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NORTON ROSE FULBRIGHT

US Financial Restructuring Newswire

A quarterly newsletter from the bankruptcy, financial restructuring and insolvency team at Norton Rose Fulbright

Fall 2017

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US Financial Restructuring Newswire

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US Financial Restructuring Newswire
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Editor
David M. LeMay
+1 (212) 408-5112
david.lemay@nortonrosefulbright.com

Editorial

With the combination of Chadbourne & Parke and Norton Rose Fulbright, we are continuing our publication of the *International Restructuring Newswire* under a new name the *Norton Rose Fulbright US Financial Restructuring Newswire*. This quarterly publication will focus on developments in the US and on cross-border cases between the US and other countries.

The combination of Norton Rose Fulbright and Chadbourne enables us to offer substantial additional resources for our clients. Here are just a few of the highlights:

- **Geographical Reach.** The Chadbourne restructuring group had a significant presence and a strong reputation in New York, as well as a long history of success in the federal bankruptcy courts of Delaware and the Southern District of New York. This experience pairs ideally with Norton Rose Fulbright's historically powerful restructuring and bankruptcy presence in Texas and the Southwest.

- **Financial Institutions.** Both Chadbourne and Norton Rose Fulbright have robust and well-established practices representing financial institutions in all manner of restructuring transactions. Those practices are now combined, offering our financial institution clients one of the premier groups of restructuring and insolvency lawyers nationally.

- **Energy.** Norton Rose Fulbright has long been a leader in oil and gas industry restructurings, and Chadbourne was equally prominent in the power generation and transmission sectors. The combination makes us a leading player across a broad range of energy-related businesses.

- **Transportation.** The Chadbourne team's aviation insolvency expertise combines perfectly with Norton Rose Fulbright's already world-class aviation and maritime finance and restructuring practice.

- **Chapter 11 Creditors' Committees.** The Chadbourne restructuring team brings to Norton Rose Fulbright a long and successful history of representing official and ad hoc committees of creditors in high-profile and often contentious major cases such as *Tribune Corporation* (media), *ACA Insurance Co.* (financial guaranty insurance), *Metromedia Fiber Networks* (fiber-optic cable), and *Spiegel/Eddie Bauer* (retail). This practice strength will enhance our offering to clients who become involved in committees in or outside of formal court proceedings.

- **Chapter 11 Debtor Representation.** Both Norton Rose Fulbright and Chadbourne have deep experience in the entire range of Chapter 11 issues that troubled businesses facing financial distress must confront in reorganizing their operations. Recent Chapter 11 cases filed by Norton Rose Fulbright include *Adeptus Health* (NDTX) and *Palmaz Scientific Inc.* (WDTX).

In the news

April

Bermuda, April 20, 2017

Andrew Rosenblatt and Eric Daucher gave a presentation to the Recovery and Insolvency Specialists Association offering a US perspective on the opportunities and challenges faced by cross-border restructuring and insolvency professionals.

May

São Paulo, May 25, 2017

Howard Seife was Educational Chair of the INSOL International One Day Seminar; Andrew Rosenblatt led a panel at the seminar which spoke on "Cross-border insolvency issues and the implementation of the UNCITRAL Model Law."

June

Texas, June 1, 2017

Tim Springer presented at the 12th Anniversary Texas Bankruptcy Bench / Bar Conference on "A Practical Guide to Bankruptcy Appeals" along with The Hon. Jennifer Walker Elrod (US Court of Appeals, 5th Cir.) and The Hon. Lee H. Rosenthal (US District Court, S.D. Texas).

July

In-house training program, July 27, 2017

Lou Strubeck and Andrew Rosenblatt participated in an in-house training program with ING and other Norton Rose Fulbright attorneys. Lou gave a primer on Chapter 11 and both Andrew and Lou highlighted the differences between the US and UK bankruptcy systems and addressed other cross-border insolvency issues.

October

Texas, October 5, 2017

Tim Springer presented at the Texas Advanced Paralegal Seminar (TAPS) on "International Bankruptcy: Chapter 15, Puerto Rico, and Beyond."

In the news

Norton Journal of Bankruptcy Law and Practice

Bob Bruner recently published an article in Norton Journal of Bankruptcy Law and Practice entitled "The Unexplored Limits of Moore v. Bay: Statutory and Equitable Basis for Limiting Money Damage Awards on Fraudulent Transfer Claims."

The Law and Practice of Restructuring in the UK and US

Howard Seife and Andrew Rosenblatt co-authored a chapter entitled "Giving Effect to Debt Compromise Arrangements - Binding the Minority or Out of the Money Classes of Creditors," Oxford University Press - *The Law and Practice of Restructuring in the UK and US* (Second Edition), 2017

- **Cross Border.** The Chadbourne team has been widely recognized as an industry leader in cross-border bankruptcy cases. The Chadbourne team has been involved in some of the most complex and cutting edge cross-border bankruptcy cases ever filed, including cases emanating from the UK, Australia, Brazil, Russia and various off-shore jurisdictions. This experience and expertise coupled with the combined firm's increased global reach will benefit our multinational clients.

- **Municipal Bankruptcy and Restructuring:** The Chadbourne team has consistently been ranked as a first tier firm in the area of municipal bankruptcy. The team has represented the largest creditors in every major municipal restructuring, both in and out of court, including the Chapter 9 cases of Detroit, MI and Jefferson County, AL, the two largest municipal bankruptcies in US history.

Our Financial Restructuring and Insolvency practice covers many key industries and offers on-the-ground presence in New York, Dallas, Houston, San Antonio, and Los Angeles. If you would like to know more about our combined restructuring practice and its capabilities, please contact either of us.

Howard Seife
Global Head Financial
Restructuring and Insolvency

Louis Strubeck
US Co-Head Financial
Restructuring and Insolvency

Supreme Court to decide scope of safe harbor protections against avoidance claims

David M. LeMay

The Supreme Court recently agreed to review a case with potentially dramatic repercussions for investors that receive money from entities that later file for bankruptcy relief. *In Merit Management Group, LP v. FTI Consulting, Inc.*, Docket No. 16-784, the high court will interpret for the first time the scope of the financial institution safe harbor for avoidance actions, potentially reversing the plurality of circuit courts that have given that provision a broad interpretation to protect defendants. This article will briefly discuss the suits to which investors can be subject, before outlining the terms of the provision that protects them from those suits, describing the competing interpretations of that provision that the Supreme Court will be asked to choose between in its upcoming term, and highlighting some aspects of the case that will serve as the vehicle for the Court's decision.

The dangers of fraudulent transfer litigation

When an entity enters bankruptcy, a trustee is appointed (or the entity itself is tasked, as a debtor-in-possession) to gather all its assets and distribute those assets to the debtor's creditors. To increase the assets available for distribution, the trustee may "avoid," or unwind, certain payments the debtor made in specified periods before the bankruptcy began. Leaving aside cases of actual fraudulent intent (which are not covered in the first place by the safe harbors discussed below) a trustee can recover two kinds of payments: those made for "less than reasonably equivalent value" while the debtor was insolvent or financially impaired ("fraudulent transfers"), and those on antecedent debts made in amounts that exceed the recovery the creditor would have received if the debtor had been liquidated ("preferences") and that were made during time periods specified in the statute and while the debtor was insolvent. In other words, the trustee can force certain payees of the debtor to give back the money they have already received.

Allegations of fraudulent transfers arise particularly often in the context of leveraged buyouts, where the shares formerly held by individual shareholders are purchased by the company using the proceeds of secured debt. The secured debt incurred to purchase the former shareholders' shares often leaves the company highly leveraged and vulnerable to market forces, which frequently leads to bankruptcy. The trustee for such a corporation frequently attempts to recover the money that was paid to the old shareholders, on the theory that the shares the company purchased from them were "less than reasonably equivalent value" for the price paid. The litigation arising from such a suit can be complex and costly, particularly in a trial on the debtor's financial condition at the time of the buyout.

How the safe harbor protects defendants

Some defendants are protected from these suits by a provision of the Bankruptcy Code known as the "financial institutions safe harbor." Under Section 546(e) of the bankruptcy code:

> the trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made

> by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract . . . or forward contract, that is made before the commencement of the [bankruptcy] case.

Defendants in avoidance actions frequently attempt to save themselves from having to litigate on the merits by arguing that payments in connection with LBOs that are made by means of banks—which is the norm in such complex transactions—are exempt from avoidance because they are made "by or to . . . financial institutions." The federal Circuit Courts of Appeals have adopted varied interpretations of this provision. Most circuits—including the Second and Third Circuits, where the majority of large corporate bankruptcy cases are filed—have held that a transfer is made "by or to" a financial institution even when the financial institution acquires no interest in the property transferred (as, for example, when money is given by a company to a bank in order for the money to be distributed to a disparate group of beneficial transferees). *See In re Kaiser Steel Corp.*, 952 F.2d 1230, 1240 (10th Cir. 1991); *In re Resorts Int'l, Inc.*, 181 F.3d 505, 516 (3d Cir. 1999); *In re QSI Holdings, Inc.*, 571 F.3d 545, 551 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009); *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 338–39 (2d Cir. 2011). Before last year, only one Circuit Court had reached a different conclusion: the Eleventh Circuit, in *Matter of Munford, Inc.*, held that a transfer is not "by or to" a financial institution if the transaction of which the transfer was a part was structured in such a way as to make the financial institution a "conduit" for the transfer, rather than a transferor or transferee. 98 F.3d 604, 610 (11th Cir. 1996).

FTI v. Merit and the threatened resurgence of the narrow view

The *Munford* interpretation, however, was recently revitalized when the Seventh Circuit—which had not previously been called upon to render an opinion on the subject—handed down its decision in *FTI Consulting, Inc. v. Merit Mgmt. Grp., LP*, 830 F.3d 690 (7th Cir. 2016). Somewhat unusually for a case of this nature, *Merit* did not begin with a leveraged buyout, but with a decision grounded in the harsh realities of the gaming industry. In 2003, Valley View Downs, LP was in competition with another racetrack, Bedford Downs, for the only harness-racing license available in Pennsylvania. Both Valley View and Bedford wanted to open what was called a "racino," or a combination horse track and casino, but with only one horse racing license available in the state it was clear that only one could be successful. The two competitors realized that it would be in both their interests to "combine and conquer," as the Seventh Circuit put it, and Valley View purchased all outstanding shares of Bedford for $55 million. The transaction was structured so that Valley View paid Bedford for the stock, and Bedford distributed the funds to its then-existing shareholders through Credit Suisse and Citizens Bank of Pennsylvania.

If the Seventh and Eleventh Circuits' narrow reading of the safe harbor is upheld, the result could be severe for the former shareholders of bought-out companies.

Unfortunately for Valley View, however, its gamble did not pay off. While it succeeded at getting its hands on the one remaining harness-racing license, it failed to secure the gambling license it would have needed to permit betting to take place at the track. Without that second license, Valley View filed for Chapter 11 bankruptcy in the District of Delaware and FTI Consulting was appointed as trustee of its estate. In its capacity as trustee, FTI sued Merit Management Group, LP ("Merit"), an entity that had held 30.007 percent of the stock of Bedford before the Valley View buyout. FTI argued that transfer of approximately $16.5 million on account of its shares of Bedford was a fraudulent transfer in violation of the Bankruptcy Code, and could therefore be avoided for the benefit of the Valley View estate. Because the District of Delaware is in the Third Circuit, which had already ruled that transfers through banks are subject to the safe harbor, FTI opted not to file its lawsuit in the bankruptcy court where Valley View's bankruptcy case was pending and instead filed a new suit in the United States District Court for the Northern District of Illinois (in the Seventh Circuit), hoping that the District Court would choose to adopt the minority position on the safe harbor.

The District Court found the reasoning of the majority of circuits persuasive, and held that the safe harbor encompasses transfers that pass through financial institutions. Noting that the Seventh

Circuit had previously held that the safe harbor was intended to prevent a "domino effect" where one firm's bankruptcy would trigger further bankruptcies, allowing "one large bankruptcy [to] rippl[e] through the securities industry," the District Court held that "[t]he word 'transfer' in the context of [the safe harbor] appears to refer to the movement of assets" as opposed to the transfer of beneficial interests in those assets. The District Court held that Merit was entitled to the safe harbor so long as the assets it had received in the buyout passed through a bank on their way from Valley View to Merit. FTI appealed the decision in Merit's favor to the Seventh Circuit.

Writing for a unanimous panel, Chief Judge Diane Wood reversed the District Court. The Seventh Circuit held that the District Court had taken an overly inclusive view of what Congress meant by the word "transfer" in section 546(e), and that a court faced with a safe harbor defense should properly look at the entire transaction to figure out who gave what to whom. When Valley View bought out Bedford, for instance, what happened was not a series of transfers—from Valley View to Bedford; from Bedford to a bank; from that bank to another bank; and from that final bank to Merit and the other old Bedford shareholders—but a single transfer from Valley View to the Bedford shareholders. While that transfer was made through financial institutions, at no point (in the Seventh Circuit's view) was there a transfer by or to a financial institution. Accordingly, the Seventh Circuit reversed the District Court's opinion dismissing the lawsuit and remanded the case to the District Court for adjudication on the merits.

Understandably displeased with this result, Merit sought discretionary review by filing a petition for certiorari with the U.S. Supreme Court. On May 1, 2017—approximately 14 years after the initial Valley View buyout—the Supreme Court granted Merit's certiorari petition and agreed to hear the case as part of its 2017–18 term, which begins in October of this year.

What to expect at the Supreme Court

Merit's briefing largely relies on the arguments that have carried the day at the plurality of Circuit Courts to consider the issue, and especially on the somewhat intuitive argument that whenever assets pass through multiple parties' hands, the move from each party to the next is a "transfer." Merit relies in particular on the history of the safe harbor provision: for much of the history of the Bankruptcy Code, section 546(e) referred only to transfers "by or to" financial institutions. It was only in 2006 that Congress extended the safe harbor to transfers "for the benefit" of a financial institution. Merit argues that the plurality interpretation is needed to give separate meaning to the three phrases "by," "to," and "for the benefit of," because the narrow interpretation requires that a transaction be for the benefit of a financial institution in order to treat it as being "to" that institution.

Merit also argues that the narrow interpretation fails to give effect to the inclusion of "securities clearing agencies" in the section 546(e) list of entities. Because a securities clearing agency only serves as an intermediary and does not send or receive securities-related transfers for its own benefit, Merit says that the narrow interpretation would read transfers "by or to (or for the benefit of) a . . . securities clearing agency" out of the safe harbor entirely.

Merit's brief also claims that the Seventh and Eleventh Circuits fail to properly distinguish between avoidance and recovery of transfers. In addition to the avoidance provisions, which permit a trustee to avoid certain transfers and obligations of the debtor, the Bankruptcy Code contains a separate section (section 550) that describes the transferees from whom the trustee may seek recovery "to the extent that a transfer is avoided" under the Code's avoidance provisions. That provision, which the Seventh Circuit relied on for evidence of the Code's general policies, distinguishes between the "initial transferee" in an avoided transfer and "immediate or mediate transferee[s] of such initial transferee," providing the two categories of defendants with different defenses to a trustee's suit.

Merit's briefing also appeals broadly to the policies of the Bankruptcy Code, arguing that "a broadly protective interpretation of the safe harbor is consistent with the context and purpose of the statute." Merit also asserts that the Seventh Circuit erred by using Congress's stated goal when the avoidance provisions were initially enacted to interpret provisions that have been amended since Congress stated that goal. The brief speaks extensively about the need for "bright-line limitations" to reflect the "legislative balancing of interests" between the need to recover assets for the benefit of creditors and the need to protect the financial markets from interference. On this last note, Merit expresses concern that the Seventh Circuit's approach will require investors to keep reserves against liability after the sale of securities, rather than injecting liquidity back into the markets.

FTI's brief in response relies on the arguments that carried the day in the Seventh Circuit. In particular, FTI appeals to the Justices' common sense and leans heavily on the policy argument that the mode of transfer (whether through a bank or not) should not be permitted to determine whether a transfer is avoidable, and that the beneficial recipient should be a potential defendant regardless whether it receives a bank transfer or a briefcase full of unmarked bills. FTI argues that the "transfer" to which the safe harbor applies should be understood to refer the flow of assets from origin to destination, not to each movement of assets from one set of hands to the next. FTI's argues that the "step" by which assets pass from a debtor to a financial institution is better characterized as a "transaction[] by which the challenged transfer [from the debtor to the recipient] is executed."

In addition to raising the argument that the distinction imposed by the broad reading of the safe harbor does not make sense on a practical level, FTI's brief traces the origin of the provision back to an attempt to abrogate a district court decision in which a trustee was permitted to go forward with litigation to avoid a transfer from a commodity broker to a clearinghouse. FTI argues that applying the safe harbor broadly would undercut congressional intent by making the statute go far beyond what it asserts were Congress's narrow aims.

Merit's arguments are likely to appeal to the textualists on the Court, especially Justices Kagan, Alito, Roberts and Thomas. Justices Sotomayor, Breyer, Ginsburg, and Kennedy may instead be swayed more by the policy arguments the parties put forward about the need to protect the integrity of the financial markets, but it is unclear which party's policy arguments the Justices are likely to find more convincing. Justice Gorsuch, the most recent addition to the Court, does not have enough of an opinion-writing record on the Supreme Court to attempt to predict which sort of arguments are likely to sway him. In sum, the Supreme Court could easily come down either way on this case, and businesses should be prepared for the fallout either way.

What to watch going forward

If the Seventh and Eleventh Circuits' narrow reading of the safe harbor is upheld, the result could be severe for the former shareholders of bought-out companies. Such shareholders—especially holders of small positions—are generally not involved participants in these transactions, instead relying on the companies' leadership. Shareholders rarely get a say in the structure of these transactions, and there is little holders of equity can do to mitigate the risk of avoidance actions arising from buyouts. Nevertheless, shareholders in such situations should carefully weigh their risks when presented with the option to sell, and recently bought-out shareholders should be aware of the risk that the Supreme Court may deprive them of the benefit of the safe harbor if their former holdings go into bankruptcy.

If the plurality view is upheld, shareholders will remain exposed to the same extent they were before the Seventh Circuit weighed in. Even so, investors should take this opportunity to carefully scrutinize the transactions through which they are bought out in order to accurately assess whether those transactions will fall into the safe harbor and weigh their litigation risk accordingly.

David M. LeMay is a partner in our New York office in the firm's financial restructuring and insolvency group.

Extraterritoriality and the Bankruptcy Code: the uncertain reach of US avoiding powers

Jamie Copeland

The world continues to shrink. Whether dealing with large, multinational corporations or smaller national (or even regional) concerns, businesses continue to seek growth and opportunity in the global marketplace. While cross-border deals create unique opportunities for firms, they bring with them unique legal risk. Counterparties in cross-border deals must take special care when dealing with insolvent or struggling companies that could soon seek bankruptcy protection under US law. The US Bankruptcy Code provides trustees and debtors in possession with broad avoiding powers to unwind pre-bankruptcy transactions to recover value for creditors. A given cross-border transaction's structure could have far-reaching implications in a US bankruptcy proceeding, sometimes even if that transaction was executed outside of US territory.

There is little circuit-level authority addressing the extraterritorial application of the US Bankruptcy Code's avoiding powers and lower-court decisions have been inconsistent.[1] Recently, however, a handful of decisions from respected judges in the country's busiest courts have deepened the divide as to the reach of Bankruptcy Code's avoidance provisions and created a split within the Southern District of New York.

The presumption against extraterritoriality: limiting the reach of US law

Under US law, federal statutes—including the US Bankruptcy Code—are presumed to apply only within US territorial jurisdiction. That convention is formally called the "presumption against extraterritoriality"; a longstanding principle of "American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States." *EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991). The presumption guards against unintended conflicts between domestic and foreign laws. *In Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010), the Supreme Court clarified the analytical framework for determining whether "the presumption forecloses [a] claim." To determine whether the presumption against extraterritoriality requires dismissal, courts engage in a two-step inquiry. First, a court determines whether the presumption applies by identifying the conduct regulated by the statue and considering whether that conduct occurred outside the US. Second, if the presumption applies, a court must then examine the statute to determine if Congress intended extraterritorial application of that statute. Congressional intent for extraterritorial application does not require express statutory language; rather, courts can infer meaning from a statute's legislative purpose or context.

The presumption against extraterritoriality has become increasingly important in bankruptcy-related litigations and, in recent years, has played a prominent role in a number of high-profile cases, beginning with the liquidation of Bernard L. Madoff Investment Securities LLC ("BLMIS").

1 *Compare Societe Gen. plc v. Maxwell Commc'n Corp. plc* (*In re Maxwell Commc'n Corp. plc*), 186 B.R. 807, 818-20 (S.D.N.Y. 1995) ("Maxwell I") (holding that Congress did not clearly express an intent that Bankruptcy Code section 547 (dealing with avoidable preferences) apply to foreign transfers),*aff'd on other grounds, Maxwell Commc'n Corp. plc v. Societe Gen. plc* (*In re Maxwell Commc'n Corp. plc*), 93 F.3d 1036, 1054-55 (2d Cir. 1996) *("Maxwell II") and Barclay v. Swiss Fin. Corp. Ltd. (In re Midland Euro Exch. Inc.)*, 347 B.R 708 (Bankr. C.D. Cal. 2006) (holding that Congress did not intend that section 548 would apply extraterritorially), *with French v. Liebmann (In re French)*, 440 F.3d 145, 151-52 (4th Cir. 2006) (holding that "Congress made manifest its intent that [Bankruptcy Code section] 548 (dealing with fraudulent transfers) apply to all property that, absent a prepetition transfer, would have been property of the estate, wherever that property is located.").

Madoff: US avoiding powers do not apply to predominately foreign transfers

In December 2008, BLMIS—the vehicle Bernie Madoff used to perpetrate his multi-billion-dollar Ponzi scheme—collapsed, and a SIPA trustee was appointed to administer the estate for the benefit of BLMIS's customers, primarily through the pursuit of claw back actions. Among BLMIS's largest customers were the so-called "feeder funds," which were foreign investment funds that pooled their customers' assets for investment (often exclusively) with BLMIS. The trustee sought to recover transfers made by various foreign feeder funds to their own foreign customers pursuant to Bankruptcy Code section 550 (which permits trustees to recover from subsequent transferees). A handful of those defendants filed motions to dismiss on grounds that section 550 does not apply extraterritorially. In July 2014, US District Judge Rakoff issued his decision dismissing the trustee's section 550(a) claims, finding that the statute cannot reach foreign transfers.[2] *See Sec. Inv'r Protection Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222 (S.D.N.Y. 2014) ("Madoff I").

Judge Rakoff's analysis and holdings were largely consistent with prior caselaw in the Southern District of New York, particularly the seminal bankruptcy court decision regarding the avoiding powers' extraterritorial application—*Maxwell I*. Judge Rakoff looked to *Maxwell I* and focused on the "the location of the transfers as well as the component events of those transactions." *Maxwell I*, 186 B.R. at 817. With respect to Congress's intent, Judge Rakoff found that nothing in the statute's language "suggest[ed] that Congress intended for this section to apply to foreign transfers." The trustee argued the global reach of section 541 was incorporated into the Bankruptcy Code's avoidance provisions, "which [provisions] use the phrase 'an interest of the debtor in property' to define the transfers that may be avoided, a phrase that is repeated in section 541 in defining 'property of the estate.'" Judge Rakoff rejected the argument, stating that "fraudulently transferred property becomes property of the estate only after it has been recovered by the [t]rustee, so section 541 cannot supply any extraterritorial authority that the avoidance and recovery provisions lack on their own." And while the initial fraudulent transfers (i.e., payments made by BLMIS to feeder funds) were domestic transactions, here, Judge Rakoff observed that the subsequent transfers (i.e., payments made by feeder funds to their customers) were predominately foreign.

Lyondell: congress must have intended that US avoiding powers reach foreign transactions

After *Madoff I*, Judge Gerber of the US Bankruptcy Court for the Southern District of New York addressed the extraterritorial application of Bankruptcy Code avoiding powers in *Weisfelner v. Blavatnik (In re Lyondell Chem. Co.*), 543 B.R. 127 (Bankr. S.D.N.Y. 2016) ("*Lyondell*"). Judge Gerber broke with *Maxwell I* and its progeny and held that the subject transfer was primarily a foreign transaction that required the extraterritorial application of section 548, and further, that Congress intended that section 548 could be given extraterritorial effect.

Lyondell concerned claims arising out of Basell AF S.C.A.'s purchase of Lyondell Chemical Co. in a multi-billion dollar leveraged buyout and merger. Two weeks before the merger, Basell, a Luxembourg company, distributed $100 million to its shareholders (the "Pre-LBO Payment"), which, allegedly, was capital Basell badly needed. Basell then distributed a portion of those funds to its own shareholders, among them, BI S.à.r.l., another Luxembourg company. Lyondell and certain affiliates were later forced to seek protection under Chapter 11 of the Bankruptcy Code. After Lyondell's Chapter 11 plan was confirmed, the litigation trustee sued Basell's shareholders to avoid the Pre-LBO Payment, arguing that it was an avoidable transfer under Bankruptcy Code section 548, and to recover the same under Bankruptcy Code section 550. The shareholders moved to dismiss the complaint arguing that, among other things, the Pre-LBO Payment was an extraterritorial transfer between two Luxembourg entities and therefore, Bankruptcy Code sections 548 and 550 did not apply. The trustee argued that Congress intended that section 548 would apply to certain foreign transfers, but nevertheless, the Pre-LBO Payment was a domestic transfer because its "center of gravity" was in the US.

Judge Gerber first reviewed whether the Pre-LBO Payment was foreign, thus invoking the presumption. As the bankruptcy court noted, the mere fact that both the transferor and transferee were foreign entities did not render the

2 *Madoff I* includes an important alternative holding dismissing the trustees' section 550 claims on comity grounds. Many feeder funds were being, or had been, liquidated in foreign insolvency proceedings where the foreign court had determined that, under foreign law, the feeder funds' liquidators could *not* recover monies the funds transferred to their customers. According to Judge Rakoff, the BLMIS trustee had only an indirect interest in those transfers, and those foreign jurisdictions had a greater interest in applying their own laws than did the US. *See Madoff I*, 513 B.R. at 231-32.

Pre-LBO Payment a foreign transaction. Instead, courts in the Southern District employ the flexible "center of gravity" test to determine whether a transaction is domestic or foreign. See *Maxwell I*, 186 B.R. 807. Under this test, courts "look at the facts . . . to determine whether they have a center of gravity outside the US," which may include "consideration of all component events of the transfer, such as whether the participants, acts, targets, and effects involved in the transaction at issue are primarily foreign or primarily domestic." Judge Gerber found that section 548 focuses on the nature of the transaction in which property is transferred, and in this case, the Pre-LBO Payment's connections to the U.S. were too minimal to "overcome the [transaction's] substantially foreign nature." Therefore, the presumption against extraterritorial effect applied. For the trustee's avoidance claim to survive there must be clear evidence that Congress intended that section 548 apply to extraterritorial transfers.

Although section 548's text does not expressly indicate a contrary intent, the bankruptcy court looked to the statute's context (i.e., other Bankruptcy Code provisions) to rebut the presumption. Citing the Fourth Circuit's decision in *French*, Judge Gerber read section 548 in conjunction with section 541 to find clear evidence of congressional intent to apply section 548 to foreign transfers. Parallel language in section 541 (which defines estate property as "all . . . interests of the debtor in property, wherever located") and section 548 (which permits avoidance of transfers of an "interest of the debtor in property") demonstrates that section 548 "applies extraterritorially *not* because it provides for recovery of property that is already property of the estate, but rather, because section 548 provides for the recovery of property that *would have been* property of the estate . . . but for the fraudulent transfer." Judge Gerber explained that Congress could not have intended that property anywhere in the world come into the estate once recovered under the Bankruptcy Code, and at the same time, precluded the extraterritorial application of section 548. According to Judge Gerber, this reasoning protects bankruptcy courts' in rem jurisdiction over assets that Congress declared would become property of the estate when recovered under section 541(a)(3).

In *Lyondell*, Judge Gerber created a split within the Southern District that mirrors the national trend. In 2017, that chasm grew both within and without the Southern District.

Ampal: deepening the nationwide divide

Months after Judge Bernstein's *Madoff II* decision, he again confronted the extraterritorial application of avoidance actions—this time writing on a clean slate—and agreed that the Bankruptcy Code's "avoidance provisions . . . do not apply extraterritorially." *See In re Ampal-Am. Israel Corp.*, 562 B.R. 601, 612 (Bankr. S.D.N.Y. 2017) ("*Ampal*"). In Ampal, the Chapter 7 trustee for Ampal-American Israel Corp., sought to avoid and recover an alleged preferential transfer made by Ampal, a New York company managed by offices in Israel, to law firm Goldfarb Seligman & Co, an Israeli law firm. Shortly before Ampal commenced its US bankruptcy proceedings, it instructed a bank in Tel Aviv, Israel to transfer $89,110.41 from its account to Goldfarb's account at the same bank. The trustee filed a complaint against Goldfarb asserting claims for the avoidance and recovery of the transfer pursuant to Bankruptcy Code sections 547 and 550. Judge Bernstein held that the trustee's avoidance claims were barred by the presumption against extraterritoriality.

Judge Bernstein reviewed and analyzed the leading decisions that construed the presumption against extraterritoriality (including *Madoff I* and *Lyondell*). Judge Bernstein concluded (i) Congress did not intend that sections 547 and 550 would apply extraterritorially, (ii) the transfer was "foreign" and therefore, (iii) it could not be avoided under the US Bankruptcy Code. Judge Bernstein found that the "only two categories of property mentioned in Bankruptcy Code [section] 541(a)(1)" are "property of the estate" and "property of the debtor" and found that property transferred prepetition to satisfy an antecedent debt is neither. He then reasoned that, under applicable caselaw, the phrases "property of the estate" or "property of the debtor" should be construed as a limitation—not an expansion—on avoiding powers under Bankruptcy Code section 547. Judge Bernstein, contrary to the decision in *Lyondell*, concluded that section 547's context and surrounding provisions further demonstrate a lack of congressional intent to apply the statute extraterritorially. Sections 541(a) and 28 U.S.C. § 1334(e)(1), for example, contain clear language commanding extraterritorial application, and section 547 simply does not. Here, the subject transfer was purely foreign as it "occurred in Israel between a US transferor headquartered in Israel and an Israeli transferee accomplished entirely between accounts at the same Tel Aviv bank."

The *Ampal* decision seemed to have firmly established Judge Gerber's *Lyondell* ruling as a local outlier and nationally, a notable (and arguably, a minority) position. Just a few months later, however, in the collective wake of *Madoff* and *Ampal*, the US Bankruptcy Court for the District of Delaware became the latest to grapple with the extraterritorial application of Bankruptcy Code's avoiding powers, and this time, expressly adopted Judge Gerber's reasoning and holding in *Lyondell* that Congress intended that section 548 apply extraterritorially. *See In re FAH Liquidating Corp.,* Case No. 13–13087 (KG) (Bankr. D. Del.).

Conclusion: while uncertainty persists, these divergent views will continue to influence cross-border transactions and the administration of us bankruptcy cases

These decisions make clear that the avoidability of foreign transactions under US law is uncertain and that the extraterritorial application of US avoiding powers is likely to remain hotly disputed for the foreseeable future. This uncertainty is likely to persist without more circuit-level decisions or clear direction from Supreme Court. On September 27, 2017, the US Court of Appeals for the Second Circuit entered an order granting a joint petition by the BLMIS trustee and certain defendants seeking a direct appeal of Judge Bernstein's *Madoff II* ruling. These decisions demonstrate the unpredictability in "divining congressional intent" underpinning the Bankruptcy Code's avoiding powers. Each judge reviewed the same collection of statutes but drew irreconcilably different inferences regarding Congress's intent from the texts. And courts are no more predictable in considering whether the transfer or transaction was domestic or foreign in nature. As caselaw interpreting the presumption against extraterritoriality continues to develop, the implications for international businesses, foreign investors, and bankruptcy estate representatives could be far reaching.

For example, some have argued that absent the extraterritorial application of the Bankruptcy Code's avoiding provisions, counterparties could structure deals around offshore transfers that cannot be avoided under US law and later re-transfer those funds to the US. Often, a bankruptcy estate's most significant assets are litigation claims to unwind or avoid prepetition transactions and transfers; creative structuring like that could affect the value of those claims under US bankruptcy law and ultimately compromise a debtor's ability to confirm a Chapter 11 plan. Some, including Judge Rakoff, have suggested that these policy arguments are unconvincing and that trustees may be able to use foreign laws "to avoid such an evasion while at the same time avoiding international discord."[3] Indeed, some US bankruptcy courts have shown a willingness to hear foreign law avoidance claims.[4] Still, there are clear practical limitations to pursuing avoidance claims under foreign law or in foreign courts, many of which would be obviated by a clear rule finding that US avoidance claims apply overseas. Accordingly, practitioners and prospective counterparties alike await any new authority regarding the extraterritorial application of the US Bankruptcy Code's avoiding powers.

Jamie Copeland is an associate in our New York office in the firm's financial restructuring and insolvency group.

3 *Madoff I,* 513 B.R. at 231.

4 *See Hosking v. TPG Capital Mgmt., L.P. (In re Hellas Telecommunications)*, 535 B.R. 543 (Bankr. S.D.N.Y. 2015) (permitting foreign representatives' UK avoidance claims to proceed).

Sales of inventory: Third Circuit clarifies the meaning of “received” under section 503(b)(9) of the Bankruptcy Code

Shantel Watters-Rogers

In an era of e-commerce, a glut of shopping malls, and a change in consumer spending habits, many distressed brick-and-mortar retailers are closing stores and liquidating their businesses. So far in 2017, major retailers, including Toys “R” Us, The Limited, Wet Seal, Eastern Outfitters, BCBG Max Azria, HhGregg, Radio Shack, Gander Mountain, Payless ShoeSource, Rue21, and Gymboree, are filing for chapter 11 bankruptcy protection at a record pace. Many distressed retailers seek a buyer for their assets, or to restructure their debt, but the reality is that many retailers will have to shut their doors and liquidate their assets. These bankruptcies affect vendors and suppliers of goods to distressed buyers because they face payment of pennies on the dollar for their claims.

A 2005 amendment to the Bankruptcy Code provides a limited measure of protection to vendors who ship to a customer on the verge of Chapter 11 but two recent decisions have clarified the scope of that protection. The United States Court of Appeals for the Third Circuit and the United States Bankruptcy Court for the District of Delaware ruled on the definition of “received” in the context of 11 U.S.C. § 503(b)(9). In an unprecedented opinion decided on July 10, 2017, the Third Circuit in *In re World Imports, Ltd.* held that to qualify for an administrative expense claim under Section 503(b)(9), “goods received” means physical possession by the debtor or its agent within 20 days of a bankruptcy filing. 2017 WL 2925429 (3d Cir. July 10, 2017). Three days later on July 13, 2017, the Delaware Bankruptcy Court cited the Third Circuit’s decision and similarly held that a vendor shipping goods directly to a debtor’s customers does not qualify for an administrative expense claim under section 503(b)(9) because “received” means physical possession by the debtor. 2017 WL 2992718 (Bankr. D. Del. July 13, 2017). These decisions have widespread implications for vendors that do business on a global scale and that sell goods to a debtor shortly before the debtor files for Chapter 11 bankruptcy petition.

Background of section 503(b)(9)

Section 503(b)(9) was added to the Bankruptcy Code as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Section 503(b)(9) was created as an alternative remedy for sellers of goods in addition to their reclamation rights. Section 503(b)(9) is interrelated to section 546(c) (dealing with reclamation rights) because: (1) it adds an administrative expense claim for the value of goods received by the debtor in the 20 days prior to the bankruptcy filing as an exemption from section 546(c)’s reclamation conditions; and (2) it is available to sellers of goods whether or not they meet the requirements for a reclamation claim or fail to assert their reclamation rights. *See* 11 U.S.C.A§ 546(c)(2) (“If a seller of goods fails to provide notice. . . the seller still may assert the rights contained in section 503(b)(9).”). Section 503(b)(9) had the effect of taking a seller’s low priority general unsecured, which generally receive payment of pennies on the dollar under a debtor’s chapter 11 plan, and elevating it to a high-priority administrative expense claim that a debtor must pay in full as a condition to confirmation of a chapter 11 plan.

Requirements of section 503(b)(9)

The Third Circuit holding, which is binding in Delaware, New Jersey and Pennsylvania, and the Delaware Bankruptcy Court's holding, have significant implications for vendors who sell to customers that file for Chapter 11 bankruptcy protection.

Under section 503(b)(9), a creditor may recover as a priority administrative expense the value of goods if the creditor sold those goods to the debtor in ordinary course of the debtor's business within 20 days prior to its bankruptcy filing:

> (b) After notice and a hearing, there shall be allowed administrative expenses ... including–
>
> > (9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under [title 11] in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

The Bankruptcy Code does not define the operative word "received" in the context of section 503(b)(9), which has given rise to several interpretations of when receipt occurs.

In re World Imports, Ltd. et al, 2017 WL 2925429 (3d Cir. July 10, 2017)

Background

World Imports, Ltd. purchased furniture from two Chinese companies, Haining Wansheng Sofa Company and Fujian Zhangzhou Foreign Trade Company (collectively, the "Creditors"). The Creditors shipped the goods via common carrier from China to the US "free on board" ("FOB") at the port of origin, which means that the risk of loss or damage to the goods passed to World Imports once the goods were delivered to the common carrier at the port. The Haining goods were shipped on May 26, 2013, and World Imports took physical possession of the goods on June 21, 2013. The Fujian goods were shipped on three separate dates during the period May 17 to June 7, 2013, and World Imports took physical possession of the goods on a date within 20 days of July 3, 2013 (the "petition date"), the date World Imports filed its voluntary Chapter 11 petition in the US Bankruptcy Court for the Eastern District of Pennsylvania.

The Creditors filed motions with the Bankruptcy Court seeking allowance and payment of their claims as an administrative expense under section 503(b)(9) of the Bankruptcy Code. The parties agreed that the Creditors shipped the goods from China more than 20 days before the petition date and that World Imports took physical possession of the goods in the US fewer than 20 days before the petition. However, they disagreed about whether the shipment or physical possession of the goods constituted receipt under section 503(b)(9). The Creditors argued that receipt occurred when World Imports took physical possession of the goods during the 20 days preceding the petition date. World Imports asserted that constructive receipt occurred when the good were delivered FOB to its common carrier. The Bankruptcy Court agreed with World Imports and denied the Creditors' motion, concluding that the goods were "constructively received" when they were shipped from China. On appeal, the US District Court for the Eastern District of Pennsylvania affirmed the Bankruptcy Court's decision.

At issue on appeal to the Third Circuit was the definition of the term "received" as used in section 503(b)(9). If World Imports received the goods when they were delivered to the common carrier in China, then the Creditors' claim for administrative expense priority would fail. If the goods were instead considered "received" when World Imports took physical possession of them in the US, then the Creditors' claim would receive administrative expense priority.

Holding

The Third Circuit agreed with the Creditors that the goods were not received by World Imports until it took physical possession of them. The Third Circuit reversed the District Court's decision, allowed the Creditors' administrative expense claims, and held that receipt under section 503(b)(9) requires physical possession by a debtor or its agent. The Third Circuit analyzed section 503(b)(9), its legislative history, and its relation to section 546(c), a provision that allows a shipper to reclaim goods sold to an insolvent debtor within 45 days of the debtor's receipt of the goods. The Third Circuit first considered Black's Law Dictionary which defines "receive" as "[t]o take ...; to come into possession of or get from some outside source."

Black's Law Dictionary (10th ed. 2014). The Third Circuit next considered Article 2 of the Uniform Commercial Code, which governs the sale of goods, for the definition of receipt. Section 2-103(1)(c) defines the receipt of goods as "taking physical possession of them." The Third Circuit then analyzed the interrelationship between section 503(b)(9) and section 546(c), finding that section 503(b)(9) should be read and interpreted consistent with section 546(c) because it provided an alternative remedy to reclamation. Lastly, the Third Circuit considered its decision in In re Marin Motor Oil when it held that the word "receipt" in section 546(c) meant the same thing as the UCC's definition- "taking physical possession." 740 F.2d 220 (3d Cir. 1984). Because "received" in section 503(b)(9) and "receipt" in section 546(c) are functionally equivalent and used in the same statutory context, the Third Circuit reasoned that they should be treated identically and that the UCC's definition must also be applied to section 503(b)(9). The Third Circuit also addressed World Imports's argument that the goods were constructively received when delivered FOB to the common carrier. The Third Circuit held that while a buyer may be deemed to have received goods when its agent takes physical possession of them, common carriers are not agents. Therefore, constructive receipt does not include FOB delivery to a common carrier. The Third Circuit concluded that receipt under section 503(b)(9) requires physical possession by the debtor or its agent and that World Imports took physical possession of the goods within the 20-day period prior to the Petition Date.

In re SRC Liquidation, LLC, 2017 WL 2992718 (Bankr. D. Del. July 13, 2017)

Background

Three days after the *In re World Imports* opinion, the Delaware Bankruptcy Court applied the Third Circuit's holding to a different set of facts. International Imaging Materials, Inc. ("IIMAK") was a vendor to Standard Register Company (n/k/a SRC Liquidation, LLC), and filed an administrative expense priority claim under section 503(b)(9) for the value of its shipped goods. IIMAK delivered its products at times to the Debtor and at other times delivered its products directly to the Debtor's customers, commonly referred to as "drop shipping," at the Debtor's direction, and using the Debtor's account with United Parcel Service ("UPS"). The parties agreed that the goods delivered by IIMAK directly to the Debtor occurred during the 20-day period before the Debtor filed its Chapter 11 bankruptcy petition. The parties also agreed that the goods delivered by IIMAK to the Debtor's customers occurred during the relevant 20-day period. The parties disagreed about whether the goods drop-shipped to the Debtor's customers during the 20-day period constituted "receipt" by the Debtor under section 503(b)(9). The Debtor argued that the drop-shipped goods were never in its physical possession and were not "received" as required by section 503(b)(9). IIMAK argued that given the commercial realities, such as the variety of shipping procedures between vendors, debtors, and their customers, the definition of receipt should not be so narrowly construed, and only the transfer of title to UPS could appropriately determine when the Debtor received the goods under section 503(b)(9).

Holding

The Delaware Bankruptcy Court rejected IIMAK's argument, noting that "the U.C.C. does not rely on the concept of title for purposes of establishing rights of buyers and sellers: possession is the key." The Delaware Bankruptcy Court sustained the Debtor's objection to IIMAK's claim, citing the Third Circuit's recent decision, and held that physical possession by the Debtor or its agent, not the passing of title, determined when the Debtor "received" goods for purposes of section 503(b)(9). The Delaware Bankruptcy Court, similar to the Third Circuit, analyzed the legislative history of section 503(b)(9) and looked to UCC § 2-103(1)(c)) and section 546(c) to find that "receipt" should be interpreted to mean "physical possession." Accordingly, the Court concluded that only UPS as common carrier, and not the Debtor, ever physically possessed the goods, and that UPS was not the Debtor's agent. Therefore, the Debtor never received the goods drop-shipped to its customers from IIMAK within the meaning of section 503(b)(9).

Practical/real world implications

The Honorable Thomas M. Hardiman of the Third Circuit began his opinion in *World Imports*, "This appeal involves a question of bankruptcy law that has important ramifications for a creditor that sells goods to a debtor soon before the debtor files a Chapter 11 bankruptcy petition." The Third Circuit holding, which is binding in Delaware, New Jersey and Pennsylvania, and the Delaware Bankruptcy Court's holding, have significant implications for vendors who sell to customers that file for Chapter 11 bankruptcy protection. These holdings will also have broad, nationwide effect because Delaware is a preferred venue for many bankruptcy cases.

The Third Circuit's decision defines when a debtor receives goods and when a vendor's claim therefore qualifies for administrative expense priority. The holding will help vendors whose goods are in transit for an extended period of time because there is an increased likelihood that the goods shipped to the debtor will arrive during the relevant 20-day period under section 503(b)(9). International vendors that ship goods from long distances, where several weeks pass between shipment and the debtors' taking possession of the goods, will see the greatest benefit because a debtor's receipt of the goods will be determined on the later date of physical possession rather than the earlier date of delivery of the goods to a common carrier. These claims will now have high priority as an administrative expense claim, the same priority afforded to the debtor's attorneys. This holding may benefit retailers and their unsecured creditors because foreign vendors may be more inclined to continue selling goods with a long transit period to a distressed retailer if they are entitled to an administrative expense claim.

While the Third Circuit's holding is good news for some vendors, the Delaware Bankruptcy Court's holding created a bright line rule that vendors that ship goods directly to the debtor's customers do not qualify for an administrative expense claim under 503(b)(9). This will make vendors reluctant to drop-ship goods to financially distressed customers. Vendors may even insist on some form of credit protection (e.g., payment in advance, cash on delivery, or a letter of credit) before they drop-ship goods to such a debtor's customers.

Shantel Watters-Rogers is an associate in our New York office in the firm's financial restructuring and insolvency group.

Chapter 15 developments: United States courts enforce Canadian restructuring plans

Francisco Vazquez

Chapter 15 of the United States Bankruptcy Code provides a mechanism for a foreign debtor or a foreign representative (e.g., trustee or administrator) to seek recognition of a foreign insolvency, liquidation, or debt restructuring proceeding (known as a foreign proceeding) in the US. To be eligible for Chapter 15 recognition, a foreign proceeding must be either (1) a foreign main proceeding, which is one pending where the debtor has the center of its main interests, or (2) a foreign nonmain proceeding, which is one pending where the debtor has an establishment (i.e., "any place of operations where the debtor carries out a nontransitory economic activity").

Upon recognition of a foreign main or nonmain proceeding, a foreign representative will have access to the US courts to sue and seek other relief. Moreover, upon recognition of a foreign main proceeding, creditors and other parties will be automatically stayed from taking any action to collect a debt against the debtor or its assets in the US. Recognition, however, does not result in the automatic enforcement of a debtor's foreign debt restructuring or liquidating plan. Nevertheless, a US court may, upon recognition, issue an order enforcing such a plan in the US. This article discusses two recent instances in which a US court enforced a plan, including the release provisions, approved by a Canadian court.

Mood Media Corporation: bankruptcy court enforces a Canadian plan that releases claims against US guarantors

Mood Media Corporation, a Canadian corporation, and its affiliates provide in-store audio, visual, and other forms of media and marketing solutions throughout the world. Mood Media issued USD $350 million of 9.25% senior unsecured notes due 2020. Certain US subsidiaries of Mood Media guaranteed the obligations on the notes. Faced with near-term debt maturities, Mood Media and its affiliates entered into an agreement in April 2017 with certain significant holders of the 9.25% notes, under which, among other things, the notes would be exchanged for new notes and new common stock and the existing common stock of Mood Media would be redeemed for CAD $0.17 per unit. In addition, the subsidiary guarantees would be released.

On May 18, 2017, Mood Media commenced a proceeding under section 192 of the Canada Business Corporations Act (the "CBCA") in the Ontario Superior Court of Justice (Commercial List) to effectuate the proposed restructuring under a "Plan of Arrangement." On the same day, the Canadian court issued an order authorizing Mood Media to hold a special meeting of the noteholders and shareholders on June 15, 2017 to consider and vote on the Plan of Arrangement. In addition, the order provided that the Plan of Arrangement must be approved by %) of the votes cast by shareholders before the Plan of Arrangement could be submitted to the Canadian court for final approval.

On May 22, 2017, Mood Media and fourteen of its US subsidiaries filed petitions under Chapter 15 of the United States Bankruptcy Code seeking recognition of the Canadian proceeding under the CBCA as foreign nonmain proceedings as well as orders enforcing the Plan of Arrangement in the US. Mood Media and the subsidiaries commenced the Chapter 15 cases prior to the special meetings of the noteholders and the shareholders to expedite the implementation of the Plan of Arrangement by minimizing the time between the approval of the Plan of Arrangement in Canada and the issuance of an order enforcing it in the US.

Following approval of the Plan of Arrangement by the Canadian court, the United States Bankruptcy Court held a hearing to consider the request for recognition of the Canadian proceeding and entry of an order enforcing the Plan of Arrangement in the US. As an initial matter, the bankruptcy court noted that the request raised two fundamental issues. First, the court had to determine whether the US subsidiaries were "debtors" for purposes of Chapter 15. Second, assuming they were debtors, the court had to determine whether the US subsidiaries had an establishment in Canada. The bankruptcy court did not question whether Mood Media was a debtor or if it had an establishment in Canada.

A necessary element for a foreign proceeding is the existence of a "debtor." Absent a debtor, there is no foreign proceeding to be recognized. For purposes of Chapter 15, a debtor is defined as "an entity that is the subject of a foreign proceeding." In this instance, the bankruptcy court concluded that Mood Media, a Canadian corporation, was the only "debtor" in the Canadian proceeding. Mood Media commenced the Canadian proceeding. In accordance with the Canadian court's order, Mood Media convened the meetings of noteholders and shareholders. In addition, the Canadian court's order approving the Plan of Arrangement (the "Approval Order") clearly referred to Mood Media and the Plan of Arrangement as being "of" Mood Media. In contrast, the Canadian court did not authorize or direct the US subsidiaries "do anything." Indeed, the US subsidiaries were not among the parties authorized to speak at the meetings. Moreover, the US subsidiaries could not have commenced their own proceeding under the CBCA, which is available only to Canadian corporations. According to the bankruptcy court, the US subsidiaries "were just there as beneficiaries of orders that related to the restructuring of the parent company's obligations."

The US subsidiaries argued that they were debtors because the Plan of Arrangement and the Approval Order released the subsidiaries' guarantees and enjoined US creditors from taking certain actions against the US subsidiaries or their assets. The bankruptcy court easily dismissed this argument, finding that the mere fact that the Canadian court has jurisdiction over (and could compel creditors to release the guarantees of) the US subsidiaries did not make the subsidiaries debtors. By way of example, the bankruptcy court noted that there are many instances in a chapter 11 case where a plan results in a release of claims against officers and directors, indenture trustees, or other parties, "but nobody would reasonably argue that the ability of a court to release those claims means that the releasees are persons who are subject to the proceedings, and subject to the jurisdiction of the court, in a way that makes them 'debtors' in the proceedings."

Moreover, the US subsidiaries did not have an establishment in Canada. According to the bankruptcy court, establishment "contemplates the existence of a place of business in the foreign country from which market-facing activities are conducted." The evidence demonstrated that the US subsidiaries were subject to oversight by and shared internal enterprise functions (e.g., cash management, accounting, legal, human resources) with Mood Media, retained service providers in Canada, and had contracts with other parties in Canada. But the US subsidiaries did not have an office or a physical presence in Canada. According to the bankruptcy court, the subsidiaries' contacts with Canada in this instance were not sufficient to support a finding that the subsidiaries had an establishment in Canada. Consequently, the Canadian proceeding could not be recognized under Chapter 15 as to the US subsidiaries.

As discussed above, the bankruptcy court found that Mood Media was a debtor. It also concluded that there was no question that Mood Media had its center of main interest in Canada. Accordingly, it recognized Mood Media's Canadian proceeding as a foreign main proceeding. Moreover, the bankruptcy court decided to enforce the Plan of Arrangement, which contained the releases of the US affiliates from their

A United States court may, upon recognition, issue an order enforcing such a plan in the United States.

guarantee obligations. The bankruptcy court also enforced a provision contained in the Plan of Arrangement and Approval Order enjoining counterparties to contracts or debt instruments with the US subsidiaries from terminating such contract because of the subsidiaries' involvement in the Canadian proceedings or the Plan of Adjustment. Because such provisions were contained in the Plan of Arrangement and the Approval Order, the US subsidiaries were able to obtain the releases and other protections they wanted upon enforcement of the Plan of Arrangement under Chapter 15 notwithstanding the lack of recognition of the Canadian proceedings as to the US subsidiaries themselves.

Artic Glacier International, Inc.: district court upholds distributions and releases provided under a Canadian plan

Artic Glacier Income Fund ("AGIF") is an income trust based in Canada that owns a group of packaged ice manufacturers and distributors. AGIF trust units are listed on the Canadian Securities Exchange and publicly traded in the US on the "Over-The-Counter" market. In February 2012, AGIF and its affiliates commenced insolvency proceedings in Canada under the Companies' Creditors Arrangement Act (the "CCAA") before the Court of Queen's Bench of Winnipeg Centre. On the same day, the Canadian court appointed a monitor, who commenced cases under Chapter 15 to obtain recognition of the Canadian proceedings in the US.

On September 5, 2014, the Canadian court issued an order (the "Sanction Order") approving AFIG's plan of arrangement under the CCAA. AFIG's plan provided detailed procedures for distribution to unitholders registered as of a particular date to be declared by the monitor (i.e., the record date). The plan further provided that once approved it was binding on all unitholders and their successors and assigns. Moreover, AFIG's plan provided for the release of liability against AFIG and certain insiders for any actions or omissions related to, arising out of, or in connection with the plan. On September 16, 2014, the United States Bankruptcy Court for the District of Delaware entered an order enforcing the Sanction Order in the US (the "Enforcement Order").

In November 2014, the monitor issued a report predicting that the plan would be implemented on or about January 8, 2015. Thereafter, AGIF issued a press release, which was posted on SEDAR (the electronic filing system for disclosure documents of investment funds in Canada), and published notice that unitholders of the fund as of December 18, 2014 would be entitled to a distribution under the plan. Because of a three-day processing period for sales, only purchasers of units on or before December 15, 2014 would have been identified as registered holders as of the December 18, 2014 record date. During the period of December 16, 2014 through and including January 22, 2015, Eldar Brodski Zardinovsky and others purchased AGIF trust units.

On January 22, 2015, AGIF distributed approximately USD $0.16 per unit to the unitholders of record as of December 18, 2014 in accordance with plan. Zardinovsky and the other buyers did not receive a distribution from AGIF under the plan because they were not identified as registered unitholders as of December 18, 2014. In a complaint filed with the United States Bankruptcy Court for the District of Delaware, Zardinovsky and the other buyers (collectively, the plaintiffs) asserted that they (and not the prior unitholders) were entitled to a distribution under certain rules and regulations governing Over-The-Counter market transactions adopted and administered by the Financial Industry Regulatory Authority ("FINRA").

Under FINRA rules, there are two key dates for distribution purposes: (1) the record date, which is set by the issuer for the purpose of determining which holders of equity securities should receive dividends, and (2) the ex-dividend date, which is set by FINRA and determines which holders are legally entitled to dividends. "The fact that an individual is the holder of record on the record date, however, does not necessarily mean that such person is entitled to retain the dividend." According to the plaintiffs, the dividend paid by AGIF was 25% or greater than the value of the units and thus under FINRA rules, the ex-dividend date should have been January 23, 2015, the first day following the payable date. However, FINRA never set the ex-dividend date because AGIF did not, as required by FINRA rules, notify FINRA of the record date or inform and obtain approval from FINRA of the date and amount of the distribution. Consequently, the plaintiffs did not receive a dividend from AGIF as required under FINRA rules. They therefore sued AGIF and certain insiders in the Bankruptcy Court, alleging that AGIF's distribution violated US securities laws.

The bankruptcy court dismissed the plaintiffs' complaint finding that (1) AGIF's plan's distribution procedure superseded any conflicting obligations, including FINRA rules, and (2) the releases contained in AGIF's plan were binding on the buyers and barred their claims. On appeal, the United States District Court for the District of Delaware affirmed the bankruptcy court's findings.

The plan supersedes FINRA rules because they conflicted with the plan

In arguing that AFIG's distributions violated US securities laws, the plaintiffs did not deny that AFIG made the distributions in accordance with AFIG's plan. Instead, they asserted that the AFIG and its fellow defendants had "concurrent and additional obligations," including those under FINRA rules, not set forth in the plan. According to the plaintiffs, the plan did not excuse the defendants from their FINRA obligations.

In rejecting the plaintiffs' arguments, the district court emphasized that the plan provided an exclusive procedure for distribution to unitholders and did not impose an obligation on AFIG to make distributions in accordance with FINRA rules. Consequently, AFIG's distributions were not subject to FINRA rules. Moreover, distributions under FINRA rules, as advocated by the plaintiffs, would have conflicted with the terms of AFIG's plan, the Sanction Order, and the bankruptcy court's Enforcement Order. In particular, application of FINRA rules in this instance could have resulted in multiple smaller distributions to unitholders or in duplicative payments--one to plaintiffs and one to the selling unitholders. The district court found that AFIG's plan did not contemplate or provide for multiple distributions. Moreover, there was no support in AFIG's plan or otherwise for making additional separate distributions to the plaintiffs, as purchasers of the trust units. According to the court, such separate distributions to plaintiffs would violate the terms of AFIG's plan and the Sanction Order.

The district court further noted that AFIG's plan was approved by a final order on the merits. The district court cited existing precedent from the Court of Appeals for the Third Circuit (which includes Delaware) and concluded that the plaintiffs were barred from "re-litigating any aspect of the Plan, including its distribution procedure" by attacking, after the fact, the distributions made in accordance with AFIG's plan. "Absent the Plan being procured by fraud, or plaintiffs establishing a due process violation, the doctrine of res judicata bars plaintiffs from now contesting the Plan's distribution procedure."

Absent a showing that a Canadian plan was procured by fraud or raised serious due process concerns, a US court will, upon recognition of a Canadian proceeding, generally enforce a Canadian plan under Chapter 15 of the US Bankruptcy Code.

The buyers' claims were released by the plan and the sanction order

After having found that AFIG's plan, including its distribution procedure, was binding on AFIG and the plaintiffs, the district court analyzed the releases contained in the plan, the Sanction Order and the Enforcement Order. The plaintiffs acknowledged that the releases protected the defendants from liability for acts taken in accordance with AFIG's plan. But they argued that the releases did not preclude a finding of liability based upon the "defendants' disregard" of their obligations under US law.

The district court concluded that the releases were broad and encompassed the plaintiffs' claims for not having received a distribution under AFIG's plan. In particular, the releases prohibited (1) all claims against the defendants "in any way related to, or arising out of or in connection with" AFIG's business and affairs, AFIG's plan, or the Canadian proceedings, and (2) "any liability as a result of payments and distributions to Unitholders," including omissions. Irrespective of the terms of the releases, the plaintiffs argued that they were not bound by the releases and that enforcement of the releases against them would violate their due process rights. The district court disagreed with the plaintiffs.

According to the plaintiffs, they were not bound by the releases because they purchased the units after approval of AFIG's plan. The district court found that the plaintiffs "stepped into the shoes of the selling unitholders, and acquired no greater rights than the selling unitholders." Indeed, AFIG's plan and the Sanction and Enforcement Orders expressly provided that all unitholders and their successors and assigns are bound to the releases. The plaintiffs, as successors and assigns of the selling unitholders, acquired the rights of the unitholders as of the date of the sale, which did not include the right to a distribution from AFIG, and were bound to the releases. In addition, the releases, by their terms, were

binding on "any Person," which would include the plaintiffs, in connection with any distribution under AFIG's plan. Moreover, "to rule that a party that buys a bankruptcy claim after plan confirmation is not bound by the terms of the plan would completely undermine the certainty and finality a plan must provide in order to be effective."

In general, a release will be ineffective if it is procured in violation of a party's due process rights. Here, the plaintiffs argued that the releases should not be enforced as against them because they did not have notice of and their interests were not represented in the Canadian proceedings. According to the plaintiffs, the Canadian court should have appointed someone to represent the interests of purchasers of unitholders. The district court, however, found that the plaintiffs' due process rights were not violated. The plaintiffs bought claims from unitholders who had notice of and who participated in the Canadian proceedings, and who overwhelmingly voted in favor of AFIG's plan. Therefore, the district court rejected the plaintiffs' due process challenge.

Conclusion

Absent a showing that a Canadian plan was procured by fraud or raised serious due process concerns, a US court will, upon recognition of a Canadian proceeding, generally enforce a Canadian plan under Chapter 15 of the US Bankruptcy Code. US courts have typically not been troubled by releases contained in Canadian plans and have enforced them without much fanfare. Indeed, the court in *Mood Media* enforced the releases contained in a plan for the benefit of non-debtor US subsidiaries without undertaking a lengthy analysis. However, a US court will typically enforce a plan only in accordance with its terms and related orders. A US court is unlikely to interpret a Canadian plan beyond its stated terms. Therefore, parties should understand the terms of a plan and the relevant orders before taking any action. Had the buyers of AGIF's unitholders been mindful of the terms of AGIF's plan before purchasing the units, they may have been able to avoid the negative consequences of their transaction in the US.

Francisco Vazquez is senior counsel in our New York office in the firm's financial restructuring and insolvency group.

Firm news

Dallas bankruptcy team guides Adeptus Health, Inc. and 139 of its affiliates through Chapter 11, contributing additional caselaw on substantive consolidation and gifting

Norton Rose Fulbright US LLP represented Adeptus Health, Inc. and 139 of its affiliates ("Adeptus")—together, the largest operator of free-standing emergency rooms in the US—in their Chapter 11 cases filed in the US Bankruptcy Court for the Northern District of Texas. Adeptus filed for bankruptcy under the weight of nearly $400 million in liabilities, sagging demand, and increasing costs. The cases were contentious from the start; and throughout, Adeptus successfully fought off challenges by post-petition purchasers of equity (and later, an official committee of equity holders), putative class claimants, and other key stakeholders. On September 27, 2017—a mere five months after filing bankruptcy—Adeptus's Chapter 11 plan was confirmed, and days later the company emerged from bankruptcy. The Adeptus bankruptcy team was led by Louis R. Strubeck, Jr., Liz Boydston, and John N. Schwartz. The cases intersected numerous practice areas, and other key members of the Norton Rose Fulbright team were **Michael Flamenbaum, Scott P. Drake, Scarlet McNellie, Greg Wilkes, Rebecca Winthrop, Benjamin Ratliff, Tim Springer, Julie G. Harrison,** and **Shivani Shah.**

Adeptus's reorganization was predicated on a hard-fought global settlement with the unsecured creditors' and equity holders' committees and Deerfield Management Company, a private equity firm and Adeptus's secured lender. In broad strokes, the plan called for the substantive consolidation of Adeptus's 140 different debtor entities for plan, voting, and distribution purposes; Deerfield's contribution to equity holders of a portion of its recoveries on its significant deficiency claims from a litigation trust; and the vesting of the reorganized entities' equity in Deerfield in exchange for its secured and DIP debt. Despite the global settlement, a handful of other creditors and the US Trustee objected to the plan's confirmation arguing, among other things, that substantive consolidation and Deerfield's sharing plan proceeds with equity violates Bankruptcy Code priorities and the Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017). After a two-day confirmation trial, Judge Stacey G.C. Jernigan overruled those objections, confirmed the plan, and later issued a written memorandum opinion, which provide practitioners and interested parties with useful guidance on key Chapter 11 issues, substantive consolidation and gifting post-Jevic.

Judge Jernigan first examined substantive consolidation, noting that the Fifth Circuit has not yet developed its own standard. After canvassing the leading substantive-consolidation standards and cases, Judge Jernigan determined that consolidation is appropriate under any test; her decision turned on a litany of facts and factors, including that (i) the company's "nerve center" is its Texas headquarters and all payroll for employees is effectuated from there, (ii) the company's centralized cash-management system and three bank accounts, (iii) all debtor entities were controlled by common officers and directors, (iv) the existence of substantial intercompany claims, (v) credible testimony demonstrated that preparing individual schedules was extraordinarily difficult and required numerous amendments, (vi) a substantial amount of creditors treated the debtors as a single unit, and (vii) that credible counsel had determined that the primary assets of many debtors—D&O litigation claims—are jointly owned by the debtors. Simply put, absent substantive consolidation, it would be too costly to allocate claims and disentangle 140 otherwise thoroughly integrated estates.

Judge Jernigan then examined the settlement between Deerfield and the equity committee. Various unsecured creditors and the US Trustee argued that the settlement effected an improper class-skipping gift, and thus, violated the absolute-priority rule. Judge Jernigan rejected those objections noting that the evidence demonstrated the settlement was in fact a discrete resolution of direct claims that existing equity threatened to assert against Deerfield. She also found that the settlement, even if treated as a class-skipping gift, was consistent with *Jevic*. Analyzing *Jevic*, Judge Jernigan discussed a potential exception to the absolute priority rule in cases where "significant Code-related objectives" are implicated. Ultimately, she distinguished *Jevic*, reasoning that Adeptus's reorganization plan left creditors better off than in a Chapter 7 liquidation, while the gift in *Jevic*'s structured dismissal provided no such benefit. Judge Jernigan also noted that the consideration paid by Deerfield to equity was only "a very remote contingent right to recovery," which arguably, was not estate property.

New York bankruptcy team victorious in North Carolina court of appeals

Bankruptcy lawyers in our New York office recently obtained a decision from the North Carolina Court of Appeals reversing a summary judgment order that had been entered against our client, Friday Investments. **Sam Kohn** argued the appeal.

Friday is the owner of a large mall in Charlotte, North Carolina, and the lessor under a lease to Bally Total Fitness of the Mid-Atlantic, which is guaranteed by its parent, Bally Total Fitness Holding Corporation. Bally Mid-Atlantic breached its obligations under the lease, and Friday sought recovery from Bally Holding as guarantor.

In the trial court, Bally Holding argued that notwithstanding the assumption by the Bally debtors of the underlying lease in its 2009 bankruptcy proceeding, its obligations under the guaranty had been discharged by the Bally debtors' Chapter 11 plan. The trial court agreed and granted summary judgment for Bally Holding, reading the provisions of the plan that consolidated all of the Bally debtors for distribution purposes to include the elimination of intercompany guaranties.

On appeal, the bankruptcy team argued that the express terms of the Bally debtors' plan provided for the continuation of the guaranty post-bankruptcy, and in the alternative that there was a genuine issue of material fact as to whether the guaranty was required to be maintained, notwithstanding the plan's consolidation provisions. By a two-to-one margin, the North Carolina Court of Appeals held that the trial court erred in granting summary judgment, and remanded for further consideration of the effect of the plan's consolidation provisions and whether the guaranty was required to be maintained under the plan. Notably, the dissenting judge would have remanded with instructions to grant summary judgment in favor of our client, reading the plan's consolidation provisions not to have any substantive effect and that Bally Holding's guaranty was not discharged by the Bally debtors' plan.

For more information, please contact

Howard Seife
Global Head Financial Restructuring and Insolvency
1301 Avenue of the Americas
New York, NY 10019-6022
+1 (212) 408-5361
howard.seife@nortonrosefulright.com

Louis R. Strubeck, Jr.
US Co-Head Financial Restructuring and Insolvency
2200 Ross Avenue, Suite 3600
Dallas, TX 75201-7932
+1 (214) 855-8040 (TX)
+1 (212) 318-3159 (NY)
louis.strubeck@nortonrosefulbright.com

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Recognized for our industry focus, we are strong across all the key industry sectors: financial institutions; energy; infrastructure, mining and commodities; transport; technology and innovation; and life sciences and healthcare. Through our global risk advisory group, we leverage our industry experience with our knowledge of legal, regulatory, compliance and governance issues to provide our clients with practical solutions to the legal and regulatory risks facing their businesses.

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