Del. 2010) (the appointment of examiner was not warranted, even though the statutory debt threshold for appointment of examiner was met, where the record contained insufficient evidence of misconduct to make investigation of the debtors appropriate and the appointment of an examiner would cause undue cost to the estate that would be harmful to the debtors and delay administration of the debtors' chapter 11 cases); *see also In re Collins & Aikman Corp.*, 368 B.R. 623, 626 (Bankr. E.D. Mich. 2007) (denying the UST's motion for the appointment of an examiner even though the debt threshold was met because the UST was seeking an investigation of the debtor's bankruptcy professionals rather than the debtor).

The Third Circuit weighed in on this issue in *FTX Trading*.

FTX TRADING

Global cryptocurrency exchange FTX Trading Ltd. and numerous affiliates (collectively, the "debtors") filed for chapter 11 protection in the Southern District of New York beginning on November 11, 2022. The bankruptcy filings came days after the debtors suffered a catastrophic decline in value and a severe liquidity crisis as customers withdrew billions of dollars from their accounts over the course of a few days in early November 2022. After the filings, it soon became apparent that the debtors' primary owner, Samuel Bankman-Fried, who also owned cryptocurrency hedge fund Alameda Research, had engaged in massive fraud, the misappropriation of billions of dollars in customer assets, and self-dealing that would ultimately lead to his criminal conviction for fraud in November 2023. It also emerged after preliminary investigations of the debtors' affairs that FTX Trading was grossly mismanaged without, among other things, basic corporate governance

practices, observation of corporate formalities, or maintenance of books and records accurately reflecting the extent of the debtors' assets and liabilities.

Less than three weeks after FTX Trading commenced its chapter 11 cases, the UST filed a motion seeking the appointment of an examiner. According to the UST, a public report of an examiner's investigation could reveal the "wider implications" of the debtors' collapse for the cryptocurrency industryz, and the appointment of an examiner could "allow for faster a more cost-effective resolution" of the chapter 11 cases by allowing the CEO who replaced Bankman-Fried to focus on his "primary duty of stabilizing the debtors' businesses" while the examiner investigated the debtors' pre-bankruptcy collapse and management.

The UST asserted that, because the debtors' unsecured debts substantially exceeded $5 million, the appointment an examiner was mandatory under the plain language of section 1104(c)(2) of the Bankruptcy Code. The UST also argued that the appointment of an examiner would be in the best interests of the estates, creditors, and equity security holders given the grounds to suspect "actual fraud, dishonesty, or criminal conduct" in the management of the debtors.

The official unsecured creditors' committee, the debtors, and the joint liquidators of a non-U.S. affiliate opposed the UST's motion. Among other things, they argued that: (i) the phrase "as is appropriate" in section 1104(c) makes the appointment of an examiner in cases satisfying the debt threshold not mandatory, but within the bankruptcy court's discretion; and (ii) the appointment of an examiner in this case would be highly inappropriate because the investigation would be too costly for creditors, interfere with efforts to stabilize the debtors, duplicate the debtors' own investigations of mismanagement, and pose a security risk to customers' confidential information.

Based on the "as is appropriate" language in section 1104(c), certain pre-Bankruptcy Code court decisions, and legislative history, the bankruptcy court concluded that the appointment of an examiner was discretionary despite the fact that the debtors' unsecured debt far exceeded $5 million. The court reasoned that the debtors' new CEO was "completely independent" from the debtors' founders and that any remaining prior officers "have been stripped of any decision making authority." It accordingly denied the UST's motion to appoint an examiner. The Third Circuit agreed to certify a direct appeal by the UST of the bankruptcy court's order.

THE THIRD CIRCUIT'S RULING

A three-judge panel of the Third Circuit reversed the bankruptcy court's order and remanded the case with an instruction to appoint an examiner.

Writing for the panel, U.S. Circuit Court Judge L. Felipe Restrepo explained that the issue before the court was one of statutory interpretation, which begins with an examination of the language of the statute to determine lawmakers' intent. According to Judge Restrepo, in section 1104(c), "Congress made plain its intention to mandate the appointment of examiner by using the word 'shall,' as in the Bankruptcy Court 'shall' appoint an examiner if the terms of the statute have been met." *FTX Trading*, 91 F.4th at 153.

The Third Circuit held that the bankruptcy court erred as a matter of statutory construction when it read "shall" to mean "may" by grafting the "as is appropriate" modifier onto the "obligatory command to appoint an examiner, when the conditions of subsection 1104(c)(2) have been met." *Id.* In addition, the panel agreed with the UST's argument that section 1104(c) does not state that the court shall order the appointment of an examiner to conduct an investigation of the debtor "*if* appropriate," indicating

that the bankruptcy court has a choice, but "*as is* appropriate," indicating that the bankruptcy court has the discretion to determine the extent of the examiner's investigation into the specified allegations, but does not have the discretion to deny the appointment of an examiner if the statutory conditions have been satisfied. *Id.* at 154 (emphases added).

In adopting this interpretation, the Third Circuit panel agreed with the Sixth Circuit's conclusion in *Revco* that the contrast between subsections 1104(c)(1) and 1104(c)(2) "could not be more striking," and that there is no "weighing of interests in subsection 1104(c)(2)." *Id.* (citing *Revco*, 898 F.2d at 501). Rather, Judge Restrepo noted that the court is allowed to determine only whether the debt threshold in subsection 1104(c)(2) has been satisfied. Interpreting the provision to give the court discretion by ignoring the differences between the plain text of subsections 1104(c)(1) and 1104(c)(2), he wrote, "would defy 'the usual rules of statutory interpretation' by assuming that 'Congress adopt[ed] two separate clauses in the same law to perform the same work.'" *Id.* (citations omitted).

Moreover, Judge Restrepo emphasized, based upon floor statements made by congressional sponsors of the Bankruptcy Code indicating that section 1104(c)(2) was enacted to protect the public interest in larger bankruptcy cases, "refusal to give effect to the mandatory language" concerning the appointment of an examiner would fail "to give effect to the legislative intention." *Id.* (quoting COLLIER at ¶ 1104.03[2][b] (internal quotation marks omitted) and citing 124 Cong. Rec. 33990 (1978)).

The Third Circuit panel rejected as unsupported by evidence the debtors' argument that granting every party-in-interest the right to seek the appointment of an examiner in cases where the debt threshold is met is illogical and encourages abuse. *Id.* at 155 and n.7. In addition, Judge Restrepo explained: (i) the bankruptcy court can set the parameters of the examiner's investigation, thereby ensuring no duplication of effort or unnecessary disruption of the reorganization process; and (ii) even if the mandatory nature of subsection 1104(c)(2) encourages a party-in-interest to "invoke an investigation to tactically delay proceedings," the bankruptcy court retains the discretion to continue with the chapter 11 plan confirmation process without considering the examiner's findings. *Id.* at *6 (citing COLLIER at ¶ 1104.03[2][b]).

Finally, the Third Circuit panel faulted the bankruptcy court's rationale that an examiner was unnecessary because old management had been supplanted by independent managers untainted by allegations of fraud or mismanagement. According to Judge Restrepo, the existence of independent management is irrelevant because the appointment of an examiner is mandatory under section 1104(c)(2).

The court also rejected the argument that an examiner's investigation would be duplicative and wasteful given the ongoing efforts of the debtors and the committee to uncover the extent of pre-bankruptcy mismanagement. Lawmakers, Judge Restrepo explained, "guaranteed that an investigation under subsection 1104(c)(2) would differ from those [conducted by the debtors and the committee] in several significant ways." Specifically, an examiner, unlike a DIP or an official committee, must: (i) be "disinterested" and "nonadversarial," and "answer[] solely to the Court"; and (ii) make his or her findings public, thereby "further[ing] Congress' intent to protect the public's interest as well as those creditors and creditors directly impacted by the bankruptcy." *Id.* at 157 (citations omitted).

OUTLOOK

The language of section 1104(c) of the Bankruptcy Code on its face requires that a bankruptcy court, upon the request of a party-in-interest or the UST, appoint an examiner to investigate past or ongoing managerial misconduct or incompetence in a chapter 11 case if the debtor has more than $5 million in qualifying unsecured debt. Courts, however, have sometimes refused to do so, reasoning that the appointment of an examiner is discretionary or simply unwarranted under the circumstances. With *FTX Trading*, two circuit courts of appeals have now ruled that the appointment of an examiner under section 1104(c)(2) is mandatory, and that the court's discretion is limited to defining the scope of the investigation. In so ruling, the Third Circuit bolstered the majority view on this question based upon the plain language of the provision and its legislative history.

Under the reasoning adopted by those circuits, it would appear that the UST or any party-in-interest (including creditors and equity interest holders) can secure the appointment of an examiner in chapter 11 cases that satisfy the debt threshold. In *FTX Trading,* the Third Circuit was unconvinced that the automatic appointment of an examiner in such cases would lead to needless expense, delay, and gamesmanship in chapter 11 cases, principally because the Third Circuit concluded that the appointing court has the right to define the scope of the examiner's investigation and need not defer the plan confirmation process pending the issuance of the examiner's report.

Nevertheless, if this approach is followed by other courts, the impact could be significant. Bankruptcy filings data indicate that approximately 270 cases were filed in the last two years that would satisfy the $5 million unsecured debt threshold.

On January 23, 2024, the debtors in *FTX Trading* informed the Third Circuit that they would not seek U.S. Supreme Court review of its decision.

ADLER: ENGLISH COURT OF APPEAL OVERTURNS RESTRUCTURING PLAN

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On January 23, 2024, the Court of Appeal in England and Wales (the "Appeal Court") upheld a challenge launched by dissenting creditors to overturn the UK Restructuring Plan (the "RP") of the Adler Group previously approved by the High Court under Part 26A of the Companies Act 2006 (*Strategic Value Capital Solutions Master Fund LP and others v AGPS BondCo PLC* [2024] EWCA Civ 24). In his judgment concerning the first-ever appeal of an RP, Lord Justice Snowden creates important authority that helps to define the creative boundaries of RPs, including, in particular, the application of the *pari passu* principle.

BACKGROUND

The Adler Group develops and operates multifamily residences across Germany. Having become overleveraged, the Group owed in excess of €6.1 billion in external debts. These included senior unsecured notes ("SUNs"), which had various maturity dates falling between 2024 and 2029.

Ahead of the SUNs beginning to mature, the Group opened restructuring negotiations with its creditors in 2022. Absent a restructuring, the Group considered itself likely to exhaust its available liquidity and default under its debt documents. The likely result would be the acceleration of its debts, an immediate insolvency, and an asset fire sale. The Group's restructuring proposals aimed to provide the Group with liquidity and time in which to conduct an orderly sale of assets, thereby seeking to maximize returns to its creditors.

Those negotiations proved unsuccessful, and the issuer of the SUNs proposed an RP—a tool pursuant to which a debtor can (with the approval of the court) seek to impose a wholesale debt and/or equity restructuring on dissenting stakeholders. The RP requires the approval of at least 75% in value of each voting class; however, a dissenting class can still be bound by an RP where the court is satisfied that two conditions are met: (i) the proposed RP would leave the dissenting class in no worse a position than in the relevant alternative; and (ii) at least one other affected class has voted in favor of the RP. This process is known as a cross-class cramdown ("CCCD").

PROPOSED RESTRUCTURING

By means of the proposed RP, the Group sought essentially the same restructuring as it had targeted through the failed, consensual negotiations. The SUNs in aggregate constituted €3.2 billion of the Group's external debt and were split across six series, each with its own maturity dates and interest rates. The first SUNs matured on July 26, 2024 (the "2024 SUNs"), others matured through 2025–2027 and the sixth series matured on January 14, 2029 (the "2029 SUNs"). A parent company within the Group had also issued a further three series of notes, with a principal amount of €965 million, that matured between April 27, 2023, and February 6, 2024.

In order to facilitate a managed wind-down of the Group's assets, the restructuring sought to introduce liquidity into the group through the: (i) capitalization of interest on the SUNs in return for an increase in the coupon; and (ii) introduction of €937.5 million worth of new money on a senior secured basis. Further, the Group sought to retain the phased maturity dates of the various SUNs (only extending the maturity date of the 2024 Suns by one year) and amending the enforcement waterfall, such that the additional liquidity would rank first for repayment, followed by the 2024 Notes, and then the other Notes equally as among themselves.

All classes achieved the requisite level of votes required to approve the RP except in respect of the 2029 SUNs. Despite challenges raised by members of the dissenting class, the High Court approved the RP on the basis that it was satisfied that the conditions required to implement the CCCD were met. Certain of these creditors appealed this decision to the Appeal Court on the grounds we discuss below.

THE APPEAL COURT'S CONCLUSIONS

As the first-ever appeal of an RP, Lord Justice Snowden's judgment creates important authority on a number of issues that help to define the creative boundaries of RPs. The key legal takeaways are as follows:

***Pari Passu*—Maturity**. One of the fundamental challenges to the RP was that, in retaining the phased maturity dates of the various SUNs (and expressly prioritizing the 2024 SUNs), it diverged from the *pari passu* principle. The concept of *pari passu* distribution is a fundamental principle of English insolvency law and embodies the concept of equality in right of payment. As Lord Justice Snowden put it, "no creditor should be paid any amount from the

common pool ahead of other creditors who rank equally with him if to do so creates a risk that the other creditors will not be able to be paid the same rateable proportion of their claims." Upon sanction of the RP, the High Court had held that the difference in maturities of the various SUNs was a risk that SUN-holders would have considered when subscribing for SUNs. Therefore, the High Court found that the RP did not transgress the *pari passu* principle but reflected the actual operation of the SUNs' differing maturities.

By contrast, the dissenting creditors argued that the RP prioritized the early-maturing SUNs whereas, in the relevant alternative, the SUNs would have been treated equally. As Adler would have repaid the SUNs by means of asset sales, as the SUNs fell due, the SUNs that matured first would have had less risk of the asset sales failing to generate sufficient funds to repay each SUN. The later-maturing SUNs, however, were exposed to greater risk—under the RP—of insufficient funds being raised. That difference in risk would not have arisen in an immediate winding-up of the Group, which the High Court found to be the relevant alternative. The dissenting creditors (comprising certain holders of the latest-maturing 2029 SUNs) were the most exposed to this risk of diminishing returns.

The Appeal Court determined that the differing treatment of the SUNs did depart from the *pari passu* principle and was unacceptable in this case (as their differing maturities would not have impacted their ranking in the relevant alternative—an immediate winding up).

***Pari Passu*—Exceptions**. Despite finding that the RP violated the *pari passu* principle, the appeal court confirmed that exceptions thereto are acceptable where a departure is "justified" by a "good" reason or "proper" basis. The Appeal Court did not consider it possible or appropriate to attempt to prescribe an exhaustive list of criteria that might qualify. Instead, it provided various examples that might pass muster, such as where creditors receive some priority or a proportionately enhanced share of the benefits in return for providing some additional benefit or accommodation to assist the achievement of the restructuring in the interest of creditors as a whole (such as, in this case, the granting of security to the 2024 SUNs within the RP, as part of a *quid pro quo* for 2024 SUN-holders providing the new money).

Rationality. In general, the Appeal Court subjects an RP to the "rationality test" (i.e., whether an honest and intelligent person would approve the proposal). The Appeal Court determined that the rationality test is not enough to justify exercise of the CCCD. Instead, the Appeal Court will test the treatment of crammed-down stakeholders on the horizontal and vertical comparators—namely, a stakeholder's return in the relevant alternative and its comparative returns against other stakeholders.

Competing Plans. The Appeal Court confirmed that RPs do not need to result in the best or fairest outcome. However, where the CCCD is exercised, the Appeal Court will conduct a more stringent evaluation of stakeholders' benefits and losses under the RP. This finding may open the door to compromised stakeholders proposing competing plans (as sometimes occurs in certain circumstances in U.S. chapter 11 proceedings).

Disclosures. Given the importance of valuation information to allow compromised stakeholders to challenge an RP, the Appeal Court indicated that the court should intervene where parties fail or delay in providing valuation evidence by exercising its powers of specific disclosure and other case management powers robustly.

Timing. Although not raised as a ground for appeal, the Appeal Court criticized Adler's restructuring timetable as affording insufficient time for the proper conduct of a contested RP. Companies need to provide the High Court with appropriate time to hear the case, deliver a reasoned opinion, and permit time for the determination of any application for permission to appeal.

Issuer Substitution. As the SUNs are governed by German law, in order to engage the jurisdiction of the English courts for the purpose of proposing an RP (and gaining access to the CCCD), the issuer of the SUNs was substituted with an English incorporated entity. While also not raised as a ground for appeal, the Appeal Court observed that the fact that it did not consider whether the substitution of an issuer was a valid technique for establishing jurisdiction in the English courts should not be taken as an endorsement of that process.

Interim Remedy. The Appeal Court noted its surprise that the dissenting creditors did not seek a stay of the sanction order or an order that the RP not be delivered to Companies House (at which point it would have become effective) pending receipt of the High Court's sanction decision and determination of any application to appeal that decision. The court indicated that such matters should be raised by dissenting parties with the High Court judge.

Share-Stripping. Under Adler's RP, the existing shareholders retained 77.5% of the equity (with the remainder offered to those creditors participating in the new money). The dissenting creditors argued that the retention of equity by the existing shareholders was unfair—the company was insolvent, and therefore they alone should own the company, and be entitled to any surplus value. The Appeal Court held that as an RP needs to involve a compromise among parties, even in insolvency-imminent situations, it cannot have been the intention of Parliament that shareholders could be stripped of their shares without an element of consideration since such an arrangement would be a "mere surrender or forfeiture" and not a "compromise." The Appeal Court left open the question of what consideration would be sufficient. That is not to say that existing shareholders could not be diluted by an RP to such an extent that their remaining interest was essentially worthless or that an alternative transaction structure could be adopted to achieve the disenfranchisement of existing shareholders.

Grounds for Appeal. For the first time, the Appeal Court defined when a party may appeal against sanction of an RP. Those grounds are if a judge applies incorrect legal principles, considers irrelevant factors (or fails to consider relevant ones), or comes to a conclusion on the facts that no reasonable judge could reach.

THREE KEY TAKEAWAYS

1. The immediate impact on the Adler Group is limited as the dissenting creditors did not seek the suspension of the restructuring pending the appeal. Next steps for Adler, therefore, remain to be seen.
2. This decision provides clearer authority on a number of issues that will be central to constructing a successful RP.
3. Each of the Appeal Court's comments as to the ability of RPs to depart from *pari passu* principles, the contemplation of competing plans, and the absence of an "absolute priority" rule clear the way for even more creative and flexible RPs to be brought before the English courts.

KEEPING IT IN THE FAMILY: BANKRUPTCY COURT DISCUSSES FACTORS FOR APPLICATION OF NEW VALUE EXCEPTION TO ABSOLUTE PRIORITY RULE

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One of the fundamental goals of a chapter 11 bankruptcy is the maximization of value available for distribution to creditors. The "absolute priority rule" generally applicable in chapter 11 requires that each class of impaired and unaccepting creditors be paid in full before any junior class of claims or interests may receive distributions under the plan. Courts recognize a limited exception to the absolute priority rule, however, allowing prepetition shareholders to retain their interest in the debtor where they contribute new value toward the debtor's reorganization. In *In re Cleary Packaging, LLC*, 2023 WL 8703920 (Bankr. D. Md. 2023), the U.S. Bankruptcy Court for the District of Maryland analyzed this "new value exception" to the absolute priority rule in denying confirmation of the debtor's proposed chapter 11 plan.

In *Cleary Packaging*, a chapter 11 debtor proposed in its plan that its sole owner would retain 100% ownership of the debtor while contributing funds that would provide only a fractional distribution to creditors over a 60-month period. The bankruptcy court closely scrutinized the various forms of the owner's proposed contributions to determine whether they were sufficiently substantial in the aggregate to justify his continued ownership of the reorganized entity. Acknowledging the merit of the new value exception in certain situations, the court nevertheless held that the requirements of the exception were not satisfied in the case before it.

CHAPTER 11 PLAN CONFIRMATION

A primary goal of any chapter 11 case is the successful confirmation and implementation of a plan of reorganization. Pursuant to section 1123 of the Bankruptcy Code, in order to be confirmed, the plan must: (i) classify claims; (ii) specify the treatment of each class and whether they are impaired; and (iii) provide the same treatment for claims of each respective class, unless the holder of a particular claim or interest agrees to less-favorable treatment.

Bankruptcy Code section 1123 requires that a plan specify any class of claims that is not "impaired." A class of claims is unimpaired where "the legal, equitable and contractual rights of the holders of such claims or interests are unaltered by the plan." Collier on Bankruptcy ¶ 1123.01[2] (16th ed. 2023). Impaired classes may vote on whether to accept or reject a plan of reorganization. A class of claims accepts the plan if it is accepted by at least two-thirds in amount and more than one-half in number of the allowed claims of a class. 11 U.S.C. § 1126(c).

Bankruptcy courts evaluate the classification and treatment of claims under a proposed plan to ensure conformity with the

statutory requirements. Section 1129(a) of the Bankruptcy Code requires certain criteria be met for confirmation of a plan of reorganization. Under that provision, a bankruptcy plan may be confirmed if either: (i) no classes of creditors are impaired; or (ii) all impaired classes vote to accept the plan. Under section 1129(b), however, confirmation is permitted despite rejection of the plan by one or more impaired classes if certain "cram-down" requirements are met. In particular, the court must find that the plan is "fair and equitable" and "does not discriminate unfairly" against any dissenting class. 11 U.S.C. § 1129(b)(1).

THE ABSOLUTE PRIORITY RULE AND THE NEW VALUE EXCEPTION

For a chapter 11 plan to be "fair and equitable" with respect to a dissenting impaired class of unsecured creditors, the Bankruptcy Code requires that the creditors in the class be paid in full or, failing full payment, no creditor of lesser priority, or shareholder, receive any distribution under the plan. This central tenet of bankruptcy law, sometimes referred to as the "absolute priority rule," predates the Bankruptcy Code and was first articulated by the U.S. Supreme Court in 1913 in *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482 (1913).

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), the Supreme Court crafted a "new value exception" to the absolute priority rule applicable in cases under the former Bankruptcy Act. In that case, the Court held that a junior stakeholder's continued ownership in an insolvent company pursuant to a plan of reorganization, over the objection of a senior impaired creditor, may be appropriate upon a contribution of new money by the junior stakeholder.

The Supreme Court has rarely addressed this new value exception to the absolute priority rule since enactment of the Bankruptcy Code in 1978. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the Court held that, even if the new value exception survived enactment of the Code, the new value requirement could not be satisfied by promised future contributions of labor. Additionally, the Court has declined to explicitly adopt or condemn a "new value exception" even in the rare instances that it has addressed the issue.

For example, the Court did not vacate on appeal the Ninth Circuit's *Bonner Mall* opinion, which held that the new value exception survived enactment of the Bankruptcy Code. *See U.S. Bancorp Mortg. Co. v. Bonner Mall P'ship*, 513 U.S. 18, 19 (1994). And in 1999, the Court declined to overrule the Seventh Circuit's acceptance of the new value exception. *See Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (1999). Instead, the Court assumed for purposes of its ruling that the exception was available and held that one or more of the five elements nevertheless were not satisfied when old equity retained the exclusive right to contribute the new value i.e., without a "market test."

Bankruptcy courts have disagreed on the effect of the enactment of the Bankruptcy Code on the "new value exception" that the Supreme Court defined in *Case.* Some courts, including the Fourth and Ninth Circuit Courts, permit the exception and will use a five-factor test to evaluate the proposed new value. The factors require the value to be: "(1) new; (2) substantial; (3) money or money's worth; (4) necessary for a successful reorganization; and (5) reasonably equivalent to the value or interest received." *See In re Brotby*, 303 B.R. 177, 195 (9th Cir. BAP 2003); *In re Juarez*, 603 B.R. 610, 622 (9th Cir. BAP 2019); *In re Crowe*, 2021 WL 2212005, at *12 (Bankr. D. Ariz. 2021). In addition, the Seventh Circuit ruled that the new value exception requires that there be a competitive bidding process for new equity, and other stakeholders must be provided the opportunity to propose competing plans. *See In the Matter of Castleton Plaza, LP*, 707 F.3d 821 (7th Cir. 2013).

SUBCHAPTER V'S LIMITED EXCEPTION TO THE ABSOLUTE PRIORITY RULE

The Small Business Reorganization Act of 2019 added subchapter V to chapter 11 of the Bankruptcy Code. Pub. L. 116-54, 133 Stat 1079 (Aug. 23, 2019) (H.R. 3311). Subchapter V provides a path for "small business debtors," as defined in in section 101(51D) of the Bankruptcy Code, to reorganize. Debtors who elect to proceed under subchapter V are able to avoid the absolute priority rule, because the subchapter specifically contemplates the provision of other creditor protections. Although subchapter V provides that a nonconsensual plan must not discriminate unfairly and be fair and equitable with respect to dissenting classes, the definition of "fair and equitable" in subchapter V does not include the absolute priority rule. *See* 11 U.S.C. §§ 1181(a) and 1191.

CLEARY PACKAGING

In *Cleary Packaging*, the bankruptcy court discussed the attempts by an owner of a small business debtor to confirm a chapter 11 plan and retain his interest notwithstanding the absolute priority rule. Cleary Packaging, LLC (the "Debtor") is a

company in the packaging industry. Vincent Cleary (the "Owner") is the Debtor's founder and owner. Cantwell-Cleary Co., Inc. (the "Judgment Creditor") is a competitor owned by other members of the Owner's family. The Owner previously worked for the Judgment Creditor, leaving to form the Debtor, and multiple employees and clients accompanied him. Unable to successfully compete with the Debtor, the Judgment Creditor brought suit in state court for tortious interference with business relations and obtained a judgment against the Debtor in the amount of almost $5 million.

Although the Debtor's business was otherwise relatively successful, it was forced to file for bankruptcy relief in the District of Maryland under the weight of the substantial state court judgment. Initially, the Debtor elected to proceed as a small business debtor under subchapter V. The Judgment Creditor opposed that designation, arguing that, under section 1192(2) of the Bankruptcy Code, debts arising from "willful and malicious injury"—as defined in section 523(a)—are not dischargeable in subchapter V.

The Debtor countered that this specific exception to discharge under section 523(a) applies only to individual debtors. Although the bankruptcy court agreed with the Debtor, the Fourth Circuit ultimately reversed, holding that the discharge exceptions of subchapter V of chapter 11 apply to individuals and corporate debtors alike. *See In re Cleary Packaging, LLC*, 36 F. 4th 509 (4th Cir. 2022). The Debtor therefore removed the subchapter V designation and proceeded with a traditional chapter 11 case. Subsequently, both the Debtor and Judgment Creditor filed competing plans of reorganization.

Under the Debtor's plan, there were two classes of unsecured creditors. Class 4 contained general unsecured creditors, while class 5 consisted of the Judgment Creditor's claim. Although the Judgment Creditor challenged the Debtor's classification of claims, the court ultimately was not required to rule on that issue. Generally, under the plan, the Debtor proposed to make payments to unsecured creditors for 60 months. The amount of the payments was to be established by the Debtor's projected disposable income. The Owner would retain his equity in the Debtor in exchange for his contribution of certain alleged new value.

The Owner's proposed new value consisted of "(i) his sweat equity [in the reorganized Debtor]; (ii) the payment or debt forgiveness on his prepetition claim against the Debtor (arguably approximately $2,000 in wages and $47,000 in commissions); (iii) his $35,000 postpetition (and preconfirmation) loan to the Debtor; and (iv) $25,000 (presumably in cash) from his retirement account." *See In re Cleary Packaging*, 2023 WL 8703920, at *16. The Debtor argued that these contributions allowed him to retain his ownership interest under the new value exception, in part because his equity interest was worthless, so any value he provided would be at least equivalent to the value of that interest.

The Judgment Creditor's competing plan proposed that the Judgment Creditor would purchase the Debtor's equity for $250,000, after which it would continue operating the business to repay unsecured creditors. The Judgment Creditor's plan relied upon continued operations of the Debtor for nine years. Although repayments would include the state court judgment, that claim would be subordinated to the claims of other creditors. The plan did not clearly provide how the reorganized business would operate or retain necessary employees.

The Debtor's other creditors preferred the Debtor's plan and voted to accept it. Only the Judgment Creditor voted to accept its plan. The bankruptcy court considered the evidence in support of confirmation of each plan at a consolidated confirmation holding.

THE BANKRUPTCY COURT'S RULING

The bankruptcy court denied confirmation of both plans of reorganization. Balancing the need for maximum value to creditors with the feasibility of reorganization, U.S. Bankruptcy Judge Michelle Harner held that neither plan met the statutory requirements of section 1129 of the Bankruptcy Code.

At the outset of her discussion, Judge Harner explained that the court need not decide whether a "market test" of value is always required for the new value exception to apply. Instead, she noted, "[a] market test may be necessary in certain cases if a debtor is not able to demonstrate new, substantial, and equivalent value through other admissible evidence." *Id.* at *14. In this case, however, the bankruptcy court explained that it had both the Debtor's evidence on new value and a competing bid/plan from the Judgment Creditor. It concluded that it need consider only the former to resolve the issue.

The Debtor's Plan. According to Judge Harner, the Debtor's plan failed because it violated the absolute priority rule and, thus, the fair and equitable requirement of section 1129(b). The court recognized that two practical "approaches have emerged to address the dilemma posed to prepetition equity holders of a chapter 11 debtor." *Id.* at *14. Those approaches consist of the express provisions of subchapter V and the judicially defined new value exception. *Id.*

The bankruptcy court focused initially on the value of the Owner's equity in the Debtor, to which the alleged new value must be reasonably equivalent. On that issue, the court disagreed with the Owner that its equity was worthless. To the contrary, based on the Debtor's demonstrated history of profitability combined with the apparent business capabilities of the Owner, the court found that the evidence established that the Owner's equity had at least some value.

Judge Harner then evaluated each form of the Debtor's proposed new value under the five-factor test stated in *Bonner Mall*. The court swiftly rejected the Owner's offers of "sweat equity" and "debt forgiveness" as potential new value. Citing cases, including the Supreme Court's decision in *Northwest Bank Worthington*, the court noted that such forms of proposed new value "are not considered 'new,' 'substantial,' or 'money or money's worth.'" *Id.* at *17. The court also found that the Owner's third proposed form of new value, a $35,000 postpetition and preconfirmation loan, was neither "new" nor "money or money's worth" under the test.

The court concluded that only the Owner's proposed contribution of $25,000 from his retirement account qualified as potential new value. Avoiding the "time consuming determination as to whether the new value contribution is reasonably equivalent to the value being received [the equivalence prong]," the court determined that the proffered new value failed the threshold requirement that it be "substantial." In this regard, the court found that the proposed new value "pale[d] in comparison to the total amount of claims in this case, the total amount of proposed distributions to creditors under the Debtor's Plan, and the percentage of creditor recovery in the case." *Id.* at *18. Specifically, the amount of the new value represented less than 0.5% of the approximately $5 million of claims in the case and only approximately 1.8% of the $1.38 million proposed to be distributed to creditors, providing them with a recovery of only 27%, while the Owner would retain 100% of his interest. The Owner's proposed new value thus failed to satisfy the substantiality prong of the applicable test, and the court accordingly ruled that the Debtor's plan could not be confirmed because it violated the absolute priority rule.

The Judgment Creditor's Plan. The Judgment Creditor's plan also failed. Because the plan did not provide a definite strategy for the operations or structure of the reorganized entity, the bankruptcy court found that the plan lacked adequate means of implementation demonstrating feasibility. For example, the Debtor's prepetition success was largely due to the Owner's business prowess and the loyalty of his employees. The Judgment Creditor's plan did not explain how the Debtor would be run effectively and retain employees without the Owner's involvement. Instead, it merely provided potential options for how the Debtor might continue after confirmation without actually addressing these issues.

OUTLOOK

Bankruptcy courts are not uniform in their acceptance of application of the new value exception to the absolute priority rule. *Cleary Packaging* recognizes the exception but provides an example of the high bar necessary to satisfy its requirements. Moreover, the requirement that proposed new value be substantial in and of itself—in addition to reasonably equivalent to the interest retained—may provide objecting parties with effective grounds to challenge asserted new value without engaging in complex and potentially costly valuation litigation.

NEWSWORTHY

***Katie Higgins* (Sydney)**, ***Kane Kersaitis* (Sydney)**, and ***Jessica Brycki* (Sydney)** were part of a team of Jones Day professionals representing Peabody Energy Corporation in connection with the establishment of a $320 million syndicated revolving credit facility with PNC Bank, National Association, as administrative agent. Peabody is the leading global pure-play coal company, serving power and steel customers in more than 25 countries on six continents. Its primary business is the mining, sale, and distribution of coal.

***Roger Dobson* (Sydney)** was included in the "Hall of Fame" in the practice area "Restructuring & Insolvency" in the 2024 edition of The Legal 500 Asia Pacific.

***Juan Ferré* (Madrid)** was recognized in the practice area "Insolvency and Reorganization Law" in the 2024 edition of The Best Lawyers in Spain.

An Article written by ***Dan T. Moss* (Washington and New York)** titled "The Year in Bankruptcy: 2023" was published on February 6, 2024, in Lexis Practical Guidance.

An Article written by ***Corinne Ball* (New York)** titled "Creditor Remedies Prevail in Delaware" was published in the February 21, 2024, edition of the New York Law Journal.

An Article written by ***Daniel J. Merrett* (Atlanta)** titled "New York Bankruptcy Court: Setoff and Unjust Enrichment Cannot Be Asserted as Affirmative Defenses in Bankruptcy Avoidance Litigation" was published on February 6, 2024, in Lexis Practical Guidance.

An Article written by ***Caitlin K. Cahow* (Atlanta and Chicago)** titled "Second Circuit Adopts Transfer-by-Transfer Approach to Bankruptcy Code's Safe Harbor for Securities Contracts Payments" was published on February 6, 2024, in Lexis Practical Guidance.

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