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NORTON ROSE FULBRIGHT

US Financial Restructuring Newswire

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Momentive: On balance, more good news for secured creditors

Eric Daucher

On October 20, 2017, the United States Court of Appeals for the Second Circuit issued its long-awaited decision in *Momentive*, bringing much-needed clarity to some of the most important issues facing secured creditors of bankrupt businesses. In an apparent split decision for secured creditors, the Second Circuit ruled that:

- "Cramdown" Chapter 11 plans must provide secured creditors with a "market rate" of interest (at least where an efficient market for similar instruments exists), rather than the generally lower "formula" interest rate; but

- Under the particular language of the indentures at issue, the secured creditors were not entitled to collect their "make-whole" premium when receiving replacement notes under a Chapter 11 plan of reorganization because no "redemption" had occurred.

The decision also put another crack in the doctrine of "equitable mootness," which previously often protected consummated chapter 11 plans from being substantially altered as a result of an appeal. That doctrine has come under steady criticism from a number of circuit courts in recent years, and appears to be less likely than ever to be applied to cut off appellate rights.

Background

The genesis of the *Momentive* make-whole litigation was a classic Chapter 11 "deathtrap" plan. Momentive's first lien and 1.5 lien noteholders had clauses in their indentures entitling them to a "make-whole premium" if their notes were prepaid. During the course of the bankruptcy case, the noteholders argued that the debtors were required to pay the make-whole claims, but the debtors disagreed. Hoping to circumvent the make-whole claims, the Momentive debtors proposed a plan of reorganization offering the two groups of noteholders a stark choice. If creditors accepted the plan, they would receive payment in full, in cash, of their principal and accrued interest, but they would waive their make-whole claims. If the secured creditors rejected the plan, they could litigate for their make-whole claims, but would be paid with new notes bearing a below-market interest rate rather than cash.

Both creditor groups voted to reject the plan and filed objections to the plan's confirmation, arguing that the interest rates on the new notes were unacceptably low and that the issuance of the new notes constituted a prepayment that triggered the debtors' obligation to pay the make-whole premiums. The bankruptcy court confirmed the plan over the creditors' objections, holding that the admittedly below market-rate interest rates on the new notes were permissible under the "formula-based" (as opposed to market-based) approach to determining interest rates established by the Supreme Court in *Till v. SCS Creditor Corp.*, 541 U.S. 465 (2004). The bankruptcy court also ruled that the debtors were not obligated to pay the make-whole premiums, finding that the issuance of the notes was not a prepayment under the indentures. On appeal, the district court upheld the bankruptcy court's rulings. The creditors then took a further appeal to the Second Circuit, which largely reversed the bankruptcy court.

Where an Efficient Market Interest Rate is Available, it Should be Used

Strangely, until quite recently the leading case on determining an appropriate interest rate for notes being issued under even multi-billion dollar cramdown bankruptcy plan was *Till*: a Chapter 13 case dealing with notes being issued to a creditor that had a loan secured by a pickup truck. In that case, a plurality (rather than a majority) of the Supreme Court endorsed a "formula" under which the interest rate for new secured notes issued under

In the news

January

Texas, January 11, 2018

Michael Parker spoke at the San Antonio Bar Association Litigation Section Monthly Luncheon on a panel discussing "Bankruptcy Issues for Litigators." The distinguished panel included The Hon. Craig A. Gargotta (US Bankruptcy Court, W.D. Texas).

February

Texas, February 8-9, 2018

Michael Parker spoke on "Bankruptcy Issues for Commercial Real Estate Landlords" at the ALI-CLE Commercial Real Estate Lease seminar.

March

Buenos Aires, March 22, 2018

Howard Seife is Technical Co-Chair of the INSOL International One Day Seminar; he will lead a panel at the seminar on *"Lessons Learned in Cross-Border Insolvencies."*

April/May

New York, April 29-- May 1, 2018

Howard Seife will lead a panel the INSOL International Annual Regional Conference. The panel will discuss "*The Future Under the Trump Administration: Winners and Losers in the U.S. Economy.*"

May

New York, May 24, 2018

Sam Kohn will participate on a panel at ABI's 20th Annual New York City Bankruptcy Conference. The panel will examine recent municipality filings and issues that arise in these cases.

a cramdown bankruptcy plan is set at the prime rate plus a risk premium of typically between one and three percent. Needless to say, an appropriate interest rate for a truck loan may fall well short of the rate the market would demand on a risky loan to a troubled business. The Momentive Chapter 11 plan exploited this difference to compel dissatisfied creditors to accept below-market rate notes.

On appeal, however, the Second Circuit noted that the Supreme Court in *Till* "made no conclusive statement as to whether the formula rate was generally required in Chapter 11 cases." Given that opening, and the well-established principle that "the best way to determine value is exposure to a market," the Second Circuit decided that a different tact was in order. Adopting the approach originally developed by the Sixth Circuit, the court ruled that a "market rate should be applied in Chapter 11 cases where there exists an efficient market." Only where no efficient market exists should *Till's* "formula-based" approach be used.

Rounding out that analysis, and providing significant comfort to secured creditors, the Second Circuit quoted approvingly from Fifth Circuit precedent holding that markets are efficient where "they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan." The court further observed that evidence provided by the creditors regarding the willingness of the credit markets to provide exit financing to the debtors—had it been credited by the bankruptcy court—would have been sufficient to establish the existence of an efficient market. Given the now well-developed market for bankruptcy exit financing, this approach suggests that bankruptcy courts in the Second Circuit will now generally find that an efficient market exists and therefore apply a market-based approach to determining a cramdown interest rate. If so, *Till* may finally be on the way out for major Chapter 11 cases.

The Make-wholes Fail, but a Drafting Solution May Exist

After addressing the interest rate dispute, the Second Circuit turned to the question of whether the debtors would also be compelled to pay the make-whole premiums to noteholders. Ultimately the court held that they were not payable in this instance, but declined to adopt a bright-line rule against their payment. Instead, the Second Circuit observed that, under the terms of the governing indentures, the make-whole amounts were only due upon a redemption, which the court interpreted to mean as a pre-maturity payment. The notes' maturity, however, had been accelerated by the debtors' bankruptcy filing. Accordingly, the court found that the post-acceleration payment contemplated by the plan was not a "redemption" and therefore did not trigger the make-whole obligation.

On one level, the Second Circuit has created a seemingly important conflict with the Third Circuit, which recently considered a similar question in the *Energy Future Holdings* bankruptcy cases and concluded that the make-whole amounts would be payable. But there is perhaps less to the split than meets the eye: neither the Second Circuit nor the Third Circuit adopted a bright-line rule for or against the payment of make-whole claims as a matter of bankruptcy law. Instead, both decisions determined that it was a question of contract interpretation, and simply reached different interpretations of the indentures at issue. The solution, which is already being adopted, is simply to draft indentures to clearly provide for payment of a make-whole not only upon "early redemption," but also in the event of a payment following an acceleration of the debt.

Equitable Mootness Takes Another Hit

Finally, the Second Circuit ruled that the appeal would not be dismissed as "equitably moot." Equitable mootness is a court-created doctrine allowing for an appeal from a confirmed bankruptcy plan to be dismissed if granting any relief in the appeal would create inequitable results. Appellate courts generally note that where a reorganization plan has been "substantially consummated" (i.e., put into effect) an appeal may—but will not necessarily—become moot.

Courts often consider five factors in determining whether an appeal should be declared moot: (1) Can effective relief be ordered? (2) Would the relief affect the debtor's emergence from bankruptcy? (3) Would the relief unravel intricate bankruptcy exit transactions? (4) Were affected parties able to participate in the appeal? (5) Did the appellant diligently seek to stay the plan? Disputes regarding mootness often boil down to whether an appeal would "knock the props out from under" a reorganization plan.

In *Momentive* the Second Circuit applied these factors and held that the appeal was not moot because the noteholders consistently prosecuted their objections to the plan and, upon its confirmation sought a stay. The court also found that compelling the reorganized debtors to pay up to "$32 million of additional annual payments over seven years" as a result of the make-whole premium would not jeopardize the Debtors' reorganization.

Conclusion

On balance, *Momentive* represents a positive development for secured creditors of bankrupt businesses. First, it provides significant comfort (even if not an absolute guaranty) that they will be entitled to a market rate of interest on any takeback paper that they are compelled to accept. Second, even though the Second Circuit denied payment of a make-whole premium under the particular contractual language of the case, the court's reasoning suggests that make-whole premiums would be enforceable if expressly payable upon acceleration. Corporate finance lawyers take note. Finally, *Momentive* further limits the circumstances in which equitable mootness will apply to cut off creditors' appellate rights, even where a declaration that an appeal is not moot will impose additional liability on the reorganized debtors.

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In the news

Municipal Finance and Chapter 9 Bankruptcy

Lawrence Larose participated in a video interview with Beth Wiggins of the Federal Judicial Center on Municipal Finance and Chapter 9 Bankruptcy. The interview is the first in a series to be published this year as part of the FJC's publication of "Navigating Chapter 9 of the Bankruptcy Code", to which Larry contributed.

The Attorney-Client Privilege in Civil Litigation

Toby Gerber and Shivani Shah recently completed "The Attorney-Client Privilege in Bankruptcy," a chapter in the American Bar Association's upcoming 7th Edition of The *Attorney-Client Privilege in Civil Litigation*, edited by Vincent Walkowiak and Oscar Rey Rodriguez which will be published later this year. Mr. Walkowiak is a retired Norton Rose Fulbright partner and Mr. Rodriguez is a former partner of the firm.

INSOL World

Andrew Rosenblatt and Francisco Vazquez recently co-authored an article in *INSOL World* entitled "The Risk of Competing Insolvency Proceedings Highlights the Need for Latin American Countries to adopt the UNCITRAL Model Law on Cross-Border insolvency."

For equity's sake: The appointment of equity committees in bankruptcy cases

Shivani Shah

Over the last several years, equity security holders have increasingly requested the appointment of official equity committees to represent their interests in bankruptcy cases. The increased frequency of these requests has been particularly noticeable in recent oil and gas bankruptcy cases where equity security holders have used fluctuations in commodity prices to advocate for valuations greater than the debtor's valuation in support of greater recoveries to equity security holders. This article examines the bases for appointment of an official equity committee and the standard that courts apply in evaluating requests for the appointment of an official equity committee.

Statutory and Judicial Authority to Appoint an Equity Committee

Section 1102(a)(1) of the Bankruptcy Code provides that the United States Trustee may appoint committees of creditors or equity security holders as the United States Trustee deems appropriate. Typically, a United States Trustee considers whether there is enough equity in the estate (i.e., value over and above all liabilities) to justify the burden and expense of an equity committee. Accordingly, the United States Trustee has some degree of discretion in the appointment and composition of an official equity committee. Ordinarily, an equity committee is composed of the seven largest equity security holders of the debtor that are willing to serve.

If the United States Trustee declines to appoint an official equity committee, section 1102(a)(2) of the Bankruptcy Code allows a party in interest to request that the bankruptcy court order the appointment of an equity committee. If the court orders the appointment of an equity committee, the United States Trustee no longer has discretion and is required to appoint an equity committee.

To determine if an official equity committee is necessary, courts often consider: (i) whether the debtor is likely to prove solvent; (ii) whether equity is adequately represented by stakeholders already at the table; (iii) the complexity of the debtor's case; (iv) the likely cost to the debtor's estate of an equity committee; and (v) whether, given the existing constituencies in the case, the appointment of an official equity committee would add value to the case.

With respect to solvency, a party or party in interest moving for the appointment of an official equity committee has the burden of proof to show the debtor is "solvent or nearly solvent." *In re Pilgrim's Pride Corp.*, 407 B.R. 211, 217 (Bankr. N.D. Tex. 2009). The burden of proof does not require an absolute showing of solvency or return to equity security holders, only that a distribution to equity security holders is a possibility. Often courts will balance the possibility of a return to equity security holders against the likely burden of additional costs on the debtor's estate. A court may instruct the United States Trustee to appoint an exploratory group of equity holders to evaluate if an equity committee is economical and consensual between parties in interest.[1] Appointment of an equity committee would generally be inappropriate if there is no possibility of a distribution to equity security holders under a plan of reorganization.

When a debtor's valuation is subject to price fluctuations, such as with oil and gas or other commodities, an increase in the commodity price can result in a corresponding increase in valuation and bolsters the possibility of a distribution to equity security holders. Solvency, however, is often a significant hurdle

1 *The court in In re ATP Oil & Gas Corporation, Case No. 12-36187 [ECF No. 663] created an innovative process by ordering the United States Trustee to select five current equity holders to serve as members of an exploratory group to determine whether an equity security holders committee could be appointed in a manner that was economical and on a consensual basis. The group was to serve without compensation, would have no authority to bind any person or group, and the group could enter into preliminary negotiations with potential committee professionals, but could not bind any future committee.*

for equity security holders to overcome. The analysis of possible solvency is fact-specific and requires evidence of the value of the debtor's assets and enterprise to show that the value may justify a distribution to equity security holders.

The absence of adequate representation may be easier for equity security holders to demonstrate the insolvency of the debtor. In response to a request for an equity committee, a debtor may allege that equity security holders are adequately represented by the debtor's board of directors because a board of directors has a fiduciary duty to equity security holders. A board of directors, however, is generally regarded as having a duty to the enterprise as a whole including its creditors, which may not be aligned with the interests of equity security holders. It follows that creditors generally maintain a rather pessimistic valuation while equity security holders will generally maintain a more optimistic valuation of the debtor's estate. It is in the court's discretion to determine which perspective is more credible.

There is an inverse relationship between the complexity of a case and the ability of a party in interest to adequately represent itself. Courts consider the issue of complexity to involve more than just a complicated capital structure. Moreover, courts frequently note that the difficulty in valuing a debtor parallels the difficulty a debtor's management experiences in advocating for the fair treatment of creditors and a distribution to equity security holders.

The cost of an equity committee does not prevent the appointment of a committee, but it often leads a court to impose restrictions on the equity committee's involvement. In imposing restrictions on an equity committee, a court may, for example, limit the committee's budget to ensure it does not duplicate efforts on issues where equity security holders are already adequately represented. A court may dissolve an equity committee if it becomes clear that equity security holders will not be able to participate in a distribution under a plan of reorganization. If the United States Trustee and the court decline to appoint an official equity committee, equity security holders may unite and form an unofficial or ad hoc committee to represent their interests. Such an unofficial committee may be able to recover its costs as an administrative expense claim if it can demonstrate that the committee made a "substantial contribution" to the estate.

With the court's permission, an official equity committee may retain attorneys, accountants, and other professionals to assist the committee in its role.

How an Equity Committee Can Play a Role

An official equity committee's role is governed by section 1103(c) of the Bankruptcy Code:

> (c) A committee appoint under section 1102 of this title may—
>
> > (1) consult with the trustee or debtor in possession concerning the administration of the case;
> >
> > (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or the formulation of a plan;
> >
> > (3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejection of a plan;
> >
> > (4) request appointment of a trustee or examiner under section 1104 of this title; and
> >
> > (5) perform such other services as are in the interest of those represented.

Sections 1102 and 1103 grant an equity committee broad authority to participate in a debtor's bankruptcy case. Similar to other parties in interest, an equity committee may propose a plan if the debtor's exclusive period to propose and confirm a plan has expired or has been terminated. Despite this broad ability to participate in a debtor's bankruptcy case, an equity committee's participation is often limited to areas and issues where equity security holders otherwise lack adequate representation. A court typically enforces the limitations upon an equity committee by requiring budgets for the committee's professional fees and employing a discerning eye when approving a committee's professional fees.

Paying Equity Committee Professionals

With the court's permission, an official equity committee may retain attorneys, accountants, and other professionals to assist the committee in its role. 11 U.S.C. § 1103. Such professionals may be awarded "reasonable compensation for actual, necessary services rendered." 11 U.S.C. § 330(a)(1)(A) (After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award . . . a professional person employed under section 327 or 1103 . . . (A) reasonable compensation for actual, necessary services rendered . . . ; and (B) reimbursement for actual, necessary expenses."). Official equity committee professionals should be aware of the limitation in section 330(a)(4), which provides a "court shall not allow compensation for . . . unnecessary duplication of services; or . . . services that were not reasonably likely to benefit the debtor's estate; or . . . necessary to the administration of the case." 11 U.S.C. § 330(a)(4).

Often times a court will apply a "material benefit" standard when evaluating whether professional services were necessary. Under the "material benefit" standard, a professional's efforts must have resulted in an identifiable, tangible, and material benefit to the debtor's estate. Alternatively, a court may employ the "reasonably likely to benefit the estate" standard so equity committee professionals do not risk non-payment of their fees in the absence of a distribution to equity under a plan of reorganization. Sometimes, a professional may be willing to represent an official equity committee on a contingency fee basis if the debtor and other parties in interest agree to reimburse the professional's budgeted expenses.

In addition, the members of an official equity committee can assert an administrative expense claim for their "substantial contribution" to the debtor's case. Consequently, a committee member may be able to recover the actual and necessary expenses it incurred as a result of performing its equity committee duties.

Equity Committee in Adeptus Health Inc.

Background
Adeptus Health Inc. was a publicly listed company. Adeptus Health, Inc. and 139 of its affiliates (collectively, "Adeptus") was the largest operator of free-standing emergency rooms in the US On April 19, 2017, Adeptus filed Chapter 11 cases in the United States Bankruptcy Court for the Northern District of Texas (Dallas). Wexford Spectrum Investors, LLC and Debello Investors, LLC (collectively, "Wexford") were equity security

holders of Adeptus Health Inc., holding approximately 10% of its stock.

Appointment

Wexford filed an Expedited Motion to Appoint an Official Committee of Equity Security Holders for Adeptus arguing that the traditional factors to appoint an official committee were satisfied. After a heavily contested evidentiary hearing on June 5 and 6, 2017, the bankruptcy court granted the motion and directed the United States Trustee to appoint an equity committee. In her oral ruling, Bankruptcy Judge Stacey G.C. Jernigan held that various factors should be considered, which include: the ability to prove solvency; whether equity security holders are represented adequately by stakeholders who are already at the table; the complexity of the debtor's case; the likely cost of an equity committee to the debtor's estate; and to what extent the debtor's shares are widely held and actively traded. The court further held that an absolute showing of solvency, or even a likely showing of solvency, was not necessary. Here, however, the court found significant indicia of solvency in a rather complicated, widely held publicly traded company. Moreover, the court in Adeptus was not convinced that the unsecured creditors' committee would adequately represent the interests of the widely held equity were there to be litigation against insiders. Accordingly, the court appointed an equity committee to represent the interest of all equity security holders.

Payment

Judge Jernigan's oral ruling appointing an equity security holder committee warned against the equity committee retaining "some bomb thrower who's in it to get paid" and noted that the court would watch for duplicative actions or actions that would slow the case down. Counsel to the equity committee submitted a final fee application in the amount of US$2,846,311 for the period of June 19, 2017 through October 1, 2017. On December 12, 2017 the court heard counsel to the equity committee's fee application. The court issued an oral ruling granting the fee application with a reduction of US$120,347.30. The court noted that while appointment of the equity committee was to challenge valuation of a complex enterprise, the proportionality of retained counsel's fees to other counsel in the case was problematic considering the equity committee reneged on a settlement, thereby causing excessive fees.

The court also reserved the right to supplement its oral ruling with a detailed final order "with pages and pages of details" if a party in interest chose to appeal. No party appealed the court's decision.

Conclusion

Ultimately, the appointment of an official committee of equity security holders hinges on two main factors: the valuation of a debtor to determine if a debtor is solvent and the cost an official committee would incur. With the same authority and power as an official unsecured creditors' committee, the possibility that an official equity committee can run up a mountain of professional fees means a debtor is unlikely to support the formation of another official committee and a court is generally hesitant to approve an official committee unless it is a necessity.

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Per-Debtor vs. Per-Plan: Evaluating accepting impaired classes under 11 U.S.C. § 1129(a)(1)

Julie Goodrich Harrison

Section 1129 of the Bankruptcy Code is the obstacle course a Debtor must conquer to have its plan confirmed. Among other things, § 1129 requires that there be at least one impaired class of creditors (exclusive of insiders) under the plan that votes to accept the plan. The application of this requirement, set forth in § 1129(a)(10), is straightforward when applied to a single debtor. In multi-debtor cases, however, courts have offered conflicting interpretations of what is required under § 1129(a)(10). The "per-debtor" approach interprets § 1129(a)(10) as requiring an accepting impaired class for each debtor, while the "per-plan" approach requires only one accepting impaired class across all debtors. This article details both approaches set forth for a plan involving multiple debtors to cross the finish line to confirmation.

Multi-Debtor Plans

Bankruptcy Rule 1015 allows for the joint administration of cases involving related debtors, such as subsidiaries and affiliated companies. Through joint administration, related debtors can have their cases administered by the same court in order to make case administration less costly and flow more smoothly. Joint administration does not affect the substantive rights of creditors or parties-in-interest; rather, each debtor's estate is considered a separate and distinct entity that must individually meet the requirements set forth in the Bankruptcy Code for confirmation.

Related debtors may also move the bankruptcy court for the substantive consolidation of their estates. In contrast to joint administration, substantive consolidation allows the bankruptcy court to combine the estates of the debtors and essentially treats the multiple debtors as if they were one debtor-entity. Thus, when debtors are substantively consolidated, there is a single estate which must meet the confirmation requirements. Substantive consolidation, however, is an "extraordinary" remedy that should rarely be invoked. *See In re Bonham*, 229 F.3d 750, 767 (9th Cir. 2000).

The interpretation of § 1129(a) has therefore become a topic of judicial debate. Where debtors are substantively consolidated—thus separate debtor estates merge into one estate—courts agree that the per-plan approach applies. *See ADPT DFW Holdings LLC*, 577 B.R. 232, 236 (Bankr. N.D. Tex. 2017). More recently, courts have considered § 1129(a) in the context of a joint plan submitted on behalf of multiple related-but-separate debtors. Interestingly, courts adopting each approach have cited to the plain language of the statute, describing the language as unambiguous but developing conflicting interpretations.

Per-Debtor Approach

The leading case adopting the per-debtor approach is *In re Tribune*, 464 B.R. 126 (Bankr. D. Del. 2011). In *Tribune*, two competing plans were proposed for over 100 jointly administered (but not substantively consolidated) debtors. Each plan proponent advocated for a different approach. The court entered a lengthy Opinion on Confirmation in which the court first noted the lack of "decisional authority" on the split of approaches, citing to *SGPA*, *Enron*, and *Charter Commc'ns* (discussed below). 464 B.R. at 181-82. The court analyzed each case, but noted that "none of the three courts considered the § 1129(a)(10) issue central to its decision in the matter before it." *Id.* at 182.

In its decision, the court began with a plain language analysis of § 1129(a)(10) and the Bankruptcy Code. Referencing 11 U.S.C. § 102(7), the Bankruptcy Code's Rules of Construction, the court noted that "the singular includes the plural" and therefore the fact that § 1129(a)(10) refers to a singular plan rather than multiple plans "is not a basis, alone, upon which to conclude that, in a multiple debtor case, only one debtor—or any number fewer than all debtors—must satisfy this standard." *Id.* Coupled with the court's interpretation of the joint plan as actually a separate plan for each debtor (as the two plans under review each provided by their own terms), the court found the application of § 102(7) to § 1129(a)(10) "entirely logical." The court then parsed through the other subsections of § 1129(a), noting that each of the other requirements could be met only if *all* debtors proposing a joint plan satisfied them. Based on this analysis, and the doctrine of corporate separateness, the court held that the plain language of § 1129(a)(10) was unambiguous and requires, "absent substantive consolidation or consent," that § 1129(a)(10) be satisfied by each debtor in a joint plan.

The Delaware bankruptcy court adopted the per-debtor approach again two months later, in *In re JER/Jameson Mezz Borrower II, LLC*. 461 B.R. 293, 301-02 (Bankr. D. Del. 2011). In contrast to the other courts that have considered the issue, the *JER* court was not ruling on the confirmability of a joint plan. Rather, creditors of JER moved to dismiss the chapter 11 petition on grounds that the case was filed in bad faith. *Id.* at 297. Agreeing with the movants, the court commented in dicta that confirmation of a plan would be impossible in the absence of substantive consolidation of the debtors or the movants' consent, as the movants were one debtor's only creditor, and so the debtor would be unable ever to produce an accepting impaired class under § 1129(a)(10). *Id.* at 302 (citing *Tribune* for the proposition that "there must be a consenting class for each individual debtor in a joint plan for it to be confirmed.").

Per-Plan Approach

The earliest case adopting the per-plan approach is *In re SGPA, Inc.*, No. 1-01-026092, 2012 WL 34750646 (Bankr. M.D. Pa. Sept. 28, 2001). In *SGPA*, the objecting party argued that § 1129(a)(10) requires acceptance by one impaired class for *each debtor* in a multi-debtor plan (the per-debtor approach) and the debtors contended that there need only be one accepting impaired class for the one joint plan that was submitted (the per-plan approach). 2012 WL 34750646, at 8-11. Noting the lack of authority cited by the objecting party, the bankruptcy court held that it was "not necessary to have an impaired class of creditors of each Debtor to vote to accept the [joint] Plan." *Id.* at 16. Commenting that "[t]here is one plan of reorganization" and that the impact on the objecting party would not be adversely affected by the debtors' substantive consolidation or joint administration, the court confirmed the plan despite having an accepting impaired class for only one debtor. Id. at 17.

Following *SGPA*, other courts have adopted the per-plan approach. The court in *In re Enron* held that the "plain language and inherent fundamental policy" of § 1129(a)(10) permitted the confirmation of a joint plan for 177 debtors where at least one class of claims per plan voted to accept the plan. No. 01-16034, 2004 Bankr. LEXIS 2549, at *235-36 (Bankr. S.D.N.Y. July 15, 2004). The *Enron* court did note the "substantive consolidation component of the global compromise," and that may have contributed to its application of the per-plan approach rather than the per-debtor approach. *Id.* at 235. In *In re Charter Commc'ns*, the court mentioned in dicta that compliance with § 1129(a)(10) is on a "per-plan basis, not . . . on a per-debtor basis." *JPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009). The court in *In re Station Casinos, Inc.* agreed with the *Enron* court that "the plain language and inherent fundamental policy behind Section 1129(a)(10) supports the view that the affirmative vote of one impaired class

While the majority of the courts have adopted the per-plan approach to § 1129, there is no certainty in how future courts will construe § 1129(a)(10) in the context of multi-debtor plans.

under the joint plan of multiple debtors is sufficient to satisfy Section 1129(a)(10)." No. 09-52470, 2010 Bankr. LEXIS 5380, at *82-83 (Bankr. D. Nev. Aug. 27, 2010).

Recent Developments

More recently, the bankruptcy court in *In re Transwest Resort Properties, Inc.*, adopted the per-plan approach in confirming the plan of five debtors. In its oral ruling, the bankruptcy court noted that § 1129(a)(10) is a "technical requirement for confirmation" that "does not give any substantive rights to objecting parties." See Hr'g Tr. at 4, No. 4:10-bk-37134-EWH (Bankr. D. Ariz. Dec. 19, 2011) [Dkt. 741]. The bankruptcy court noted that the majority of the cases to have addressed the issue have adopted the per-plan approach and that the decision in the *Tribune* case described below is an outlier. Rejecting the *Tribune* court's analysis, the bankruptcy court construed the joint plan before it as one more akin to a substantive consolidation plan, where the claims of the mezzanine lender, if it voted to accept the plan, would have been paid on a subordinated basis from the assets and profits of the reorganized operating debtors. *Id.* at 6-7. Accordingly, the bankruptcy court determined that the joint plan met the requirements of § 1129(a)(10).

The mezzanine lender appealed to the district court, which affirmed. 554 B.R. 894, 899-901 (D. Ariz. 2016) In its decision, the district court held that the plain language of § 1129(a)(10) was dispositive, emphasizing the statute's use of the phrase "under the plan" and construing such language to mean that "once an impaired class has accepted the plan, § 1129(a)(10) is satisfied as to all debtors because all debtors are being reorganized under a joint plan of reorganization." *Id.* at 901.

Unsatisfied with the district court's ruling, the mezzanine lenders appealed to the United States Court of Appeals for the Ninth Circuit, which was the first circuit court to address § 1129(a)(10). During oral argument, the appellant panel of judges focused on the per-debtor vs. per-plan approaches, with one judge commenting on the holding in *Tribune* and questioning whether *Tribune* is the "isolation" and a "rare, out of the field approach." *Hr'g Recording: JPMCC 2007-C1 Grasslawn Lodg. v. Transwest Resort Props., Inc.*, No. 16-16221 (Oct. 25, 2017), https://www.ca9.uscourts.gov/media. The panel also questioned the difference between substantive consolidation and what occurred below in the bankruptcy court, considering whether there would have been a difference had the debtors been substantively consolidated. One judge showed interest in the district court's plain language reading of the statute and questioned the applicability of § 102(7), suggesting that it is not the court's duty to decide whether the legislature could have better drafted the statute, but only to interpret the statute as written.

In late January 2018, the Ninth Circuit issued its opinion, holding that § 1129(a)(10) applies on a per-plan basis, rather than a per-debtor basis. *Grasslawn Logd., LLC v. Transwest Resort Props., Inc.*, No. 16-16221 (9th Cir. Jan. 25, 2018). Citing to the plain language of § 1129, the Ninth Circuit noted that § 1129(a)(10) refers to "the plan" and "makes no distinction concerning or reference to the creditors of different debtors under 'the plan,' nor does it distinguish between single-debtor and multi-debtor plans." The Ninth Circuit determined that the singular rather than plural reference allows § 1129(a)(10) to be satisfied once a single impaired class accepts a plan. In so ruling, the Ninth Circuit expressly rejected the argument that § 102(7) requires a per-debtor interpretation of § 1129(a)(1) and the arguments set forth in *Tribune* regarding the interpretation of other subsections in section § 1129(a).

Conclusion

While the majority of the courts have adopted the per-plan approach to § 1129, there is no certainty in how future courts will construe § 1129(a)(10) in the context of multi-debtor plans. Although the courts in *Transwest* and *Enron* purported to interpret the plain language of the statute as endorsing the per-plan approach, the court in *Tribune* also relied on the plain language of the statute but found the plain language required the per-debtor approach. It remains to be seen whether additional circuit courts will adopt the per-plan approach and how debtors should best structure their reorganization plans to achieve confirmation.

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Review of Chapter 15 cases in 2017: COMI shifting is still possible

Francisco Vazquez

In 2017, more than eighty-five Chapter 15 cases were filed in more than a dozen different judicial districts. The Southern District of New York was the preferred Chapter 15 venue with fifty-four cases filed there. Delaware and the Southern District of Florida were second, each with nine new Chapter 15 filings. The Chapter 15 cases filed in 2017 were related to foreign proceedings pending in the following countries: Australia, Austria, Azerbaijan, Bermuda, Brazil, the British Virgin Islands, Canada, the Cayman Islands, Chile, Colombia, France, Germany, Indonesia, Italy, the Netherlands, the Republic of Korea, Romania, Russia, and South Africa.

There were several interesting decisions issued in 2017, including some that contrasted with prior rulings. For example, the United States Bankruptcy Court for the Southern District of Florida held that a Brazilian liquidator had standing to pursue fraudulent transfer claims under New York law. This was in contrast to a prior decision of the United States Bankruptcy Court for the Southern District of New York dismissing New York law-based fraudulent transfer claims asserted by English liquidators. *See Chapter 15: Pursuing "Avoidance Actions" Under Nonbankruptcy Law, Zone of Insolvency Blog* (April 27, 2017). Other decisions in 2017 reinforced prior rulings. As discussed in our Fall 2017 issue, the United States Bankruptcy Court for the Southern District of New York continued to recognize Canadian proceedings and restructuring plans this year. *See Chapter 15 Developments: United States Courts Enforce Canadian Restructuring Plans, US Financial Restructuring Newswire* at 17 (Fall 2017). In several other cases, New York bankruptcy courts highlighted the ease with which a foreign debtor can satisfy the debtor-eligibility requirements as mandated by the Court of Appeals for the Second Circuit. *See In re Cell C Proprietary Limited*, 571 B.R. 542 (Bankr. S.D.N.Y. 2017) (noting in a case in which Norton Rose Fulbright represented the foreign representative of a South African proceeding that a foreign entity is eligible to be a debtor if it has property in the US, such as retainer or bank account, or debt that is subject to New York governing law and a New York forum selection clause).

This article focuses on two of the more interesting 2017 decisions from the United States Bankruptcy Court for the Southern District of New York addressing Chapter 15 petitions for recognition of foreign main proceedings. Before discussing the two cases, the article summarizes the standard for recognition of a foreign main proceeding.

Recognition of Foreign Main Proceedings

Under section 1517(a) of the Bankruptcy Code, a foreign proceeding, such as a foreign insolvency, bankruptcy, liquidation, or debt adjustment proceeding, shall be recognized, if (1) the foreign proceeding is a foreign main or foreign nonmain proceeding, (2) the petition for recognition was filed by a foreign representative, and (3) the petition satisfies certain procedural requirements. If all three criteria are satisfied, the petition for recognition must be granted, unless recognition would be "manifestly contrary" to US public policy.

Upon recognition of a foreign proceeding, a foreign representative, such as a trustee, liquidator, or debtor in possession, will have access to the United States courts and can sue or be sued in the United States. Further, upon recognition of a foreign main proceeding, certain protections arise automatically in favor of the foreign debtor and the foreign representative. In particular, creditors will be enjoined from taking most actions against the foreign debtor or its assets in the US. Recognition of a foreign nonmain proceeding does not have the same automatic effect as recognition of a foreign main proceeding. However, a bankruptcy court may grant the same relief in connection with a foreign nonmain proceeding on a discretionary basis. Thus, the type of foreign proceeding being recognized ultimately may have little consequence beyond timing and procedural issues.

If the foreign proceeding is not a foreign main proceeding or a foreign nonmain proceeding, a court should not grant recognition.[1] A foreign main proceeding is a foreign proceeding pending in the country where the debtor has the center of its main interest or "COMI." Chapter 15 does not define COMI, but a debtor's registered office is presumed to be its COMI. In determining a debtor's COMI, United States courts have considered, among other things: the location of the debtor's headquarters; the location of those who manage the debtor; and the location of the debtor's assets. Several United States courts, including the Court of Appeals for the Second Circuit (whose precedent is binding on New York bankruptcy courts), have concluded that COMI should be determined at the time of the filing of the Chapter 15 petition without regard to the debtor's operational history. A court may thus consider activities following the commencement of the foreign proceeding, which may result in a shift of a debtor's COMI from its historical location to another jurisdiction.

Oi: A Tale of Competing Foreign Proceedings

In one of the more interesting cases decided this year, the United States Bankruptcy Court for the Southern District of New York was faced with competing foreign insolvency proceedings and competing Chapter 15 cases. Following recognition of a Brazilian proceeding as a foreign main proceeding, certain noteholders initiated a competing proceeding in the Netherlands. The court-appointed Dutch trustee thereafter filed a Chapter 15 petition for recognition of the Dutch proceeding. A debtor, however, may only be subject to one foreign main proceeding at any given time. Accordingly, the bankruptcy court had to choose between granting recognition to the Dutch proceeding and terminating recognition of the Brazilian proceeding, or maintaining the *status quo* and denying recognition of the Dutch proceeding. As discussed below, the case raised several issues, including the applicable standard to apply when considering recognition of a competing Chapter 15 filing and the significance of creditor motivation.

Oi S.A. and its affiliates form one of the largest groups of telecommunications service providers in Brazil. Facing financial distress, certain members of the Oi Group, including Oi Brasil Holdings Coöperatief U.A., a Dutch subsidiary of Oi S.A., commenced reorganization proceedings in Brazil. Thereafter, the Southern District of New York Bankruptcy Court granted recognition to the Brazilian proceedings of the Oi debtors, including Dutch Oi, as foreign main proceedings, finding that the COMI of each of the debtors was Brazil. Although recognition of the Brazilian proceedings was not opposed, the court expressly found that Brazil was the COMI of Dutch Oi. According to the court, Dutch Oi was a special purpose vehicle created to obtain financing for the Oi Group, and the COMI of a special purpose vehicle, such as Dutch Oi, "turns at a location of the corporate nerve center and the expectation of creditors," which, in this instance, was Brazil.

Prior to the bankruptcy court's hearing on the petition for recognition of the Brazilian proceedings, certain US holders of notes issued by Dutch Oi filed involuntary bankruptcy petitions against Dutch Oi in the Netherlands. Following recognition of the Brazilian proceedings, Dutch Oi filed a petition for a "suspension of payments" in the Netherlands that generally resulted in a stay of actions against the debtor. Ultimately, the suspension of payments proceeding was converted to a bankruptcy case and a trustee was appointed.

The Dutch trustee, with support from certain noteholders, filed a petition with the New York bankruptcy court for recognition of the Dutch bankruptcy case as a foreign main proceeding under Chapter 15. A debtor may only have one COMI at any particular time and therefore can only be subject to one foreign main proceeding at a time. Consequently, in deciding whether to grant recognition to Dutch Oi's Dutch proceeding, the bankruptcy court had to address its prior order granting recognition to Dutch Oi's Brazilian proceeding.

As a threshold matter, the bankruptcy court needed to determine the standard that governed the petition for recognition of the Dutch proceeding. The Dutch trustee (and supporting noteholders) argued that the bankruptcy court should apply the formulaic approach set forth in section 1517(a). According to the trustee, if the bankruptcy court determined that Dutch Oi's COMI was the Netherlands as of the date of the new Chapter 15 filing, then the court was required to recognize the Dutch proceeding as a foreign main proceeding and terminate recognition of Dutch Oi's Brazilian proceeding.

1 *The cases discussed in this article do not address foreign nonmain proceedings and therefore the elements of a foreign nonmain proceeding are not discussed here.*

In contrast, Oi argued that the court could recognize the Dutch proceeding only if the court first terminated recognition of the Brazilian proceeding under section 1517(d) of the Bankruptcy Code. Under section 1517(d), a court may terminate or modify a prior recognition order if the grounds for recognition "were fully or partially lacking," or "have ceased to exist."

The bankruptcy court agreed with Oi, finding that section 1517(d) "specifically contemplates the question currently before this Court: a request to terminate or modify a prior recognition." The bankruptcy court noted that, unlike the decision to recognize a foreign proceeding in a typical case, which is governed by section 1517(a), the decision to terminate a prior recognition is discretionary and not mandatory. Moreover, the court noted that two prongs of section 1517(d) required the court to evaluate recognition at different times. The first requires the court to analyze "whether the basis for recognition previously presented to the Court was flawed in some way." The second prong requires the court to analyze "whether something has changed since recognition."

The Dutch trustee and supporting noteholders argued that the evidence supported termination of recognition of the Brazilian proceeding under both prongs of section 1517(d). First, the trustee asserted that the basis for recognition of the Brazilian proceeding was flawed. According to the trustee, the bankruptcy court was not aware of certain facts that would have supported a finding of COMI in the Netherlands when it recognized the Brazilian proceeding. In particular, according to the trustee, the bankruptcy court did not know that (1) Dutch Oi's registered office was in the Netherlands, (2) Dutch Oi's board had issued resolutions and obtained an opinion letter stating that Dutch Oi's COMI was in the Netherlands, (3) Dutch Oi fraudulently transferred assets to Brazilian affiliates before commencing the Brazilian proceeding, (4) Dutch Oi was planning on filing a Dutch proceeding during the Brazilian Chapter 15 case, and (5) Dutch Oi engaged in financing and hedging activities beyond its purported special purpose of issuing notes.

The bankruptcy court dismissed each of the trustee's allegations, finding that evidence refuted the trustee's position or that the trustee's assertions were not relevant to the COMI analysis. The bankruptcy court began by noting that Oi previously disclosed and the court was aware of Oi Dutch's connections to the Netherlands — including that it was incorporated and maintained its registered office in the Netherlands and that its directors, one of whom lived in the Netherlands, met in the Netherlands — when the court recognized the Brazilian proceeding. Moreover, these facts did not support a finding of COMI in the Netherlands.

The bankruptcy court also found that statements made by Oi (and its board) in the Dutch proceeding regarding COMI were not relevant to the bankruptcy court's determination because the standards under applicable law (i.e., the European Union Convention on

Insolvency and/or Dutch law versus US law) were different. For similar reasons, the bankruptcy court concluded that the Dutch court's determination that Dutch Oi's COMI was the Netherlands was not entitled to comity, and Oi was not estopped from challenging the assertion that the Netherlands was Dutch Oi's COMI. Moreover, the fact that Dutch Oi may have fraudulently transferred assets or was planning on filing a Dutch proceeding when the Brazilian proceeding was being recognized was irrelevant to the COMI analysis. The bankruptcy court concluded that the evidence demonstrated that Dutch Oi was a special purpose financing vehicle that did not engage in activities beyond serving the financing needs of the Oi Group. Consequently, the nerve center of Dutch Oi was found to be in Brazil, where the Oi Group conducted its operations and managed Dutch Oi.

Second, the Dutch trustee argued that his appointment was a significant development that would support termination of recognition of the Brazilian proceeding. Specifically, the trustee asserted that his conduct in the Netherlands following recognition of the Brazilian proceeding resulted in a shift of Dutch Oi's COMI from Brazil to the Netherlands. Consequently, according to the trustee, the Dutch proceeding (and not the Brazilian proceeding) was the foreign main proceeding for Dutch Oi as of the date of the new Chapter 15 filing.

The bankruptcy court acknowledged that the actions of a foreign trustee prior to a Chapter 15 filing can be relevant to the COMI analysis. The activities, however, must be sufficiently significant or material to result in a COMI shift. In this instance, the bankruptcy court concluded that the trustee's activities in the Netherlands were insufficient to shift Dutch Oi's COMI "for two reasons: 1) his actions do little to change the economic realities associated with [Dutch Oi's] status as a special purpose financing vehicle and the related expectations of creditors; and 2) there are significant legal and pragmatic limitations on the [Dutch trustee]." In particular, the trustee had no ability to restructure Dutch Oi. Under Dutch law, the board of Dutch Oi had the exclusive authority to propose a restructuring plan. Moreover, as conceded by the Dutch trustee, it was unlikely that Dutch Oi would restructure its debts separate from the Brazilian proceeding. The court therefore found that the evidence did not reflect that Dutch Oi's COMI had shifted to the Netherlands after recognition of the Brazilian proceeding and so, the court refrained from terminating the prior recognition.

In denying the Chapter 15 petition for recognition of the Dutch proceeding, the bankruptcy court emphasized that it was troubled by the actions taken by a certain noteholder, describing how the noteholder "weaponized" Chapter 15 by "strategically" not opposing recognition of the Brazilian proceeding and then later initiating (and supporting recognition of) the Dutch proceeding with the ultimate goal of gaining leverage over the Oi Group in the restructuring negotiations. According to the court, the noteholder "kept silent at the Prior Recognition Hearing while pursuing bankruptcy proceedings for [Dutch Oi] in the Netherlands with the intent of overturning this Court's Prior Recognition Order, and undermining the Brazilian RJ Proceeding."

The Dutch trustee and the noteholder tried to minimize the import of the noteholder's actions by stressing that the noteholder acted on its own behalf and did not control the trustee or the debtor. The court acknowledged that the noteholder did not have fiduciary obligations to other creditors, and did not control the debtor or the trustee. Nevertheless, the court concluded that it would consider the noteholder's actions in determining whether to terminate or modify the prior recognition under section 1517(d) given the noteholder's "unique and central role in creating the factual record." The court found the noteholder's strategy of remaining silent through recognition of the Brazilian proceeding while planning to eventually terminate recognition to thwart the restructuring to be "troubling" and inconsistent with the aims of Chapter 15, including promoting cooperation between US and foreign courts. According to the court, the noteholder's conduct, including lack of candor with the court, was an independent basis for the court to refrain from terminating recognition of the Brazilian proceeding.

Following the bankruptcy court's decision, that noteholder released a statement declaring that it had acted "with utmost candor and good faith" and ultimately filed a motion requesting that the bankruptcy court reconsider and vacate that portion of the decision critical of the noteholder. In addition, the noteholder was part of a group of noteholders that appealed the bankruptcy court's decision. The Dutch trustee also appealed the bankruptcy court's decision. As of the date of this article, the appeals and the motion for reconsideration have not been decided. It remains unclear what effect, if any, the appeals will have on the Oi Group's restructuring plan that was approved by creditors in Brazil, including the noteholders that advocated for the recognition of the Dutch proceeding, and the Brazilian court.

Ocean Rig: Recognition of Foreign Main Proceedings Following a COMI Shift

In a decision issued prior to *Oi*, the Southern District of New York Bankruptcy Court was presented with a case involving a COMI shift by a debtor in anticipation of a debt restructuring. There, the court was not troubled by the COMI shift, finding it to be motivated by a "legitimate, good faith purpose."

Ocean Rig UDW Inc. and certain affiliates form a group that operates as an international offshore oil drilling contractor, owner, and operator. Ocean Rig is a holding company and the parent of three other holding companies, each of which owns non-debtor companies that directly or indirectly own a fleet of deepwater oil drilling rigs. The principal assets of the four debtor holding companies were the equity interests in their subsidiaries. Facing significant payment obligations due in 2017, the four holding companies filed winding-up petitions with the Grand Court of the Cayman Islands on March 24, 2017. Thereafter, the Cayman Islands court appointed joint provisional liquidators to promote "schemes of arrangement" for the debtors.

Many countries, including the United Kingdom and the Cayman Islands, permit a company to restructure its debt under a scheme of arrangement, much like a company can restructure its debts in the US under a plan under Chapter 11 of the Bankruptcy Code. A scheme is generally binding on creditors after it has been approved by the requisite majorities of creditors and sanctioned by the appropriate foreign court. A debtor or its foreign representative will often seek an order enforcing a scheme of arrangement in the US after the related foreign proceeding has been recognized under Chapter 15.

In accordance with their powers, the provisional liquidators filed Chapter 15 petitions for recognition of the Cayman Islands proceedings with the New York bankruptcy court. A purported shareholder of Ocean Rig objected to recognition, arguing that the debtors' COMI was not the Cayman Islands. The court found that the shareholder failed to demonstrate she had standing to contest recognition. Nevertheless, the court concluded that it would address the merits of the shareholder's objection because the court was required to determine whether the provisional liquidators had satisfied the requirements for recognition under Chapter 15 and, in particular, demonstrated that the debtors' COMI was the Cayman Islands.

The court found that, prior to filing the winding-up petitions in the Cayman Islands, the debtors' COMI was located in the Republic of the Marshall Islands. Unlike the Cayman Islands, however, the Marshall Islands does not provide for debt restructuring. Accordingly, a financially distressed company would likely be liquidated in the Marshall Islands. In contemplation of restructuring their debt under a Cayman Islands scheme, the debtors began shifting their COMI from the Marshall Islands to the Cayman Islands in April 2016. Initially, Ocean Rig, which was registered as a non-resident corporation in the Marshall Islands, registered as an exempted company in the Cayman Islands. Thereafter, the subsidiary holding companies, which were registered as non-resident corporations in the Marshall Islands, registered as foreign companies in the Cayman Islands.

According to the court, the evidence demonstrated that the debtors' COMI as of the date of the Chapter 15 filing was the Cayman Islands. As of that particular date, the debtors' head office and administrative service functions were performed by a non-debtor affiliate located in the Cayman Islands. All of the employees of the affiliate had residences in the Cayman Islands, and the services agreement between the affiliate and the debtors was governed by Cayman Islands. Further, the debtors' restructuring activities, which included meetings with creditors and the debtors' legal and financial advisers, were conducted from the Cayman Islands. In addition, each of the debtors' board of directors met and had a director that resided in the Cayman Islands. The debtors' books and records were also located in Cayman Islands. Moreover, the debtors notified key parties in interest, including paying agents, indenture trustees, and administrative and collateral agents, and published notice of their relocation. Significantly, according to the court, there was no evidence supporting an alternative COMI for the debtors as of the Chapter 15 filing date.

The court acknowledged that a court may disregard a COMI shift where there is evidence of "mischief" or improper manipulation. In this instance, the court found that the motivation for the COMI shift was legitimate and valid. Under the laws of the Marshall Islands, a financially distressed company can be dissolved and liquidated. However, there is no provision that would have allowed the debtors to restructure their debt in the Marshall Islands. The court noted that a restructuring under a Cayman Islands scheme would yield a greater recovery for creditors than a liquidation under the laws of the Marshall Islands. Consequently, "the Foreign Debtors' COMI shift to the Cayman Islands was done for legitimate reasons, motivated by the intent to maximize value for their creditors and preserve their assets." The court thus recognized the Cayman Islands proceedings as foreign main proceedings.

The purported shareholder and a creditor appealed the bankruptcy court's order granting recognition to the Cayman Islands proceedings as a foreign main proceeding. The creditor subsequently withdrew its appeal. The shareholder's appeal is still pending. In the interim, the bankruptcy court entered an order enforcing the scheme of arrangement in the United States. According to a status report filed by the provisional liquidators with the bankruptcy court, the restructuring has been effectuated. Consequently, the appeal may now be moot and indeed, the debtors have filed a motion to dismiss the appeal on that basis. Please stay tuned to zoneofinsolvencyblog.com for further updates on this Chapter 15 case and others

Conclusion

In New York, a debtor's COMI will be determined as of the Chapter 15 filing date. In determining a debtor's COMI, a court may consider the actions following the commencement of the foreign proceeding. Consequently, bankruptcy courts have granted recognition to foreign main proceedings upon finding that the debtor or a foreign representative shifted the debtor's historical COMI to the jurisdiction where the foreign proceeding is pending. The Oi decision should not be interpreted as a bar to a COMI shift. Instead, it reinforces a court's ability to consider the motivation for the shift. If the COMI shift is driven by a valid reason, as occurred in Ocean Rig, a court would likely not be concerned with the shift and grant recognition to the foreign proceeding pending in the debtor's new COMI as a foreign main proceeding.

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Notable Supreme Court decisions

SCOTUS determines that 546(e) Safe Harbor does not protect transfers where financial institution is a mere conduit

Kristian Gluck and Shivani Shah

In a decision significantly impacting the ability of a plaintiff to prosecute avoidance actions, the United States Supreme Court, in *Merit Management Group, LP v. FTI Consulting, Inc.*, 583 U.S. ___ (2018), unanimously held that a transfer of funds, where a financial institution served as a mere conduit, does not entitle the recipient of the transfer to avail itself of the "safe harbor" defense provided for in section 546(e) of the Bankruptcy Code. Focusing on the construction and plain meaning of the statutory language, the Court's ruling resolved the current split among circuits interpreting and applying § 546(e).

Case Background

In *Merit*, Valley View Downs, LP and Bedford Downs Management Corporation wanted to open a combination horse track and casino, but only one horse harness-racing license was available in Pennsylvania. After determining that it would be in their best interests to combine efforts rather than compete against each other, Valley View acquired Bedford by purchasing all of its outstanding shares for US$55 million. Credit Suisse financed Valley View's purchase and wired the funds to an escrow account with Citizens Bank of Pennsylvania. In turn, Bedford's shareholders, including Merit Management Group, escrowed their stock certificates with Citizens Bank. As part of the closing, Valley View received the stock certificates and the shareholders received US$55 million from the escrow accounts.

Despite Valley View being awarded the harness-racing license, it was unable to secure the requisite gaming license to operate, and ultimately filed bankruptcy in Delaware. Following confirmation of Valley View's reorganization plan, FTI Consulting, Inc. was appointed to serve as the trustee of the plan's litigation trust. FTI sued Merit Management in the District Court for the Northern District of Illinois to unwind Valley Views' "significantly over[priced]" purchase of stock certificates, alleging the transfer was constructively fraudulent under the Bankruptcy Code because Valley View did not receive reasonably equivalent value. The District Court held that § 546(e) safe harbor shielded the transfer to Merit Management from being avoided because Credit Suisse and Citizens Bank, as financial institutions, transferred or received funds in connection with the transaction. On appeal, the Seventh Circuit Court of Appeals disagreed and found that the transfer was not protected by the safe harbor because the financial institutions were merely conduits.

Court's Analysis

Writing for a unanimous court, Justice Sotomayor sided with the Seventh and Eleventh Circuits (and rejected the rulings of a majority of the circuits – the Second, Third, Sixth, Eighth, and Tenth Circuits) finding a transfer is not "by or to (or for the benefit of)" a financial institution if the financial institution served as a mere conduit for the transfer. In its opinion, the Court found that the plain language of § 546(e), the context in which the language was used, and the broader structure of the statute supported the interpretation that § 546(e) denies safe harbor where a financial institution serves as a mere conduit for payments made by a debtor to a defendant.

Guided by the relevant section heading ("Limitations on avoiding powers") and the plain language of § 546(e) (which begins with the clause "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title"), the Court determined that the safe harbor is a limitation on the trustee's avoidance power and thus the starting point is to determine the avoidance power at issue and analyze the overarching transfer that the plaintiff is seeking to avoid. The Court was unpersuaded by Merit's argument that the component parts of the transaction should be examined, instead siding with FTI that the only relevant transfer was the overarching transfer, which in this case was Valley View's purchase of Bedford's stock from Merit. As such, the Court found that Credit Suisse's and Citizens Bank's participation as conduits for the overall transfer was irrelevant to the analysis under § 546(e).

As part of its analysis, the Court also rejected Merit's argument that the added parenthetical "(or for the benefit of)" to § 546(e) in 2006 was meant to abrogate the Eleventh Circuit's ruling in *In re Munford, Inc.*, 98 F. 3d 604 (11th Cir. 1996), which found § 546(e) was not applicable to transfers where the financial institution was only an intermediary. The Court found nothing in the text or legislative history to support this argument and determined that the language was added to make § 546(e) consistent with the avoidance powers of other substantive avoidance provisions (e.g., § 547(b)(1)). In fact, the Court found the added parenthetical reinforced the connection between § 546(e) and the applicable avoidance power, thus bolstering its analysis that the applicability of § 546(e) must be measured against the transfer that the plaintiff is seeking to avoid.

Finally, the Court addressed Merit's contention that it was Congress' intent to broadly protect the securities industry by providing a safe harbor for transactions "to" those entities covered by the safe harbor, but also "by" those entities, thereby protecting non-covered entities. The Supreme Court disagreed with this argument stating that "[t] ransfers 'through' a covered entity, conversely, appear nowhere in the statute." Ultimately, the Supreme Court found the plain language of § 546(e) to be straightforward: § 546(e) does not protect transfers where financial institutions serve as mere conduits. As a result, because neither Valley View nor Merit was a financial institution, the transfers at issue were not covered by the safe harbor in § 546(e).

Conclusion

The Supreme Court's limitation on the § 546(e) safe harbor is a significant setback to defendants in avoidance litigation, taking away what has become a commonly raised defense in complex avoidance litigation over leveraged buyouts and other pre-bankruptcy financial transactions, since most, if not all, similar transactions involve funds passing through financial institutions on their way to the ultimate transferee. As a result, we expect to see more trustees and committees (especially in the Second and Third Circuits) seeking to avoid those transfers given that a defendant can no longer argue that merely because the funds passed through a financial institution they are exempt from being avoided.

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