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JOURNAL

July 2023 • Vol. XLII, No. 7

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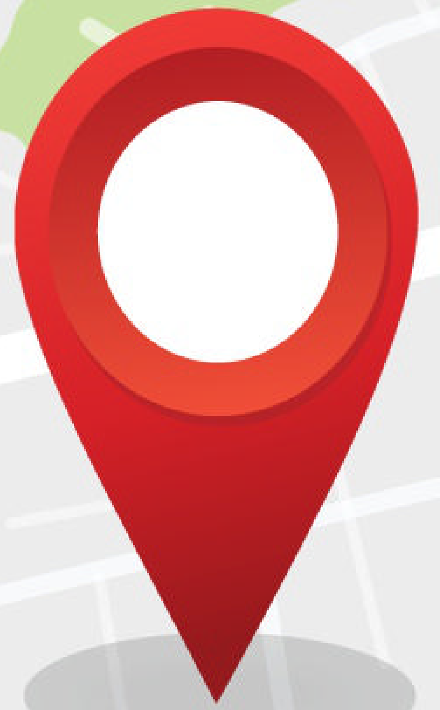

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JOURNAL

The ABI Journal (ISDN: 1931-7522) is published 12 times per year for the price of membership by the American Bankruptcy Institute, 66 Canal Center Plaza, Suite 600, Alexandria, VA 22314-1583, (703) 739-0800, Fax (703) 739-1060, info@abiworld.org, abi.org. Periodical postage paid at Alexandria, VA, and additional mailing offices. POSTMASTER: Send address changes to ABI, 66 Canal Center Plaza, Suite 600, Alexandria, VA 22314-1583.

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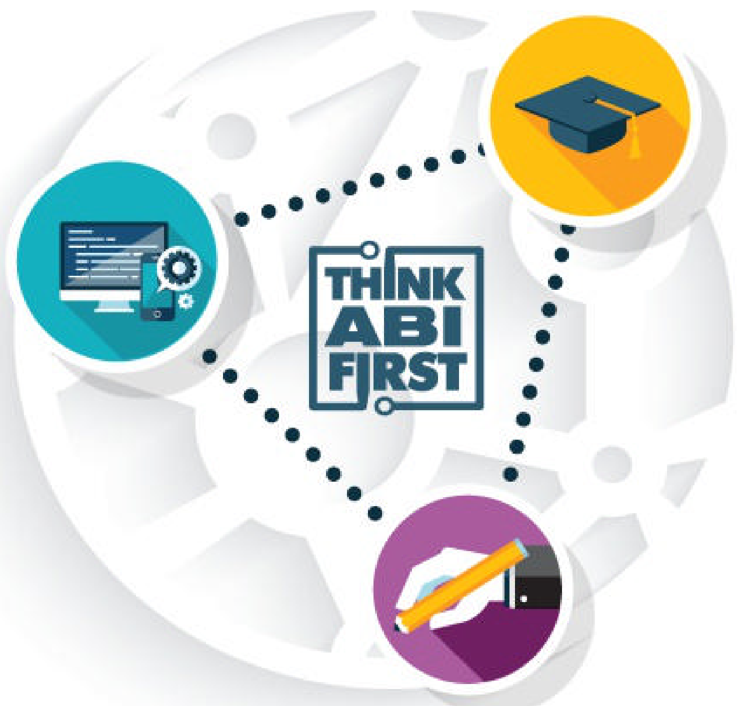

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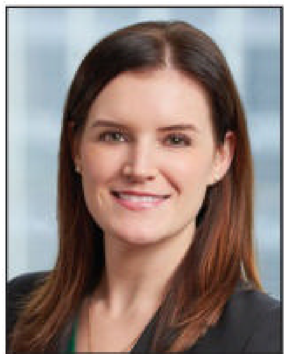

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Supreme Court Holds that § 363(m) Does Not Create Jurisdictional Bar; Side-Steps Mootness Issue

Under 11 U.S.C. § 363(m), absent a stay of an order approving a sale or lease of bankruptcy estate property, the reversal or modification of the order on appeal "does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith." In *MOAC Mall Holdings LLC v. Transform Holdco LLC*,[1] the U.S. Supreme Court resolved a circuit split by holding that this provision is *not* jurisdictional. Thus, the protections of § 363(m) may be forfeit through waiver, estoppel or other doctrines. The Court left to lower tribunals the task of determining whether the transfer of property out of the bankruptcy estate pursuant to an order approving a sale or lease necessarily moots an appeal from the order in instances when avoidance under 11 U.S.C. § 549 is no longer possible.

In a case that some viewed as a harbinger of the "retail apocalypse,"[2] iconic department store operator Sears, Roebuck & Co. filed a chapter 11 petition, which culminated in the sale of most of Sears's assets to a company called Transform Holdco LLC. The assets sold to Transform included the right to designate an entity to whom a lease between Sears and some landlords should be assigned. Transform later designated a wholly owned subsidiary as the assignee of a lease of premises located in Mall of America in Minnesota. The mall's owner objected, arguing that the assignment did not satisfy certain "adequate assurance" requirements under 11 U.S.C. § 365. The bankruptcy court overruled Mall of America's objection and entered an order (the "assignment order") approving the assignment. The bankruptcy court also denied Mall of America's request for a stay of the assignment order pending appeal, based in part on Transform's express representation "that it would not invoke § 363(m)."[3]

Mall of America appealed to the district court, which agreed at first with the mall's arguments on the merits and reversed the assignment order. However, in a motion for rehearing, Transform reneged on its prior representations and argued for the first time that § 363(m) deprived the district court of the jurisdiction to reverse the assignment order. Although "appalled" by Transform's conduct, the court determined that it was bound by Second Circuit precedent to treat § 363(m) as jurisdictional, and thus not subject to waiver or judicial estoppel. The district court thus dismissed the appeal, and the Second Circuit affirmed.[4]

On *certiorari*, the Supreme Court held that § 363(m) is not jurisdictional, reversed the dismissal of the appeal, and remanded for consideration of the parties' other arguments (such as whether § 363(m) even applies to the Assignment Order). The Court explained the difference between statutes creating "preconditions to relief" from those that prescribe "jurisdictional rules," noting that the latter "are impervious to excuses like waiver or forfeiture" and that courts must raise and enforce them *sua sponte*. In view of these "unique and sometimes severe consequences," courts may only treat a statute as jurisdictional if Congress "clearly states as much."[5]

Nothing in the text of § 363(m) offers a clear statement of jurisdictional importance, the Supreme Court held. The statute does not refer to the district courts' jurisdiction. To the contrary, it assumes that an order approving a § 363 sale or lease *may* be reversed or modified on appeal. The availability of appellate relief is merely subject to certain limits as to its effect (*e.g.*, it will not invalidate a sale or lease of estate property to a good-faith purchaser), and the limitations apply only if the approval order has not been stayed. The Court concluded, "This is not the stuff of which clear statements are made."[6] The Court also found it significant that § 363(m) is separate from the statutes governing jurisdiction over bankruptcy matters, including 28 U.S.C. §§ 157, 158 and 1334, and that § 363(m) does not include a "clear tie" to these "clearly jurisdictional provisions."[7] The Court was not persuaded by Transform's "creative retorts," holding that its arguments could not overcome "the paucity of textual or contextual clues indicating a clear statement of jurisdictional intent."[8]

The Supreme Court also expressly declined to address Transform's argument that Mall of America's appeal from the assignment order was moot because the assignment of the subject lease had already been completed, the leasehold was no longer bankruptcy estate property, and the lease could not be "reconstituted" as estate property through an avoidance action under 11 U.S.C. § 549 because the limitations period for commencing such actions had expired. In a footnote, the Court stated that Mall of America's response to that argument

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1 143 S. Ct. 927 (2023); *see also* Thomas J. Salerno, "SCOTUS's *MOAC*: A Bombshell or a Sputtering Firecracker?," XLII *ABI Journal* 6, 12-13, 56-57, June 2023, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on May 23, 2023).

2 *See, e.g.*, "The 'Retail Apocalypse,'" *The Week* (Aug. 7, 2021), *available at* theweek.com/feature/briefing/1003385/the-retail-apocalypse.

3 *Id.* at 933-34.

4 *Id.* at 934.

5 *Id.* at 935-36.

6 *Id.* at 937.

7 *Id.* at 937-38.

8 *Id.* at 939.

was not frivolous, but did not otherwise address the merits of the mootness argument. It chose not to "act as a court of 'first view,' plumbing the Code's complex depths in 'the first instance'" to determine whether Transform was right that no effective appellate relief was still available.[9]

Bankruptcy Courts Split on Standing Chapter 13 Trustees' Right to Payment When Plan Confirmation Has Been Denied

Highlighting the growing split on an emerging issue, two bankruptcy courts reached different conclusions as to whether a standing chapter 13 trustee may retain pre-confirmation payments made by the debtor when confirmation of the chapter 13 plan is ultimately denied.[10] In districts where the U.S. Trustee has appointed a standing chapter 13 trustee (or a panel of such trustees), the trustee is paid a percentage of the plan payments made by the debtor. Under 28 U.S.C. § 586(e)(2), the trustee "shall collect such percentage fee from all payments received" under the plan.

Chapter 13 debtors are generally required to commence making plan payments shortly after filing a bankruptcy petition, even before the plan has been confirmed.[11] Under 11 U.S.C. § 1326(b)(2), such payments "shall be retained by the trustee until confirmation or denial of confirmation." If the plan has been confirmed, the trustee must distribute plan payments in accordance with the terms of the plan. However, if the plan has *not* been confirmed, "the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) [dealing with court-ordered modifications in plan payments] *to the debtor*, after deducting any unpaid claim allowed under section 503(b) [dealing with administrative claims]."[12]

The courts have been divided as to whether § 586(e)(2) means that standing trustees may pay themselves before returning pre-confirmation payments to the debtor, or whether § 1326(a)(2) instead requires chapter 13 trustees to return all plan payments to the debtor — net of allowed administrative-expense claims and payments to creditors that have already been paid or that have become due and payable — without first deducting their own fees.

Hon. **Timothy A. Barnes** of the U.S. Bankruptcy Court for the Northern District of Illinois recently joined the Tenth Circuit (to date, the only circuit that has ruled on the issue) in holding that when read together, §§ 586(e)(2) and 1326(a)(2) "unambiguously" require the trustee to return pre-confirmation payments to the debtor without deducting his/her own fee. This reading of the statutes is supported by the fact that the Bankruptcy Code expressly directs trustees serving under chapter 12 and in subchapter V cases to deduct their fees before returning plan payments to the debtor when confirmation is denied. Judge Barnes held that if the word "collect" in § 586(e)(2) is read to mean "collect and retain," it would render "the specific deduction provisions in subchapter V and chapter 12 as surplusage."[13]

Judge Barnes also recognized that it has been a widespread practice for chapter 13 trustees to deduct their fees from pre-confirmation payments upon denial of plan confirmation, and given the large percentage of chapter 13 cases that fail to reach confirmation, the effect of decisions like his on standing trustees' compensation "will be momentous."[14] Accordingly, he certified his decision for direct appeal to the Seventh Circuit and stayed his decision pending appeal.

One week before the issuance of Judge Barnes's decision, Hon. **Thomas J. Tucker** of the U.S. Bankruptcy Court for the Eastern District of Michigan sided with the other camp of courts holding that chapter 13 trustees *are* entitled to retain their percentage fees when plan confirmation has been denied.[15] The cases to which he cited have reasoned, among other things, that § 1326(a)(2) "is silent as to whether the trustee's percentage fee shall be returned," and because the fee "is separate and apart from payments to creditors," the statute does not require the return of the fee to the debt-

9 *Id.* at 935.

10 *Compare In re Johnson*, Case No. 22-bk-04449, ___ B.R. ___, 2023 WL 3409597 (Bankr. N.D. Ill. May 12, 2023) (trustee may retain its fees), *with In re Baum*, Case No. 22-40755, ___ B.R. ___, 2023 WL 3294625 (Bankr. E.D. Mich. May 5, 2023) (opposite conclusion).

11 11 U.S.C. § 1326(a)(1).

12 *Id.*

13 *In re Johnson*, 2023 WL 3409597, at *5.

14 *Id.* at *7 (Bankr. N.D. Ill. May 12, 2023).

15 *In re Baum*, 2023 WL 3294625 at *6 (Bankr. E.D. Mich. May 5, 2023) (citing *In re Nardello*, 514 B.R. 105, 113 (D.N.J. 2014); *In re Soussis*, 624 B.R. 559, 571-74 (Bankr E.D.N.Y. 2020); *In re Harmon*, 2021 WL 3087744, at *2, 3, 12 (B.A.P. 9th Cir. July 20, 2021)).

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By Brittany M. Woodman

The Consumer Bankruptcy Reform Act: The Uncoupling of Debts

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The Consumer Bankruptcy Reform Act (CBRA), originally introduced in December 2020, was reintroduced in September 2022 by Sen. Elizabeth Warren (D-Mass.) and Rep. Jerrold Nadler (D-N.Y.).[1] This previously rejected bill is once again causing bankruptcy lawyers and scholars alike to contemplate what a re-envisioned consumer bankruptcy system could look like.

The bill aims to streamline and update the bankruptcy process, making it easier for those who must file for bankruptcy to be able to reach financial stability without enduring avoidable expenses and hardship.[2] Essentially, the CBRA would repeal current chapter 13 in its entirety and prohibit individuals from filing under chapter 7, replacing these options for consumer debtors with what the CBRA calls "chapter 10."[3] Section 103 of the proposed CBRA repeals chapter 13. The CBRA does not contain a provision repealing chapter 7, but instead strikes it from consumer-related areas of the current Bankruptcy Code. While the CBRA is meant to replace chapters 13 and 7 for individual-debtors, chapter 7 appears to still be available for non-consumer debtors.[4]

A recent article discussed the major changes proposed by the CBRA, along with an overview of how chapter 10 differs from current chapters 7 and 13.[5] Although many of the proposed changes in the CBRA, such as the discharge of student loan debt and cures of rent deficiencies, have received attention, there are some additional and significant changes tucked away in the fine print that are worth deeper analysis.

"Residence" and "Property" Plans

One such change is how secured debts will be handled under the proposed chapter 10. Under § 1026 of the CBRA, debtors in a chapter 10 who wish to cure secured debt deficiencies in a bankruptcy proceeding shall provide separate "residence" and/or "property" plans for secured debts related to the debtor's principal residence and all other property.[6] Section 1021 of the CBRA explains the three different plan types that a debtor may file, making it clear that secured debts and unsecured claims are not to be intermingled under one plan.[7] Each plan would be treated separately for the purposes of confirmation, discharge and revocation of a confirmation or setting aside the discharge order.[8] This is a significant change from the current system in which consumer debtors in chapter 13 simply provide one plan that accounts for the handling of all debts, both secured and unsecured.[9]

The CBRA proposes multiple protections for debtors, such as plan modifications, no requirement that priority claims be paid in full, and flexibility if repayment delinquency occurs because of circumstances that a debtor reasonably could not avoid.[10] Under a residence or property plan, debtors may change the terms of secured obligations by modifying the interest rate, adjusting the amortization schedule or curing defaults.[11] Chapter 10 effectively eliminates the mortgage-modification restrictions under chapter 13 for primary-residence properties.[12] A residence or property plan does not result in a discharge unless paired with a completed repayment plan.[13] However, if a chapter 10 debtor has a zero-minimum-payment obligation, he/she is entitled to an immediate discharge, which is similar to chapter 7.[14]

Residence and other property plans operate similarly. Both plans allow secured creditors to retain their liens, and debtors make payments directly as determined under each plan,[15] which is differ-

1 *See generally* "The Consumer Bankruptcy Reform Act of 2020," S. 4991, 116th Cong. (2020); *see also* "The Consumer Bankruptcy Reform Act of 2022," S. 4980, 117th Cong. (2022).

2 "Senator Warren and Representative Nadler Reintroduce the Consumer Bankruptcy Reform Act," Press Release (Sept. 28, 2022), *available at* warren.senate.gov/newsroom/press-releases/senator-warren-and-representative-nadler-reintroduce-the-consumer-bankruptcy-reform-act (unless otherwise specified, all links in this article were last visited on May 22, 2023).

3 Mahlon J. Mowrer, "The Consumer Bankruptcy Reform Act: A Transformation of the Law," XLII *ABI Journal* 1, 8-9, 95, January 2023, *available at* abi.org/abi-journal ("By far the most striking provision of the CBRA is the elimination of chapter 13 and the prohibition of individuals filing pursuant to chapter 7. Instead, consumers would now file under the newly created chapter 10.").

4 CBRA, *available at* congress.gov/bill/117th-congress/senate-bill/4980/text (section 309(k) still includes chapter 7 language, as does §§ 303(i), 103 and more; "The bill eliminates the ability of individual debtors to file for bankruptcy under Chapter 7 liquidation bankruptcy and repeals Chapter 13, which requires individual debtors to comply with a repayment plan to receive a discharge of debt.").

5 Mowrer, *supra*, n.3.

6 S. 4980, § 1026.

7 S. 4980, § 1021.

8 *See* S. 4980, § 1021(c)(2) ("Except as provided in section 1023(a), each plan shall be treated separately for purposes of confirmation, discharge, and revocation of an order of confirmation or discharge.").

9 *See* 11 U.S.C. § 1322.

10 *See generally* S. 4980.

11 *See* S. 4980, §§ 1022(b), 1022(c); *see also* Michael A. Morris, "7 + 13 = 10: The CBRAs Huge Proposals to Change Consumer Bankruptcy," *Am. Bankr. Law J.* (March 14, 2022), *available at* ablsonline.com/2022/03/14/7-13-10-the-cbras-huge-proposals-to-change-consumer-bankruptcy ("Property and residence plans give the debtor the option to adjust interest rates and payment schedules, and allow defaults to be cured. Additionally, Chapter 13's mortgage modification restrictions are eliminated in Chapter 10.").

12 *See* S. 4980, §§ 103, 1022(b).

13 *See* S. 4980 § 1052(3); *see also* Morris, *supra* n.11 (describing how discharge works under chapter 10).

14 S. 4980, §§ 1021(b), 1031.

15 S. 4980, §§ 1022(b), 1022(c), 1024(c), 1024(d).

ent from a repayment plan under chapter 10, as repayment plans would be repaid through a trustee.[16] The CBRA further details how secured debts, such as mortgages and car loans, would differ as far as valuation and repayment determination under the residence and property plans in comparison to the current bankruptcy system.[17] Finally, secured creditors are prohibited from taking any action unless there is a default under the plan, which mandates 120 days of delinquency for mortgages and 90 days of delinquency for all other forms of secured debt.[18]

Á la Carte Bankruptcies

Since the CBRA proposes three plan types that are treated separately for the purposes of bankruptcy proceedings, chapter 10 debtors would be able to decouple certain debts.[19] Under the current system, a debtor filing for bankruptcy must confront all of his/her debts during a bankruptcy. It does not matter whether a debtor wants to address a car loan or a mortgage on which he/she is falling behind only; every financial obligation for a debtor comes into play. Under chapter 10, a debtor may file a "limited proceeding" allowing him/her to tackle only certain debts, instead of all of the financial obligations at once.[20] Under this type of filing, a debtor may file a bankruptcy proceeding that consists only of a residence plan or property plan.[21] This separation of plans allows debtors to reconcile failing mortgages and/or car loans without the expense, stress and time necessitated by a current chapter 13 bankruptcy. However, as will be explained in further detail, a discharge would only apply to a residence or property plan if coupled with a repayment plan.[22]

The Good and the Bad

The CBRA proposes to overhaul the current consumer bankruptcy system in an attempt to resolve the common financial struggles and difficulties incurred by the average debtor.[23] With these goals in mind, it is important to examine the potential pros and cons of such legislation. As many bankruptcy lawyers have found, there is often no perfect solution to the problems and expenses that consumer debtors face. Instead, laws and guidelines are created as safety valves to make the bankruptcy process as fair and as painless as possible. How will the proposed separation of secured debts and the allowance of limited proceedings with separate confirmation, discharge and revocation treatment for different plan types affect consumer debtors?

The Pros

- Limited proceedings via residence or property plan filings would allow debtors to address certain secured debts without having to go through an expensive and time-consuming full bankruptcy, saving consumer debtors time and money.
- Mortgage modifications can be time-consuming and difficult for the average debtor to navigate, particularly without counsel. The CBRA promises to make the restructuring of home mortgages easier by allowing the modification of mortgages on personal residences and investment property.[24] Section 101(6) of the CBRA would allow "the modification of mortgages on all residences." When the CBRA states "all residences," it is referring to its repeal of chapter 13, which does not allow a debtor to cram down a mortgage on a principal place of residence.[25]
- The CBRA ends the requirement that filers with car loan deficiencies must pay the full amount of the loan deficiency within the life of the plan to keep a vehicle.[26] For car owners, the CBRA summary from Sen. Warren's website states that it "[e]nds the requirement that filers

16 S. 4980, § 1025.
17 *See generally* S. 4980.
18 S. 4980, §§ 1028(c), 1028(d).
19 S. 4980, § 1051.
20 S. 4980, §§ 1051, 1052, 1053.
21 *Id.*
22 S. 4980, § 1052(3).
23 "Senator Warren and Representative Nadler Reintroduce the Consumer Bankruptcy Reform Act," *supra* n.2 (CBRA "takes long overdue steps to make it a little easier and a little less expensive for people who are in deep financial trouble to get meaningful bankruptcy relief") (quoting Sen. Warren).

24 S. 4980 §§ 101(a)(8), 101(b)(6).
25 "The Consumer Bankruptcy Reform Act of 2020" ABI, *available at* abi.org/feed-item/the-consumer-bankruptcy-reform-act-of-2020 ("Chapter 10 also removes chapter 13's restrictions on mortgage modification ("cram down"), and pares back (but does not eliminate) the restriction on auto loan lien-stripping"). That article refers to the 2020 CBRA, but the 2020 and 2022 CBRA are virtually identical.
26 *See generally* Sen. Elizabeth Warren, "Consumer Bankruptcy Reform Act Summary" (Sept. 20, 2022), *available at* warren.senate.gov/download/consumer-bankruptcy-reform-act-summary_-92022.

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Awaiting Decision of Supreme Court, Biden Vetoes Measure to Cancel Student Debt Relief

President Joe Biden on June 7 vetoed a legislative measure (House Joint Resolution 45) that would have canceled his plan to forgive student debt, leaving the relief plan in the hands of the U.S. Supreme Court. The measure was brought up as a joint resolution under the Congressional Review Act, which allows Congress to nullify newly placed rules and regulations. Such measures are not subject to the filibuster, so Democrats in the Senate could not block the measure, and a super-majority of 60 votes was not required to advance it.[1] The joint resolution had been pushed by Republicans, but it also garnered a handful of Democratic votes in the Senate. The measure to block the plan passed the Senate on June 1 in a 52-46 vote and cleared the GOP-majority House in a party-line vote, with two Democrats joining Republicans.

President Biden's proposal, which has been a target of Republicans since he first unveiled it last year, would impact 40 million borrowers by providing $10,000 in loan forgiveness to those making less than $125,000 annually and $20,000 in forgiveness for Pell Grant recipients. At press time, the Supreme Court was still reviewing a legal challenge that could eliminate the plan (a decision is expected in late June). If enacted, President Biden's plan would forgive up to $20,000 in federal student loan debt for borrowers making less than $125,000 per year. Student loan payments were paused at the beginning of the COVID-19 pandemic, but they will resume in August for anyone whose debt is not wiped out by President Biden's plan.

Lawmakers Reintroduce Bill Taking Aim at Visa, Mastercard Fees, Garnering Broader Support

Lawmakers in the House and Senate on June 7 reintroduced legislation aimed at enhancing competition and choice in the credit card network market, which they say is currently dominated by Visa and Mastercard. "In 2022 alone, Visa, Mastercard and their card-issuing banks charged merchants a total of $93 billion in credit card fees," according to a factsheet for the "Credit Card Competition Act of 2023" (CCCA).[2] Building off of debit card competition reforms enacted by Congress in 2010, the CCCA would direct the Federal Reserve to ensure that giant credit card-issuing banks offer a choice of at least two networks over which an electronic credit transaction may be processed. "Bringing real competition to credit card networks will help reduce swipe fees and hold down costs for Main Street merchants and their customers," Senate Judiciary Committee Chair Richard Durbin (D-Ill.) said in a statement.[3]

Currently, when a consumer pays with a credit card that has Visa or Mastercard listed on it, merchants generally have to route the payment through that network. The bill would mandate that merchants in many cases have the right to route payments through an unaffiliated network, which could lower the fees that merchants have to pay. Visa and Mastercard set and pocket network fees that merchants pay when consumers shop with the cards. They also set interchange fees that merchants pay to the banks that issue credit cards.

Sen. Durbin and Sen. Roger Marshall (R-Kan.) introduced an identical bill in the 117th Congress, but the legislation did not advance past the Senate Banking Committee. This year's legislation has broader bipartisan support in both the Senate and House. At introduction, the Senate version garnered two additional co-sponsors, Sens. Peter Welch (D-Vt.) and J.D. Vance (R-Ohio.). Rep. Lance Gooden (R-Texas), who co-sponsored the bill in the House last year, is joined by Reps. Jeff Van Drew (R-N.J.), Tom Tiffany (R-Wis.) and Zoe Lofgren (D-Calif.).

CFPB Report Finds that Billions of Dollars Stored on Popular Payment Apps May Lack Federal Insurance

The Consumer Financial Protection Bureau (CFPB) published an issue spotlight[4] on June 1 examining digital payment apps heavily used by consumers and businesses. The analysis found that funds stored on these apps might not be safe in the event of financial distress, since the funds might not be held in accounts with federal deposit insurance coverage. The CFPB also issued a consumer advisory for customers holding funds in these apps and how they can make sure their funds remain safe.

The CFPB report pointed to the growing use over the past few years of nonbank payment apps such as PayPal, Venmo and Cash App. These apps allow people to quickly pay retailers and others, while providing the option to store funds. The CFPB findings included:

- More than three quarters of adults in the U.S. have used a payment app. Younger customers' use of these payment app services is especially prevalent. Approximately 85 percent of consumers aged 18-29 have used such a service. Transaction volume across all service providers in 2022 was estimated at approximately $893 billion and is projected to reach approximately $1.6 trillion by 2027.
- Nonbanks can earn money when users store funds on their platforms. When users of these digital apps receive

1 Alex Gangitano, "Biden Vetoes Measure Overturning Student Loan Forgiveness Plan," *The Hill* (June 7, 2023), *available at* thehill.com/homenews/administration/4031775-biden-vetoes-measure-overturning-student-loan-forgiveness-plan (unless otherwise specified, all links in this article were last visited on June 14, 2023).

2 "Short Summary of the Credit Card Competition Act of 2023," Office of Sen. Richard Durbin (D-Ill.), June 7, 2023, *available at* durbin.senate.gov/imo/media/doc/The%20Credit%20Card%20Competition%20Act%20of%202023%20-%20one-pager.pdf.

3 "Bipartisan, Bicameral Lawmakers Introduce the Credit Card Competition Act," Office of Rep. Zoe Lofgren (June 7, 2023), *available at* lofgren.house.gov/media/press-releases/bipartisan-bicameral-lawmakers-introduce-credit-card-competition-act.

4 "CFPB Finds that Billions of Dollars Stored on Popular Payment Apps May Lack Federal Insurance," CFPB Press Release (June 1, 2023), *available at* consumerfinance.gov/about-us/newsroom/cfpb-finds-billions-of-dollars-stored-on-popular-payment-apps-may-lack-federal-insurance.

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By Scott A. Wolfson

Critically Thinking About Your Critical-Vendor Status

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Critical-vendor orders are back in retail, automotive and other cases (if they ever even left).[1] Entry of these orders inspires immediate bravado by vendor clients who reflexively insist that they must be critical and cease providing the debtor with goods or services until they are rightfully so named and their pre-petition indebtedness is paid in full. And then they call you.

Being designated a critical vendor requires more than the debtor's dire need for a vendor's product. Since *Kmart*[2] and *Jevic*,[3] the critical-vendor landscape has been littered with landmines for even the well-intentioned. This article maps the hazards and opportunities for vendors when financing is available to pay critical vendors.

Authority for Critical-Vendor Orders

Perhaps the comeback of critical-vendor orders should not be heralded, as they have been here in some form for years.[4] The "doctrine of necessity" or the "necessity-of-payment rule" has roots in railway cases going as far back as 1882 in *Miltenberger v. Logansport Ry. Co.*,[5] allowing a receiver to pay pre-receivership unsecured creditors.[6] Since the Bankruptcy Code's enactment,[7] courts have relied on § 105(a)[8] and its grant of broad equitable powers to the bankruptcy courts, along with § 363(b)(1), which allows a trustee to "use, sell, or lease, other than in the ordinary course of business, property of the estate."[9]

However, there is no statutory Code provision that expressly authorizes payment of vendor pre-petition debts before the confirmation of a chapter 11 plan, nor is the term "critical vendor" defined in the Code. The practice of authorizing the payment of pre-petition amounts owed to vendors designated by the debtor as critical had become routine until the Seventh Circuit closely examined the practice in *In re Kmart*.[10]

Kmart obtained a critical-vendor order and paid in full the pre-petition debts of 2,330 suppliers, which collectively received about $300 million.[11] Calling the doctrine of necessity "just a fancy name for a power to depart from the Code," the Seventh Circuit held that § 105(a) did not create discretion to set aside the Code's priority rules. Thus, "the power conferred by § 105(a) is one to implement rather than override."[12] The court suggested in *dicta* that § 363(b)(1) could provide support if paying the critical vendors — that is, vendors who would have ceased deliveries if old debts were unpaid — would enable a successful reorganization and make even the disfavored creditors better off.[13]

Critical-vendor-order proponents received a golden nugget of *dicta* from the U.S. Supreme Court in *Czyzewski v. Jevic Holding Corp.*[14] The court's decision that distributions in a structured dismissal of a chapter 11 case could not — without the consent of the affected parties — deviate from basic Bankruptcy Code priority rules did not seem like a setup for critical-vendor-order support. However, the court contrasted the invalid *Jevic* distributions that violated the Code's priority scheme with priority-skipping distributions in the critical-vendor context:

> [O]ne can generally find significant Code-related objectives that the priority-violating distributions serve. Courts, for example, have approved "first-day" wage orders that allow payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' pre-petition invoices, and "roll-ups" that allow lenders who continue financing the debtor to be paid first on their pre-petition claims.
>
> ***
>
> In doing so, *these courts have usually found that the distributions at issue would "enable a successful reorganization and make even the disfavored creditors better off*." *In re Kmart Corp.*, 359 F.3d 866, 872

1 *See, e.g., In re Party City Holdco Inc., et al.*, Case No. 23-90005 (Bankr. S.D. Tex. 2023) (Docket No. 440); *In re Stanadyne LLC, et al.*, Case No. 23-10207 (Bankr. D. Del. 2023) (Docket No. 50); *In re Bolta US Ltd.*, Case No. 23-70042 (N.D. Ala. 2023) (Docket No. 177); *In re Invacare Corp., et al.*, Case No. 23-90068 (Bankr. S.D. Tex. 2023) (Docket No. 299).

2 *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004), *cert. denied sub nom., Handleman Co. v. Capital Factors Inc.*, 543 U.S. 986 (2004).

3 580 U.S. 451 (2017).

4 *See* LL Cool J, "Mama Said Knock You Out" (1991).

5 106 U.S. 286 (1882).

6 *Id.* at 311 ("Many circumstances may exist [that] may make it necessary and indispensable ... for the receiver to pay preexisting debts of certain classes, out of the earnings of the receivership, or even the corpus of the property, under the order of the court, with a priority of lien.").

7 11 U.S.C. § 101, *et seq.*

8 11 U.S.C. § 105(a) permits a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code.

9 11 U.S.C. § 363(b)(1).

10 359 F.3d 866 (7th Cir. 2004).

11 *Id.* at 869.

12 *Id.* at 871.

13 *Id.* at 872-73.

14 580 U.S. 451 (2017).

(CA7 2004) (discussing the justifications for critical-vendor orders).[15]

While not deciding the issue, the Supreme Court went out of its way to suggest that critical-vendor orders may provide the "significant offsetting bankruptcy-related justification"[16] that the *Jevic* structured dismissal lacked. It behooves not only debtors, but also the vendors who would receive payments under a critical-vendor order, to ensure that an adequate evidentiary record supports entry of the critical-vendor order.

Don't Violate Automatic Stay by Demanding Payment of Pre-Petition Indebtedness

If the debtor has successfully persuaded the bankruptcy court to enter a critical-vendor order, vendors must be careful about how they seek to obtain payment under the order. The automatic stay is fundamental, and courts go to great lengths to ensure that a debtor has a breathing spell from its creditors. Section 362(a)(6)[17] of the Bankruptcy Code specifically prohibits any act to collect a claim against the debtor that arose before the commencement of the case. This applies even when the vendor is not obligated under a contract to provide goods or services to the debtor.

An example of the reach of this provision, and the care with which vendors must approach post-petition supply requests from a debtor, is *In re Sportfame of Ohio*.[18] Sportfame was a sporting goods retailer, and Wilson Sporting Goods Co. supplied the debtor for almost 10 years. It ceased supplying goods before Sportfame's bankruptcy filing due to its failure to timely pay.[19]

Sportfame sought to restart shipments from Wilson after filing for bankruptcy, but Wilson refused to do so unless Sportfame brought its account current or made arrangements to pay 100 percent of the arrearage.[20] Sportfame asserted that Wilson's refusal to resume shipments absent full payment of its pre-petition debt violated § 362(a)(6) and sought an injunction requiring Wilson to resume supply on a cash basis.[21]

The bankruptcy court found that Wilson's "sole animus in refusing to ship goods to [the] debtor for cash was its desire to coerce debtor's repayment of its pre-petition indebtedness and that this act, albeit a passive one,"[22] violated § 362(a)(6).[23] Sportfame could have hung up the phone when Wilson called and not violated the stay, and Wilson

15 *Id.* at 467-68 (emphasis added).
16 *Id.* at 468.
17 11 U.S.C. § 362(a)(6) (petition "operates as a stay, applicable to all entities, of — any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title").
18 *In re Sportfame of Ohio Inc.*, 40 B.R. 47 (Bankr. N.D. Ohio 1984).
19 *Id.* at 48-49.
20 *Id.* at 49.
21 *Id.*
22 Creditors may have additional arguments under *City of Chicago, Illinois v. Fulton* that the "passive" refusal to ship is not a prohibited "affirmative act" to collect a pre-petition claim under § 362(a)(6), which, similar to § 362(a)(3), prohibits "any act to...." 141 S. Ct. 585 (2021) (section 362(a)(3) prohibits only "affirmative acts" that would change "status quo" of estate property as of time a bankruptcy petition is filed and that, therefore, entity's "mere retention" of estate property after filing of bankruptcy petition does not violate § 362(a)(3)).
23 *Id.* at 50.

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By Brigette McGrath and Eric Steinfeld

Did the SBRA Really Change Much for Preference Litigation?

Editor's Note: *ABI's newly formed Subchapter V Task Force is seeking input from those who have had experience working with subchapter V. To participate in a survey on subchapter V, please visit abi.org/subvsurvey.*

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In an amendment to the Bankruptcy Code, the Small Business Reorganization Act of 2019 (SBRA) amended § 547(b) to add an explicit requirement for a bankruptcy trustee or debtor in possession to conduct "reasonable due diligence" before filing a preference action.[1] Because Congress did not provide legislative history regarding the new language's purpose or application, a host of questions have arisen as to the rule's proper application. Commentators and practitioners have surmised that the new language is intended to curtail certain chapter 7 trustees and chapter 11 liquidating trusts from bringing preference actions against all recipients of transfers without any review of whether such recipients have obvious affirmative defenses under § 547(c) of the Code.[2] However, it is unclear whether the reasonable due diligence requirement is an element of the preference claim or whether it is an affirmative defense. In addition, questions as to what constitutes "reasonable due diligence" under the new rule, and under what circumstances § 547(c) affirmative defenses are not reasonably knowable for a trustee to conduct due diligence, have plagued the courts.

Case Survey

Amended § 547(b) sets forth the *prima facie* elements of a bankruptcy trustee's preference action. Congress amended § 547(b) to include the italicized language:

> Except as provided in subsections (c), (i), and (j) of this section, the trustee may, *based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c)*, avoid any transfer of an interest of the debtor in property.[3]

While the amended language does not explicitly require trustees to plead due-diligence efforts in the complaint, defense attorneys have sought refuge in the amendment at the motion-to-dismiss stage to argue that preference complaints are insufficiently pled if they fail to explicitly state that the trustee has performed his/her due diligence.[4] Despite these attempts, the majority of courts have been reluctant to weigh in on whether the reasonable due-diligence requirement is an element of the preference claim that must be affirmatively pled.[5] However, at least one court has stated that it is a condition precedent, and thus a new element that the plaintiff must allege and prove.[6]

Apprehension to Finding Due Diligence as a New Element

Courts hesitating to weigh in on whether the reasonable due-diligence requirement is an element of the preference have instead relied on the allegations in the complaint to conclude that the trustee adequately conducted due diligence. In *In re Trailhead Eng'g LLC*,[7] the bankruptcy court denied a motion to dismiss and declined to determine whether the "reasonable due diligence" requirement was an element of a preference action because the complaint

1 *See* Small Bus. Reorganization Act of 2019, Pub. L. No. 116-54 § 3(a), effective Feb. 19, 2020.

2 *See* Gregory G. Hesse & Michael R. Horne, "Courts Begin Interpreting New Due Diligence Requirements for Trustees Before Filing Preference Actions," 18 *Pratt's J. of Bankr. Law* 1(2022); *see also* 5 *Collier on Bankruptcy* ¶ 547.02A (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2020) (presuming amendment's purpose was to combat "preference mills," which are law firms employed on contingent basis who file adversary proceedings for small-dollar actions in districts other than defendant's residence with little or no evaluation of merits, solely to force nuisance value settlements).

3 *See* 11 U.S.C. § 547(b) (emphasis added).

4 *See, e.g., In re Ctr. City Healthcare LLC*, 641 B.R. 793 (Bankr. D. Del. June 13, 2022) (collecting cases); *Miller v. Nelson (In re Art Inst. of Phila. LLC)*, No. 18-11535 (CTG), 20-50627 (CTG), 2022 Bankr. LEXIS 68, at *49 (Bankr. D. Del. Jan. 12, 2022); *Faulkner v. Lone Star Car Brokering LLC (In re Reagor-Dykes Motors LP)*, No. 18-50214-RLJ-11, 2021 WL 2546664 (Bankr. N.D. Tex. 2021); *Sommers v. Anixter Inc. (In re Trailhead Eng'g LLC)*, No. 18-32414, 2020 WL 7501938 (Bankr. S.D. Tex. 2020); *Husted v. Taggart (In re ECS Ref. Inc.)*, 625 B.R. 425 (Bankr. E.D. Cal. Dec. 15, 2020).

5 *See In re Ctr. City Healthcare LLC*, 641 B.R. at 802 (Bankr. D. Del. June 13, 2022) ("The Court finds it unnecessary to resolve this issue. Even if the amended language of section 547(b) added 'reasonable due diligence' as an element of a claim for an avoidable preference, the Court concludes that the Debtors in this case have adequately pled factual allegations to satisfy that element."); *In re Insys Therapeutics Inc.*, 2021 WL 5016127, at *3 (Bankr. D. Del. Oct. 28, 2021) (concluding that although purpose of reasonable-due-diligence language was susceptible to more than one interpretation, there was no need to rule on interpretative issue because trustee adequately pled due diligence in his complaint); *In re Reagor-Dykes Motors LP*, 2021 WL 2546664 at *5 (explaining that court need not decide whether due-diligence language created additional element, but emphasizing that trustee must exercise certain level of due diligence before bringing preference action); *In re Trailhead Eng'g LLC*, 2020 WL 7501938, at *7 (declining to conclude whether due diligence language created additional element and deciding that court had discretion to apply requirement based on what complaint alleged).

6 *In re ECS Ref. Inc.*, 625 B.R. 425 (Bankr. E.D. Cal. Dec. 15, 2020); *see also Weinman v. Garton (In re Matt Garton & Assocs., LLC)*, Case No. 19-18917 TBM, 2022 WL 711518 (Bankr. D. Colo. Feb. 14, 2022) ("[A]rguably, the new due diligence requirement is an element of a preference claim under Section 547.").

7 *Sommers v. Anixter Inc. (In re Trailhead Eng'g LLC)*, No. 18-32414, 2020 WL 7501938 (Bankr. S.D. Tex. 2020).

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By Brendan Porter

Did Accounting Classifications Play a Role in SVB's Collapse?

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Silicon Valley Bank (SVB) disclosed on March 8, 2023, that it completed the sale of $21 billion in assets, incurring a loss of $1.8 billion on the transaction. In an attempt to raise additional equity capital, SVB also announced that it was conducting a secondary offering of common stock. Within 48 hours, SVB's clients struggled to withdraw more than $140 billion (or 80 percent) of deposits, and the bank collapsed under the pressure. Two days later, SVB was closed by its regulators and placed under the administration of the Federal Deposit Insurance Corp. In the process, more than $15 billion of shareholder value was wiped out.[1]

SVB's sudden and dramatic demise has sparked intense scrutiny and questions about what went wrong and whether relevant risks had been adequately disclosed to investors. With the subsequent failure of First Republic Bank and the turmoil in regional bank stocks, further questions have been raised about the adequacy of existing accounting practices and the extent to which this contributed, if at all, to current market unrest. Although the topic of how a bank's debt securities should be recorded on financial statements was the subject of reforms in the years following the Great Financial Crisis, some now argue that it should be revisited in light of recent bank failures.

This article sheds light on the mixed-measurement model used in the U.S., which refers to the fact that some debt securities are measured at "fair value" (an estimate of their market value), while others are measured at their historical cost. Each classification has specific ramifications for the presentation of financial results. By examining SVB's disclosure practices and associated financial statements, this article reviews the information made publicly available to market participants. In addition, the article explores arguments in favor of and against the mixed-measurement model, and concludes with a review of the Federal Reserve's findings regarding the root causes of SVB's failure.

The Accounting Classification of Debt Securities

There are various accounting classifications for the financial reporting of debt securities. Each one has its own distinct accounting treatment, and these treatments can have a direct impact on how financial results are presented. The classification chosen depends on such factors as the transaction's purpose, management's intended use of the securities and the reporting entity's ability to meet specific criteria. There are three primary classifications:[2]

- *Trading Securities:* These securities are acquired with the intent of selling the security in the near term to capitalize on short-term price movements. On the balance sheet, these securities are recorded at fair value. Any changes in fair value are recorded as unrealized gains or losses on the income statement.
- *Available for Sale (AFS):* If a debt security is not intended to be held until maturity or used for short-term trading, it can be classified as AFS. These securities, similar to trading securities, are also recorded at fair value on the balance sheet. However, unlike trading securities, changes in the fair value of AFS securities will not affect the income statement. Rather, these changes will be recorded in accumulated other comprehensive income (AOCI), a component of equity on the company's balance sheet.
- *Held to Maturity (HTM):* If management intends and has the ability to hold a security until its maturity, it can be classified as HTM. This means that regardless of, for example, short-term changes in value, interest rates or funding markets, management does not plan to sell the security. HTM securities are recorded on the balance sheet at their amortized cost, reflecting the initial value of the security (*i.e.*, its historical cost). Changes in the fair value of HTM securities generally do not directly affect financial statements.

The fact that certain securities are measured at fair value while others are measured at their historical cost, depending on their accounting classification, is referred to as the "mixed-measurement model." It is important to understand these classifications for a robust assessment of risk, given that each classification will have a different impact on how financial results are presented. Using a simple illustrative example, Exhibit 1 shows how the classification of a debt security could affect the income statement and balance sheet of a reporting entity. It

1 SVB Financial Group, Press Release (Form 8-K) (March 8, 2023); S&P Capital IQ (2023), SVB Financial Information; Gregory W. Becker, Written Testimony Before the U.S. Senate Committee on Banking, Housing and Urban Affairs (May 16, 2023).

2 Financial reporting can be complex. The descriptions herein represent a simplified discussion of the relevant accounting standards (ASC 320).

assumes that the fair value of a debt security decreased by $1,000 during the measurement period.[3]

As the simplified Exhibit 1 demonstrates, if the debt security in question had been classified as HTM, the impact of a $1,000 loss in value would have no direct impact on the financial statements. Under the other two classifications, the loss would affect the company's equity balance, either through the income statement or AOCI. While some have concluded that the HTM designation allows reporting entities to "hide" losses on HTM securities, in SVB's case, as set forth herein, these unrealized losses were hiding in plain sight.

SVB's Recent Performance and Disclosures

From 2019-22, the commercial banking industry experienced a substantial increase in deposits, totaling more than $5 trillion. This increase can be partly attributed to the monetary and fiscal accommodation implemented in response to the COVID-19 pandemic. Across the industry, banks elected to invest a large portion of the deposit inflow into liquid assets, such as cash and securities, rather than using the deposits to fund new loans. A review of SVB's financial statements confirms this trend.

During this period, SVB's deposit base grew by more than $110 billion, a nearly 300 percent increase. While a portion of these deposits were invested in new loans, SVB's management chose to invest a large portion of these funds in debt securities, including Treasury bonds and mortgage-backed securities. These securities were predominantly highly rated and backed by the U.S. government, and the potential for credit losses was low. However, similar to any debt security exposed to interest-rate risk, changes in interest rates could lead to changes in the fair value of SVB's securities portfolio. Exhibit 2 provides an overview of SVB's investments in debt securities from 2019-22.[4]

As shown in Exhibit 2 on p. 60, the majority of SVB's investments were classified as HTM, and the bulk of this investment occurred in 2021, prior to recent increases in interest rates. In 2022, the Federal Reserve began to raise interest rates, and in just 14 months, the federal funds rate increased from near 0 percent in February 2022 to almost 5 percent currently. As interest rates increase, the market value of debt securities with fixed interest rates decreases rapidly. Therefore, SVB's HTM portfolio experienced significant losses. However, these losses would not (and did not) directly affect the presentation of financial results because of how they were classified on SVB's balance sheet.

Yet the information to assess this potential risk existed in SVB's financial disclosures. Its balance sheet noted that while the carrying amount of HTM securities was $91.3 billion, their fair value was $76.2 billion. In addition, in the accompanying notes to the financial statements, SVB provided even more detail regarding the composition of its HTM securities portfolio and the components of the $15 billion unrealized loss, as shown in Exhibit 3 on p. 61.

With this information, a financial analyst could restate SVB's balance sheet on a fair-value basis and, despite the limitations of accounting classifications, incorporate the HTM losses directly into a set of non-GAAP,[5] amended financial statements. In light of this, one might question opponents of the mixed-measurement model. If the relevant losses are disclosed anyway, then what is the issue? In the subsequent section, there will be a review of the arguments

continued on page 60

3 Actual financial reporting would involve additional considerations and complexity beyond the scope of this article.

4 SVB Financial Group, Annual Reports (Form 10-K) (2020-2022); S&P Capital IQ (2023), SVB Financial Information.

5 GAAP stands for "Generally Accepted Accounting Principles."

Exhibit 1

	Classification: Trading		AFS		HTM
Income Statement:					
Revenue	$	100,000 $	100,000 $		100,000
Less: Costs		(80,000)	(80,000)		(80,000)
Add: Unrealized Gain/(Loss)		(1,000)	-		-
Net Income	**$**	**19,000 $**	**20,000 $**		**20,000**
Balance Sheet					
Beginning Equity Balance	$	10,000 $	10,000 $		10,000
Add: Net Income		19,000	20,000		20,000
Add: AOCI		-	(1,000)		-
Ending Equity Balance	**$**	**29,000 $**	**29,000 $**		**30,000**

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Feature

By Joshua A. Lesser

LTL: Third Circuit Dismisses J&J Subsidiary Bankruptcy, Citing Lack of Financial Distress

On March 31, 2023, Hon. **Thomas L. Ambro**, for a three-judge panel of the Third Circuit, authored an opinion in *In re LTL Management LLC*[1] reversing the bankruptcy court's denial of motions to dismiss Johnson & Johnson's (J&J) divisional-merger bankruptcy, remanding with instructions to dismiss. The bankruptcy court dismissed four days after remand. J&J's litigation-trust vehicle, LTL Management LLC, refiled hours after dismissal. This article focuses on the Third Circuit's reasoning for dismissal and LTL's second filing.

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LTL's Initial Bankruptcy Filing[2]

Before October 2021, Johnson & Johnson Consumer Inc. (Old JJCI) was the wholly owned subsidiary of J&J responsible for the production and sale of Johnson's Baby Powder. Beginning in 2010, J&J and Old JJCI saw a precipitous rise in the number of lawsuits alleging that the baby powder caused such diseases as ovarian cancer and mesothelioma, with more than 38,000 lawsuits having been filed by October 2021.

In October 2021, Old JJCI underwent a divisional merger under Texas law through which its operating assets, worth approximately $61 billion, were transferred to "new" Johnson & Johnson Consumer Inc., n/k/a Johnson & Johnson Holdco (NA) Inc. (New JJCI). Old JJCI simultaneously transferred all liability for the talc-related lawsuits (and future lawsuits), along with approximately $360 million in royalty assets, to LTL to enter bankruptcy and establish a litigation trust under § 524(g) of the Bankruptcy Code to administer all talc-related claims.

In exchange for LTL's assumption of liability and the allocation of assets to New JJCI, J&J and New JJCI granted LTL payee status under a funding agreement whereby New JJCI and J&J agreed to fund LTL up to New JJCI's value, which was then approximately $61 billion. This commitment was pegged to any increased value of New JJCI.

Various parties moved to dismiss for "cause" under § 1112(b) of the Bankruptcy Code. Hon. **Michael B. Kaplan** denied these motions, reasoning, in pertinent part, that LTL was under financial distress: "Even without a calculator or abacus, one can multiply multi-million-dollar or multi-billion-dollar verdicts by tens of thousands of existing claims, let alone future claims, and see that the continued viability of all J&J companies is imperiled."[3]

The Third Circuit's Dismissal

Section 1112(b) permits a bankruptcy court to dismiss a bankruptcy petition filed without good faith. In the Third Circuit, a debtor has the burden to show good faith by proving a valid bankruptcy purpose and that the petition was not merely filed to obtain a tactical litigation advantage.[4] At a minimum, a valid bankruptcy purpose requires financial distress.[5]

Financial distress is determined on a case-by-case basis without a bright-line rule.[6] While insolvency is not required, the Third Circuit "cannot ignore ... a debtor's balance-sheet insolvency or insufficient cash flows to pay liabilities (or the future likelihood of these issues occurring)."[7] For example, "uncertain and unliquidated future liabilities could pose an obstacle to a debtor efficiently obtaining financing and investment."[8]

In finding financial distress, the bankruptcy court reasoned that future talc litigation imperiled LTL's financial well-being. According to LTL's expert, Dr. James Bell, "Old JJCI was not positioned to continue making substantial Talc Litigation payments from working capital or other readily marketable assets."[9] The bankruptcy court also seemingly characterized the funding agreement as something less than an immediate $61 billion asset because LTL would not exhaust the full commitment to avoid bankrupting New JJCI (the "golden goose") or having "a horrific impact" on J&J.[10]

Finally, the bankruptcy court took issue with the fairness of the multi-district litigation (MDL) sys-

1 *In re LTL Mgmt. LLC*, 64 F.4th 84 (3d Cir. 2023).
2 For a more in-depth background, *see* Joshua A. Lesser, "*LTL Management*: 'Not a Case of Too Big to Fail … a Case of Too Much Value to Be Wasted,'" XLI *ABI Journal* 5, 40-41, 88-89, May 2022, *available at* abi.org/abi-journal.

3 *In re LTL Mgmt. LLC*, 637 B.R. 396, 419 (Bankr. D.N.J. 2022), *rev'd and remanded*, 58 F.4th 738 (3d Cir. 2023), *rev'd and remanded*, 64 F.4th 84 (3d Cir. 2023).
4 *In re LTL Mgmt.*, 64 F.4th at 100-01.
5 *Id.* at 101.
6 *Id.* at 102.
7 *Id.*
8 *Id.*
9 *In re LTL Mgmt. LLC*, 637 B.R. at 419 (quoting and citing *Bell Report* at 19-21, 32).
10 *Id.* at 418.

tem for claimants and defendants — a question that the Third Circuit did not address. The bankruptcy court's opinion is characterized in greater detail in a previous article.[11]

In reversing, the Third Circuit placed greater emphasis on the funding agreement, stating that "the Bankruptcy Court did not consider the full value of LTL's backstop when judging its financial condition."[12] The court reasoned that the notion that LTL would want to avoid fully exhausting the funding agreement was "unsupported and disregard[ed] the duty of LTL to access its payment assets."[13]

At the same time, the Third Circuit de-emphasized LTL's "forecasts of hypothetical worst-case scenarios"[14] (referring to the $2.24 billion verdict in *Ingham*[15]). In projecting LTL's future liability, the Third Circuit relied on Old JJCI's settlement of 6,800 cases for just under $1 billion total and the fact that judgments averaged $39.7 million to conclude that "[w]hile LTL inherited massive liabilities, its call on assets to fund them exceeded any reasonable projections available on the record before us."[16] This comparison led the Third Circuit to conclude that "LTL, at the time of its filing, was highly solvent with access to cash to meet comfortably its liabilities as they came due for the foreseeable future."[17]

In an aside, the Third Circuit also reasoned that the bankruptcy court "erred by overemphasizing the relevance of Old Consumer's financial condition" because the funding agreement "gave LTL direct access to J&J's exceptionally strong balance sheet."[18] Old JJCI's financial condition was relevant only so far as it helped the court project future talc liability; it was not relevant to assessing LTL's ability to pay that future liability (and litigation spend) because LTL had the funding agreement. The court applied state laws not just to characterize the divisional merger, but also to value the funding agreement as a $61 billion asset.

LTL's Second Bankruptcy Filing

The Third Circuit acknowledged that its opinion raised an obvious question:

> Some might read our logic to suggest [that] LTL need only part with its funding backstop to render itself fit for a renewed filing. While this question is also premature, we note [that] interested parties may seek to "avoid any transfer" made within two years of any bankruptcy filing by a debtor who "receive[s] less than a reasonably equivalent value in exchange for such transfer" and "became insolvent as a result

11 Lesser, *supra* n.2.
12 *In re LTL Mgmt. LLC*, 64 F.4th at 107.
13 *Id.* at 108. Use of the term "duty" here is curious, as the bankruptcy court seemingly regarded LTL's corresponding duties in and out of bankruptcy court. *See In re LTL Mgmt. LLC*, 637 B.R. at 423 ("The divisional merger ... in the absence of any subsequent bankruptcy filing by LTL, may possibly have prejudiced creditors by requiring them to await LTL's draw upon the Funding Agreement" but "[w]ith [LTL's] chapter 11 filing, this Court ... can ensure that [the] Debtor pursues its available rights against J&J and New JJCI.").
14 *In re LTL Mgmt. LLC*, 64 F.4th at 108.
15 *Ingham v. J&J*, 608 S.W.3d 663 (Mo. Ct. App. 2020), *cert. denied*, —— U.S. ——, 141 S. Ct. 2716, 210 L.Ed.2d 879 (2021).
16 *In re LTL Mgmt. LLC*, 64 F.4th at 109.
17 *Id.* at 108.
18 *Id.* at 106.

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By Kaila D. Spivey

After *Bartenwerfer*, What Is an "Honest Debtor"?

Kaila D. Spivey
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The Bankruptcy Code provides a fresh start to the honest-but-unfortunate debtor.[1] An "honest debtor" is one who accurately discloses necessary information and abides by the Code.[2] However, after the U.S. Supreme Court's ruling in *Bartenwerfer v. Buckley*, an honest business partner, obligor, spouse, friend or any other similarly situated individual in a relationship involving a shared obligation is at risk of the wrongdoer's actions being imputed on the innocent. Thus, this article briefly discusses the Court's *Bartenwerfer* decision and its potential effects on honest debtors, and discusses two recent bankruptcy court opinions analyzing the decision.

The *Bartenwerfer* Decision

The Supreme Court in *Bartenwerfer* was faced with the question of whether to declare the creditor's claim against the debtor dischargeable under § 523(a)(2)(A) for her husband's fraud.[3] The debtor and her husband jointly owned the property at issue and decided to renovate it. The husband controlled the renovation process, while the debtor remained uninvolved. Once the renovations were complete, the couple sold the property to the creditor. The creditor sued the couple in state court after discovering many defects on the property. The state court ruled in the creditor's favor, awarding her more than $200,000 in damages. Because of their inability to pay, the couple jointly filed for chapter 7. In response, the creditor filed an adversary complaint against the couple seeking to declare the judgment nondischargeable under § 523(a)(2)(A).[4]

The bankruptcy court determined that the claim was nondischargeable under § 523(a)(2)(A), finding the husband directly liable and imputing the husband's culpability on the debtor. The bankruptcy appellate panel (BAP) remanded the case back to the bankruptcy court and found that the debtor did not have the requisite knowledge required under § 523(a)(2)(A) to be held liable. On remand, the bankruptcy court agreed with the BAP discharging the creditor's claim as to the debtor. The matter was sent back to the BAP, which affirmed. The Ninth Circuit reversed, finding both the husband and debtor liable despite the debtor's lack of culpability. The Supreme Court granted *certiorari*.[5]

The Supreme Court found the debtor liable and determined the creditor's debt as to the debtor nondischargeable under § 523(a)(2)(A). In reaching its decision, the Court noted that the Bankruptcy Code's purpose is to "strike ... a balance between the interests of insolvent debtors and their creditors."[6] Despite the general allowance of dischargeability of debts to honest debtors, the Court notes that § 523(a)(2)(A) is a specific Code provision where "the creditor's interest in recovering a particular debt outweighs the debtor's interest in a fresh start."[7]

The Supreme Court determined that Congress's intent of favoring creditors in § 523(a)(2)(A) is demonstrated by the passage being written in passive voice.[8] The debtor argued that despite the section being written in passive voice, § 523(a)(2)(A) is commonly interpreted as the wrongdoer's own culpability.[9] The Court disagreed, noting that the common law does not limit fraud to the wrongdoer alone but also imputes liability on the wrongdoer's agents.[10] The Supreme Court found that the debtor and her husband established a partnership when they decided to renovate and sell the property.[11] As a partner in the transaction, the debtor was vicariously liable for her husband's fraud.[12]

The Potential *Bartenwerfer* Problem

Simply put, in terms of § 523(a)(2)(A) liability, *Bartenwerfer* stands for the proposition that innocent partners in a partnership are deemed guilty by association for the wrongdoing of another partner. As pondered in another article on this case, "[t]he Supreme Court's decision could force thousands of individual debtors into 'permanent or at least indefinite pauperism,' and could do so in the context of

1 *Grogan v. Garner*, 498 U.S. 279, 289 (1991).
2 Andrew F. Emerson, "Identifying the Honest Debtor: Section 727(a)(4)(a) of the Bankruptcy Code and the Need for Consistency in Denial of Discharge Proceedings," 89 *Am. Bankr. L.J.* 607, 609 (2015).
3 *Bartenwerfer v. Buckley*, 143 S. Ct. 665 (2023).
4 *Id.* at 670-71. Section 523(a)(2)(A) declares debts nondischargeable if due to false pretense, false representation or fraud:

> (a) A discharge under section 727, 1141, 11921 1228(a), 1228(b), or 1328(b) ... does not discharge an individual debtor from any debt —
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

5 *Bartenwerfer* at 671.
6 *Id.* at 670.
7 *Id.*
8 *Id.* at 670 and 672.
9 *Id.* at 671-72.
10 *Id.* at 672.
11 *Id.* at 674-75.
12 *Id.* at 676.

a marital relationship where an innocent spouse loses a discharge because of the wrongdoing of the other spouse."[13]

How far will the *Bartenwerfer* holding extend? With the Supreme Court's decision, it appears as though creditors have another route to reach seemingly honest obligors in a joint obligation if they do not recoup their debt from the wrongdoer. Whether these concerns are valid or not, the more pressing issue is this: How will courts apply the *Bartenwerfer* decision?

Recent Case Law Analyzing *Bartenwerfer*

Two bankruptcy courts recently analyzed *Bartenwerfer*. The first, *In re Rassbach*, applied *Bartenwerfer* in reaching its decision on a motion to dismiss.[14] The wife and husband jointly owned and operated a concrete business. The creditor hired the couple's concrete business to complete a project at his home. The husband provided a price estimate for the project and completed the project himself without the wife. The creditor was unsatisfied with the finished product and initiated suit against the husband and the concrete business in state court.

The state court ruled in the creditor's favor, awarding him $22,775.05 in damages and attorneys' fees. The state court also found liability as to the husband and the concrete business only, but not the wife. As a result of the judgment, the couple filed for chapter 7. In response, the creditor filed an adversary complaint against the couple seeking to declare the judgment nondischargeable under § 523(a)(2)(A). The couple moved to dismiss the adversary for failure to state a claim under Rule 12(b)(6) and argued for the wife to be dismissed from the proceeding.[15]

The bankruptcy court denied the couple's motion to dismiss and their request to remove the wife from the adversary. In ruling on the motion to dismiss, the court found that the creditor sufficiently pled enough allegations under § 523(a)(2)(A) to state a plausible claim for relief. The court further denied the couple's request to remove the wife from the adversary, finding that it could later be determined that the wife was personally liable for the debt under § 523(a)(2)(A).

Following the guides of *Bartenwerfer*, the bankruptcy court noted the similarities between the couples in *Rassbach* and *Bartenwerfer*: Both were husband and wife who co-owned a business, with the husband seemingly running the operation and the wife not being involved. The bankruptcy court stated that it is plausible after *Bartenwerfer* that the wife could be liable for the husband's wrongdoing as a co-owner to the concrete business, and thus denied the request for her removal.[16]

In *Matter of Colquitt*, the bankruptcy court found that the debtor's liability to the bank was not due to the friend's vicarious liability but to the debtor's own direct liability.[17] The debtor's friend owned a concrete business and asked the debt-

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13 David R. Kuney, "Supreme Court's Vicarious Liability Approach to Discharge Needs Congressional Reform," XLII *ABI Journal* 4, 22-23, 74-76, April 2023, *available at* abi.org/abi-journal (quoting Prof. Steven H. Resnicoff, "Is It Morally Wrong to Depend on the Honesty of Your Partner or Spouse: Bankruptcy Dischargeability of Vicarious Debt," 42 *Case W. Rsrv. L. Rev.* 147 (1992)).

14 *Clinton v. Rassbach (In re Rassbach)*, 2023 WL 2482726, at *7 (Bankr. W.D. Wis. March 13, 2023).

15 *Id.* at *1-*2.

16 *Id.* at *7-*8. The bankruptcy court also noted that if the judgment debt is later found to be dischargeable as to the wife, she could still be responsible under Wisconsin law, which is a community property state, thus any of the couple's community property would be used to cover the debt.

17 *Matter of Colquitt*, 2023 WL 2361103, at *8 (Bankr. M.D. Ga. March 2, 2023).

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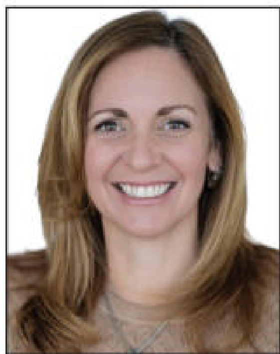
By Kate Deringer Sallie and Abby Kaspszyk Hrbek

How to Hold Your Liquor (License)

Perfecting and Enforcing Liquor License Liens



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A liquor license can be an extremely valuable asset of a business. In states that allow for liens to be attached to a liquor license, creditors lending to entities or individuals that control liquor licenses should take steps to attain a security interest in the license in the event the debtor fails to make payments on the loan or otherwise defaults. A liquor license is a legal authorization to serve alcohol and is therefore not easily defined collateral. Accordingly, perfecting and executing a lien on a liquor license is often a complicated and difficult exercise.

When creditors seek to secure an obligation with a liquor license as collateral, the threshold inquiry is whether the state in which the license was issued allows for a lien to attach to such liquor license. Liquor license laws vary greatly among the states, largely depending on whether the state characterizes the license as property or privilege. For example, a liquor license may be granted as collateral in Pennsylvania, as it characterizes liquor licenses as *property* between a licensee and a third-party creditor and as a *privilege* between a licensee and the liquor control board.[1] Accordingly, lenders may attach a lien on the liquor license because it is considered property in that state.[2] On the other hand, New Jersey prohibits liens on liquor licenses, specifically stating that a liquor license shall not be deemed property.[3]

Most states are divided into two liquor license constructs: quota and non-quota. In a non-quota state, liquor licenses hold little to no value because there are no limits on the number of licenses issued; therefore, licenses are plentiful and easily attainable by businesses.[4] In these states, creditors would have little to gain by placing liens on liquor licenses. Moreover, as in New Jersey, creditors are sometimes prohibited from granting a security interest or allowing the attachment of a lien on a license altogether.[5]

Quota states place population-based caps on the number of liquor licenses available in each county or municipality, which forces businesses to look for a license on the secondary market, thereby driving up the value. Liquor licenses in quota states are regularly interpreted as property and could have substantial value in areas with maxed-out quotas. States permitting liens on a liquor license include Florida, Massachusetts, Michigan, Montana, New Mexico, Pennsylvania and South Dakota.[6]

Properly Perfecting a Liquor License

In order for creditors to have a legal right to take possession of a liquor license in the event of a default, they must comply with the governing state's version of Article 9 of the Uniform Commercial Code (UCC) covering secured transactions.[7] Attaining a lien on a liquor license under the UCC in states that recognize liquor licenses as property is accomplished by properly attaching and perfecting a security interest in the liquor license.[8]

To attach a security interest in the liquor license: (1) the value must be given for the security interest by the secured creditor; (2) the debtor must have rights in the collateral (in this instance, the liquor license) or the power to transfer rights in the collateral; and (3) the debtor must grant a security interest in the collateral to the debtor.[9] The grant of a security interest is typically contained in a security agreement or other written document, and most lenders/lessors rely on an executed security agreement to ensure proper attachment.[10]

Once a security interest is attached through a security agreement, creditors must perfect the security interest. A secured party perfects a security interest to have priority over other parties in the event that the borrower defaults or becomes insolvent.[11] Pursuant to UCC § 9-301, while collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.[12]

States recognizing liquor licenses as property provide for different perfection methods. Several

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1 *See* 47 Pa. Stat. Ann. § 4-468(d); *see also In re B & M Hosp. LLC*, 584 B.R. 88, 92 (Bankr. E.D. Pa. 2018) (holding that between debtor/licensee and third party, liquor license constituted property under Pennsylvania law, in which security interest could be granted).

2 *Id.*

3 N.J. Stat. Ann. § 33:1-26 ("Under no circumstances, however, shall a license, or rights thereunder, be deemed property, subject to inheritance, sale, pledge, lien, levy, attachment, execution, seizure for debts, or any other transfer or disposition whatsoever, except for payment of taxes, fees, interest and penalties imposed by any State tax law.").

4 *See, e.g.*, City of Baltimore Liquor License Bd., "Application Process," *available at* llb.baltimorecity.gov/application-process (unless otherwise specified, all links in this article were last visited on April 25, 2023).

5 *See* N.J. Stat. Ann. § 33:1-26; IC § 7.1-3-1-2, *interpreted by Matter of Eagles Nest Inc.*, 57 B.R. 337, 341 (Bankr. N.D. Ind. 1986); Cal. Bus. & Prof. Code § 24076.

6 *See* 34 Fla. Stat. Ann. §§ 561.32-561.35; 20 Mass. Gen. Law ch. 138, § 23; *Brown v. Yousif*, 445 Mich. 222, 232 (1994); Mont. Code Ann. § 16-4-404(8); N.M. Stat. Ann. § 60-6A-19; 47 Pa. Stat. Ann. § 4-468; S.D.C.L. § 35-10-18.

7 U.C.C. § 9-201.

8 U.C.C. §§ 9-203, 9-308.

9 U.C.C. § 9-203(b).

10 U.C.C. § 9-102(74) ("Security agreement" means agreement that creates or provides for security interest).

11 U.C.C. § 9-308.

12 U.C.C. § 9-301.

quota states will accept general UCC-1 financing statements to perfect a security interest in a liquor license,[13] while other states require specific forms to be filed in order to properly perfect the lien.[14] The UCC determines the priority of a creditor's claim to the collateral, and for secured lenders, the UCC priority rules are set forth in § 9-322.[15] Priority with respect to a liquor license lien is typically based on the time of filing but, as previously stated, the jurisdiction whose law covers whether perfection has occurred also governs priority.[16]

The UCC requires the description of the property in the security agreement and UCC-1 financing statement to "[r]easonably identify" the collateral subject to the lien.[17] For most collateral, examples of reasonable identification are a description that identifies the collateral by specific listing, category, collateral type, quantity, formula or any other method if the collateral's identity is objectively determinable.[18] The official comment to UCC § 9-108 provides that while an "all assets" or "all personal property" description for purposes of a security agreement is not sufficient, under § 9-504, a UCC-1 financing statement sufficiently indicates the collateral if it "covers all assets or all personal property."[19]

With respect to liquor licenses, courts have looked to security agreements for identification purposes when the UCC-1 financing statement failed to properly identify the liquor license. However, many courts have held that a specific reference to the liquor license identification number is required to be included on the UCC-1 financing statement in order to properly perfect a security interest in the liquor license.[20]

Despite the UCC's relatively relaxed description requirements for financing statements, the best practice for secured lenders seeking to perfect a security interest in a liquor license is to specifically describe such license in both the security agreement and the UCC-1 financing statement. This practice provides lenders with additional security in the event that there are issues with either document and removes any doubt with respect to the priority of one creditor over another based on a more specific description of the liquor license in the security agreement and/or UCC-1 financing statement. If the liquor license number is unknown at closing, creditors should require the debtor to execute an amendment to the security agreement once the borrower receives such information.

It is also important that creditors confirm the liquor license lien procedures with local counsel due to the variation

13 *See* 47 P.S. § 4-468(b); "Information Regarding Third-Party Claims Upon a Liquor License," Pa. Liquor Control Bd. (April 27, 2017), *available at* lcb.pa.gov/Legal/Documents/Information%20Regarding%20Third%20Party%20Claims%20Upon%20A%20Liquor%20License.pdf (hereinafter referred to as the "PLCB Guidance on Third-Party Claims").

14 *See* Fla. Stat. Ann. § 561.32.

15 *Id.*

16 *See* U.C.C. § 9-301.

17 *See* U.C.C. § 9-108(a) ("[A] description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described."); U.C.C. § 9-203(b)(3)(a).

18 U.C.C. § 9-108(b).

19 U.C.C. § 9-108, cmt. 2.

20 *See, e.g., In re B & M Hosp. LLC*, 584 B.R. 88, 96 (Bankr. E.D. Pa. 2018) (citing 13 Pa. C.S.A. § 9-101 cmt. 4(h); 13 Pa. C.S.A. § 9-108, cmt. 2); *see also In re Ciprian Ltd.*, 473 B.R. 669, 675 (Bankr. W.D. Pa. 2012) (generic description such as "general intangibles" was broad enough to give creditor security interest in debtor's liquor license); *In re TSAWD Holdings Inc.*, 565 B.R. 292, 303 (Bankr. D. Del. 2017) (description "all assets of debtor" in security agreement was sufficient to identify disputed goods in question).

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By Michael J. Riela

Comprehensive Data-Privacy Laws May Affect a Distressed-Asset Sale

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Michael Riela is an in-house attorney with Genworth Financial in Stamford, Conn., where he advises clients with respect to the firm's investments in several asset classes, particularly private-placement transactions and alternative investments. He was previously a business bankruptcy and restructuring attorney in private practice.

Potential acquirers of assets of a financially distressed seller, whether or not that seller is in bankruptcy, need to conduct their legal due diligence. One aspect of that diligence process is understanding whether the seller is complying with all applicable federal, state and non-U.S. data-privacy laws. This is particularly important for out-of-court sale transactions, which do not have the benefit of a "free and clear" § 363 sale order, as the acquirer may ultimately be required to spend significant money defending claims that the seller had violated applicable data-privacy laws before the sale. Understanding the seller's compliance with applicable data-privacy laws is important, even if the seller disposes of its assets in a bankruptcy proceeding. There is always a risk that a potential claimant contends that it did not receive notice of the sale and challenges the sale order's protections.

The asset acquirer's need to conduct this due diligence is not limited to situations where the seller is a technology company. Any business that "processes" (*e.g.*, collects, stores, uses or transfers) personally identifiable information (PII) about its customers, employees and other individuals is subject to data-privacy laws. In many cases, an acquirer desires to purchase the seller's "customer list," which could contain PII, such as each customer's name, mailing address, email address, Social Security number, driver's license or other government identification number, medical information and financial account information.

Except for certain industries such as health care, financial services, telecommunications and education, there is no comprehensive U.S. federal privacy law. Further, an organization is not just subject only to the data-privacy laws of the state of its formation. Thus, a Delaware corporation is not subject to only Delaware's privacy laws exclusively.

Which Data-Privacy Laws Apply to the Seller?

A business that processes the PII of individuals in multiple states is most likely subject to the data-privacy, breach-notification and data-security laws of all states in which those individuals reside. For example, an organization that has customers and employees in 20 states is likely subject to the laws of each of those 20 states.

In addition, a small — but growing — number of states have recently adopted comprehensive and prescriptive data-privacy laws that provide strict limitations on how an organization may process the PII of residents of their states. Specifically, California, Colorado, Connecticut, Indiana, Iowa, Tennessee, Utah and Virginia have each adopted such comprehensive data-privacy laws. Of these, the laws in California, Colorado, Connecticut, Utah and Virginia are currently in effect, or will take effect by the end of 2023. The remaining laws will take effect after 2023. In conducting legal due diligence, potential acquirers first need to understand whether the seller is subject to any of the foregoing states' comprehensive data laws. These comprehensive data-privacy laws generally apply only to organizations that process the PII of a minimum number of residents of those states or that have annual revenues over a minimum threshold.

For example, the California Privacy Rights Act applies to businesses that conduct business in California and that either (1) have annual gross revenues of more than $25 million, (2) process the PII of at least 100,000 California residents or households, or (3) derive at least 50 percent of annual revenues from selling or sharing the PII of California residents.[1] The Colorado Privacy Act applies to persons who conduct business in Colorado, or produce or deliver commercial products or services that are intentionally targeted to Colorado residents, and that either control or process the personal data of 100,000 or more Colorado residents during a calendar year, or derive revenue or receive a discount on the price of goods or services from the sale of personal data and process or control the personal data of 25,000 or more Colorado residents.[2] The Virginia Consumer Data Protection Act applies to persons who conduct business in Virginia or produce products or services that are targeted to Virginia residents and that either control or process the personal data of at least 100,000 Virginia residents during a calendar year, or control or process the personal data of at least 25,000 Virginia residents and derive at least 50 percent of their gross revenue from the sale of the personal data of Virginia residents.[3]

1 *See* Cal. Civ. Code § 1798.140(d).
2 *See* Colorado Revised Statutes, C.R.S. § 6-1-1304.
3 *See* Va. Code Ann. § 59.1-576.

What Obligations Do the Comprehensive Data-Privacy Laws Impose on Businesses?

If a seller is subject to one or more comprehensive data-privacy laws, potential acquirers need to understand what rights those laws grant to consumers (which, in turn, impose obligations on the seller). Although none of the states' comprehensive data-privacy laws are identical to each other, they share many commonalities. Here is a description of some of the rights that these laws commonly grant to consumers.

Right to Access

The "right to access" refers to a consumer's right to obtain the information or categories of information that the business has collected about that consumer, the information or categories of information shared with third parties, or the specific third parties or categories of third parties to which the information was shared. This right (in some form) exists under all of the currently enacted comprehensive data-privacy laws.

Right to Request Corrections

The "right to request corrections" refers to a consumer's right to request that a business correct any incorrect or outdated PII that the business currently has regarding that consumer. This right exists under all currently enacted comprehensive data-privacy laws except for Iowa.

Right to Request Deletion

The "right to request deletion" refers to a consumer's right to request that a business delete the PII that the business has regarding that consumer, under certain conditions. This right (in some form) exists under all of the currently enacted comprehensive data-privacy laws.

Right to Opt Out of Certain Processing

The "right to opt out of certain processing" refers to a consumer's right to either restrict a business's ability to process certain types of sensitive PII about the consumer or restrict a business from processing that consumer's PII for certain purposes (such as targeted advertising). This right exists under all of the currently enacted comprehensive data-privacy laws except for Iowa.

Right to Portability

The "right to portability" exists under all of the currently enacted comprehensive data-privacy laws and refers to a consumer's right to request that personal information about the consumer be disclosed in a common file format.

Right to Opt Out of a Business "Selling" a Consumer's PII

Under all of the currently enacted comprehensive data-privacy laws, a consumer has a right to opt out of the sale of personal information about the consumer to third parties.

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By Anne M. Eberhardt

The Continuing Conservatorships of Fannie Mae and Freddie Mac

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Once again, there are tremors in the world of financial institutions, and somehow, Fannie Mae, Freddie Mac and home mortgages are involved. Fifteen years ago, housing finance was at the center of a global financial crisis and an enormous rescue effort by the Treasury Department. Today, headlines cry out everywhere for answers: Are we facing another housing crisis? Is this 2008 all over again? Or worse, is it 1929?

In September 2008, the two government-sponsored enterprises (GSEs) at the center of the nation's housing finance system — the Federal National Mortgage Association and Federal Home Loan Mortgage Corp., commonly known as Fannie Mae and Freddie Mac — were placed into conservatorship, and the Treasury Department entered into senior preferred stock agreements (PSPAs) with them. Credit markets had seized up, bringing down venerable financial institutions and investment banking firms. The Treasury made a commitment to provide financial support to the GSEs during the biggest financial crisis in nearly 80 years.

Almost 15 years later, the GSEs' conservatorships have survived and become profitable. Accordingly, it is worth revisiting their story, along with the lessons that 2008's intervention may hold. The story of systemic housing finance begins during the Great Depression, and the evolution of the GSEs into the titans they have become mirrors the story of the nation's efforts to grapple with issues that grew out of periods of great economic turmoil.

The Creation of the GSEs

Fannie Mae was one of the entities created when the federal government attempted to stimulate the economy through home construction in response to the Great Depression. Chartered in 1938 as a government corporation, Fannie Mae's purpose was to operate a secondary market for the purchase of loans guaranteed by the Federal Housing Administration. Fannie Mae's mission expanded following World War II when the Department of Veterans Affairs was created, and Fannie Mae was given the authority to purchase mortgage loans guaranteed by the Department of Veterans Affairs.[1]

In the late 1960s, the Department of Housing and Urban Development was created, and the Government National Mortgage Association (Ginnie Mae) was spun off from Fannie Mae. Ginnie Mae's purpose was to assume administration of the portfolio of mortgage loans expressly insured by the federal government, while Fannie Mae continued to operate in the secondary markets. By 1970, Fannie Mae had transitioned to a shareholder-owned corporation with a government charter authorizing it to acquire mortgages that were not insured by the federal government. Freddie Mac was created to provide competition to Fannie Mae.

At first, the business models of the GSEs were different. Both acquired mortgages from lenders, but Fannie Mae retained the mortgages on its books, while Freddie Mac securitized most of its mortgages into pass-through participation certificates. Fannie Mae began securitizing its mortgage acquisitions in the high-interest-rate environment of the early 1980s after it was nearly pushed into insolvency because of the interest-rate risk it retained through its mortgage holdings.

Following the savings-and-loan and Latin American debt crises, regulators began to address capital adequacy at financial institutions. The GSEs' relatively limited capital requirements, well below those required of thrifts and other banks, created a competitive advantage for holding mortgage-related risk. The *perception* that the GSEs' mortgage-backed securities and debt securities were guaranteed by the federal government allowed the GSEs to operate with higher leverage than non-government-insured mortgage lenders, creating incentives for financial institutions to sell mortgage loan originations to the GSEs.

The portfolio of mortgages that the GSEs retained grew markedly in the 1990s, increasing from about $135 billion in 1990 to more than $1.5 trillion in 2003. Again, the *perception* of a government guarantee permitted the GSEs to use their advantageous borrowing rate to fund investments in mortgage portfolios retained on their books. During this time, the GSEs' unsecured debt grew to $1.7 trillion, while the federal debt held by the public was $4 trillion.

Conservatorship and the PSPAs

In mid-2006, when President George W. Bush nominated Henry Paulson to be Treasury Secretary,

1 This section is drawn from the Housing Reform Plan issued by the U.S. Department of the Treasury in September 2019, pp. 4-7, and 31-32, *available at* home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf (unless otherwise specified, all links in this article were last visited on May 22, 2023).

Fannie Mae was in the middle of a multi-year accounting restatement. (Freddie Mac's own restatement was completed three years earlier.) High on Paulson's list of objectives was GSE reform, but he soon learned the nature of the resistance he would encounter. In his account of his time at the Treasury Department, Paulson described his initial briefing on the GSEs:

> But change was hard to come by. The GSEs wielded incredible power on the Hill thanks in no small part to their long history of employing — and enriching — Washington insiders as they cycled in and out of government. After accounting scandals had forced both GSEs to restate years of earnings, their CEOs were booted, and House and Senate efforts at reform broke down in a dispute over how to manage the size and composition of the GSEs' portfolios. These had been expanding rapidly and moving into dicier assets — exposing Fannie and Freddie to greater risk.
>
> Answering one of my many questions, [David] Nason pointed out a simple fact: "Two-thirds of their revenue comes from their portfolios, and one-third comes from the securitization business."
>
> I didn't need to hear much more than that. "That's why this is next to impossible to get done," I said. Their boards had a fiduciary duty to resist giving up two-thirds of their profit, and they would.[2]

Paulson saw that the way to GSE reform was to build congressional support for establishing a new regulatory entity: the Federal Housing Finance Agency (FHFA), which would hold powers similar to those of banking regulators. The White House was in favor of congressional rather than regulatory action, but once the Republicans lost both chambers in the November 2006 elections, Paulson worked to build support for the FHFA's establishment.

However, the legislation authorizing its creation, the Housing and Economic Recovery Act, would not pass until July 2008, in the middle of the world's most devastating financial crisis in decades. While in Beijing for the 2008 Summer Olympic Games, Paulson learned that "Russian officials had made a top-level approach to the Chinese suggesting that together they might sell big chunks of their GSE holdings to force the U.S. to use its emergency authorities to prop up those companies. The Chinese had declined to go along with the disruptive scheme, but the report was deeply troubling — heavy selling could create a sudden loss of confidence in the GSEs and shake the capital markets."[3]

In early September, the FHFA placed the GSEs into conservatorship and Paulson exercised the authority provided under the Housing and Economic Recovery Act to initiate the PSPAs. The Treasury committed to providing each GSE with equity infusions following any quarter in which reported total liabilities exceeded total assets in accordance with Generally Accepted Accounting Principles (GAAP), up to a limit of $100 billion each.

2 Henry M. Paulson, Jr., *On the Brink: Inside the Race to Stop the Collapse of the Global Financial System* (2013), p. 57. Nason was assistant secretary for Financial Institutions from 2005-09.

3 *Id.* at p. 161.

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By Richard J. Cooper, Luke A. Barefoot and Jack Massey

Chapter 11 Restructurings of Latin American Energy Companies

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The effects of recent macroeconomic and environmental conditions (*e.g.*, higher interest rates, spiking commodity prices and El Nino effects, among others), as well as changing legislative and industry conditions (*e.g.*, the move to decarbonization and the shortage of transmission assets), have created challenging conditions across many global energy markets, but none more so than in Latin America, particularly in Chile. Stakeholders in businesses stressed by these conditions often ask whether chapter 11 can be used as a tool to effectuate a balance-sheet restructuring — leaving the operations of their business intact while right-sizing their financial obligations.

While chapter 11 can be a highly efficient means of accomplishing a restructuring for energy companies located outside of the U.S., it also presents a unique set of challenges relating to the treatment of certain contracts, which, for energy companies in particular, may take the form of one or more commodity supply agreements or forward contracts (such as power-purchase agreements) that can be among a debtor's most significant assets.

One challenge for foreign debtors relates to the Bankruptcy Code's safe harbors, which may protect contracts on the basis of characteristics of the counterparty, or its other business dealings, that are likely to be unknown (or unknowable) to the debtor — creating uncertainty in the process of developing a plan structure, or significant litigation risk, delay and/or discovery expense. Another challenge is presented by key contracts with counterparties that may claim not to be subject to the jurisdiction of U.S. courts, and may lack material assets in the U.S., such that U.S. court orders may be difficult to enforce against them.

Recent experience shows that one option to address these issues is to deploy the "ride-through doctrine," which permits contracts to "ride through" unaffected by a chapter 11 plan (*i.e.*, neither assumed nor rejected), allowing a balance-sheet restructuring to take place without litigation in the U.S. over any individual contract. However, the ride-through option requires careful consideration of subsequent litigation risks in foreign tribunals.

Commodity Supply Agreements, Forward Contracts and Other Potentially Safe-Harbored Contracts

Energy firms are likely to have significant contracts in the form of commodity supply agreements or forward contracts, such as power-purchase agreements, whether as suppliers, providers or intermediaries. Depending on the contract's terms, prevailing market conditions and the role played by the debtor, a contract may represent a significant asset (*e.g.*, a contract to sell power to a particular purchaser at higher than market rates) or a significant liability (*e.g.*, a contract to purchase power from a particular supplier at higher than market rates). With some important exceptions, § 365 of the Bankruptcy Code provides a valuable tool in either scenario, permitting a debtor to assume or reject these sorts of executory contracts. In the case of a contract that is a liability, § 365 permits the debtor to reject it (with the counterparty obtaining a contractual-damages claim that is pre-petition and subject to compromise), even where the contract could not ordinarily have been terminated unilaterally. In the case of a contract that is an asset, § 365 permits a debtor to assume it, even where the contract includes an *ipso facto* clause that would otherwise permit the counterparty to terminate or accelerate the contract upon the debtor's filing of a bankruptcy petition or the existence of other indicia of insolvency.

The § 556 Safe Harbor

The Bankruptcy Code includes a swath of provisions that vest rights and powers in the debtor (most notably the automatic stay and the qualified right to assume, reject and assign executory contracts and unexpired leases), and render unenforceable certain types of contractual provisions (such as anti-assignment clauses and *ipso facto* clauses that permit a party to terminate a contract based on a debtor's insolvency or the filing of a bankruptcy case). These provisions are designed to give the debtor breathing room to reorganize and prevent individual creditors from exercising contractual rights at the expense of the debtor's reorganization efforts. However, these goals of the Code can directly conflict with the proper functioning of the securities and commodities markets, in which participants must be able to close existing positions and enter into new ones, and where the inability of a single participant to do so can have destructive ripple effects on entire segments of financial markets. The Code's safe harbors are designed to prevent this ripple effect.

The safe harbor under § 556 of the Bankruptcy Code is of particular relevance to foreign ener-

gy companies considering a balance-sheet restructuring under chapter 11. This safe harbor applies only where the contract itself, and the contract counterparty, meet certain criteria. In order to qualify for the safe harbor, the contract in question must be either a commodities contract (which is defined broadly in § 761(4) of the Bankruptcy Code) or a forward contract (where the reason for termination relates to the financial condition of the debtor or the chapter 11 filing itself).

The § 556 safe harbor also applies only where the counterparty is a "commodity broker, financial participant, or forward contract merchant" (all of which have specific definitions under the Code). A debtor is likely to be able to assess whether a contract counterparty is a commodity broker (defined as a "futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer ... with respect to which there is a customer")[1] or a forward contract merchant (defined as a company, "the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity").[2] In the context of a commodity contract with a debtor in the energy industry, commodity brokers and forward-contract merchants stand in contrast to *end users* of a commodity (*e.g.*, an industrial plant that consumes electricity that is delivered pursuant to a power-purchase agreement), even if the power-purchase agreement in question is otherwise fairly characterized as a forward contract.

A debtor is much *less* likely to know whether a given counterparty may qualify as a "financial participant," the final category of counterparty that is protected under the § 556 safe harbor. This definition calls for a much more detailed and fact-intensive inquiry, involving information that — critically — a debtor might not necessarily know about a given contract counterparty, and that might not be publicly available. The Code's definition of "financial participant" includes any firm that has one or more outstanding financial contracts[3] with the debtor or any other entity of a total aggregate gross value of at least $1 billion in notional or actual principal amount outstanding, or has gross mark-to-market positions of not less than $100 million in such contracts.[4]

This holistic consideration of the contract counterparty's total exposure, including through contracts with third parties, is consistent with the Code's goal of preventing a chapter 11 restructuring from creating destructive ripple effects through the financial markets. However, it creates significant uncertainty for debtors, who may not know (without the benefit of discovery) whether a valuable contract may be assumed, or whether the counterparty may rely on this safe harbor to exercise contractual termination rights immediately following a chapter 11 filing. This uncertainty creates the risk that a debtor will enter chapter 11 with the intention of effectuating a reorganization plan that depends on the assumption of a key contract, only to learn belatedly that the counterparty will take the position that the debtor cannot do so because the counterparty is able to terminate the contract.

Contracts with Foreign Firms Not Subject to U.S. Jurisdiction

The aforementioned uncertainties can be compounded in the case of foreign debtors, because the contractual counterparties to these and other contracts might have few or no contacts with the U.S., and therefore might not be — or might claim not to be — subject to the jurisdiction of U.S. courts. It is black-letter law that a presiding bankruptcy court possesses exclusive *in rem* jurisdiction over all property of the estate.[5] Bankruptcy courts have consistently held that this jurisdiction forms the basis for courts' decisions affecting most (if not all) elements of a debtor's estate, including executory contracts to which the debtor is a party.[6] However, at least one court has held that in order to make the determi-

1 11 U.S.C. § 101(6).
2 11 U.S.C. § 101(26).
3 The relevant types of contracts, for purposes of the definition of "financial participant," are securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements. 11 U.S.C. § 561(a)(1)-(6).
4 11 U.S.C. § 101(22A).

5 11 U.S.C. § 1334(e)(1).
6 *See In re Drexel Burnham Lambert Grp. Inc.*, 138 B.R. 687, 702 (Bankr. S.D.N.Y. 1992) ("Executory contracts are property of the estate.").

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By Michael C. Barber and Katherine S. Dute[1]

Cash Is Not King Anymore

Strategies for Protecting Tenant Assets in Landlord Bankruptcy

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Like many rights in bankruptcy, a commercial tenant's rights to recover assets held by a bankrupt landlord are primarily determined by the negotiated contractual rights under the lease and applicable state law. When representing commercial tenant-creditors, bankruptcy practitioners must adequately gauge avenues for maximizing recoveries. When negotiating commercial leases, real estate practitioners must likewise account for how the Bankruptcy Code's application may impact the character and treatment of commercial-tenant security deposits when a landlord becomes insolvent. This article explores, in the context of a landlord bankruptcy, (1) the characterization, treatment and priority of commercial security deposits; (2) the role that state statutes might play in making such determinations; and (3) strategies for mitigating risks to the recovery of such assets held by nonresidential landlords.

Unexpected Effects of Bankruptcy

An example of how a landlord's bankruptcy may unexpectedly prevent a commercial tenant from recovering its security deposit can be found in Hon. Valerie Caprioni's October 2022 opinion in *10FN Inc. v. Cerberus Business Finance, et. al.* in the U.S. District Court for the Southern District of New York.[2] What began as an adversary proceeding between two nondebtors resulted in the tenant having an unsecured claim for its more than $270,000 security deposit that was paid to the debtor for its sublease of office space in Chicago.

Following the debtor's rejection and after several failed attempts to recover the security deposit, the commercial tenant sought recovery from the debtor-landlord's secured lenders, who — after exercising their rights to sweep the debtor's accounts just prior to the bankruptcy filing — managed to subsume the tenant's security deposit among the swept funds. Upon withdrawing the reference from the bankruptcy court to hear the dispute among the nondebtors, Judge Caprioni found that the tenant-plaintiff failed to state a claim for conversion[3] against the secured lenders because under Illinois law,[4] commercial tenants have no express rights to cash security deposits held by their landlords for securing performance under the lease. This resulted in the tenant's $271,092.87 deposit being deemed an unsecured claim.

In contrast, some state statutes,[5] common law rules or express trust language in the underlying lease agreement may serve to preserve a tenant's ability to recover cash security deposits. In *In re Cold Harbor Associates*,[6] the court found that certain nondefaulting commercial tenants whose security deposits were held by the landlord-debtor were not considered creditors for purposes of determining the number of creditors as of the petition date.[7] In making its determination, the *Cold Harbor* court invoked a rarely cited common law rule set forth by the Virginia Supreme Court, which directs that "until he defaults on his lease terms, a commercial tenant continues to have a full ownership interest in his security deposit and does not merely hold a [contingent] right to repayment."[8]

Likewise, although not arising in the context of a landlord's bankruptcy, the courts in *23 E. 39th Street Management Corp.*,[9] *In re Verus Investment Management*[10] and *In re Timothy Dean Restaurant*[11] serve as examples of the influence that express lease provisions and state statutes will play in determining tenants' rights to recover security deposits. In contrast to *10FN*, the case of *23 E. 39th Street Management Co.* makes clear that because New York has statutorily[12] determined the

1 Disclaimer: The authors do not regularly negotiate or draft commercial lease provisions and therefore present the following merely for informational purposes only. Practitioners should consult applicable law before advising clients on any matters related to the negotiation or drafting of commercial leases.

2 Opinion and Order, *10FN Inc. v. Cerberus Bus. Fin., et. al.*, Case No. 21-5996, 2022 WL 11274633 (S.D.N.Y. 2022) [ECF No. 78].

3 The plaintiff also asserted claims for unjust enrichment against the lenders and negligence against certain executives of the defendants, which were also dismissed for failure to state a claim. *10FN Inc. v. Cerberus Bus. Fin. LLC*, Case No. 21-5996, 2022 WL 11274633, at *6-7 (S.D.N.Y. 2022).

4 Although choice-of-law rules mandated application of New York law to the underlying claims, the terms of the plaintiff's sublease required treatment of the security deposit to be interpreted under Illinois law. *10FN Inc. v. Cerberus Bus. Fin. LLC*, Case No. 21-5996, 2022 WL 11274633, n.10 at *4, *6-7 (S.D.N.Y. 2022).

5 Most states do not regulate security deposits in commercial leases and (as was the case in *10FN*) do not require commercial landlords to segregate security deposits or hold them in trust for the benefit of the tenant. *See generally* Security Deposit Laws (Commercial Lease): State Comparison Chart, Practical Law Checklist w-024-5140. However, a small number of states have enacted statutes or regulations that may govern commercial security deposits to some extent. For example, New York has enacted nonwaivable conditions for how all landlords of rental or real property must hold security deposits, which retain certain possessory rights in the deposits for tenants, in addition to providing the general parameters for the retention or return of deposits. *See* N.Y. Gen. Oblig. Law § 7-103 (McKinney). In comparison, California has enacted similar laws that govern the treatment of cash security deposits, but it has separated residential tenancies from commercial ones, and provides great leeway for commercial parties to waive the statutory requirements. *See* Cal. Civ. C. § 1950.7; *see generally In re Art & Architecture Books of the 21st Century*, 518 B.R. 43 (Bankr. C.D. Cal. 2014) (debtor-tenant waived rights to seek relief from forfeiture and right to redeem its right of occupancy after termination).

6 *In re Cold Harbor Assocs. LP*, 204 B.R. 904 (Bankr. E.D. Va. 1997).

7 *Id.* at 913.

8 *Id.*

9 *23 E. 39th St. Mgmt. Corp. v. 23 E. 39th St. Dev. LLC*, No. 117303/08, 2011 N.Y. Slip Op. 51390(U), 936 N.Y.S.2d 61 (Sup. Ct. 2011); *aff'd*, 23 N.Y.S.3d 33 (N.Y. App. Div. 2015).

10 *In re Verus Inv. Mgmt. LLC*, 344 B.R. 536 (Bankr. N.D. Ohio 2006).

11 *In re Timothy Dean Rest. & Bar*, 342 B.R. 1 (Bankr. D.D.C. 2006).

12 N.Y. Gen. Oblig. Law § 7-103 (McKinney).

legal relationship between a landlord and tenant to be "trustee-*cestui que* trust," commercial tenants in New York may sustain an action for conversion where a landlord fails to segregate a security deposit from other funds.[13]

Both courts in *In re Verus Investment Management*[14] and *In re Timothy Dean Restaurant*[15] found that perfected security interests had been properly created via certain provisions of their respective lease agreements. In *Verus*, the bankruptcy court found that a landlord's security interest in a $1.8 million (uncertificated) certificate of deposit, which was used as the tenant's security deposit, had been properly created by operation of Ohio's version of the Uniform Commercial Code and certain lease language. In addition, its interest remained perfected through a subsequent assignment without any additional filing by the assignee.[16] In *Timothy Dean Restaurant*, the language in a debtor's restaurant lease with its hotel-landlord, which required the landlord to hold the security deposit in an interest-bearing account and return the deposit (plus interest) to the debtor once it had fully performed its obligations under the lease, created an "express trust" under applicable District of Columbia law that also barred setoff by the landlord.[17] These decisions perfectly illustrate the varying outcomes for commercial tenants seeking to protect their interests in security deposits, and the critical importance of understanding the extent to which state law and lease language impact the chances of recovery against a bankrupt landlord.[18]

Considerations for Drafting Commercial Leases

Notwithstanding the limited statutory protections for tenants, there are several appealing equivalents and alternatives to cash security deposits to keep in mind while negotiating and drafting commercial leases. Examples of cash equivalents include pledged certificates of deposit or letters of credit. In addition, cash equivalents may involve a guaranty, some other form of collateral or any combination thereof.

Letters of credit may mitigate the risks of losing a security deposit because they rest on the stability of the issuer rather than the tenant's access to acceptable collateral, and arguably lessen the potential for misappropriation by insolvent landlords. Negotiated provisions in a standby letter of credit may include — but are not limited to — evergreen provisions for automatic renewal; obligations to provide notice of, or conditions on how or when, the landlord may draw upon the letter; and mechanisms for replenishment, burndown or substitution over time. While the provisions can be more challenging to negotiate, partially because of the additional party involved, one of the largest benefits to

13 *23 E. 39th St. Mgmt., slip op.* at *5.
14 *In re Verus Inv. Mgmt. LLC*, 344 B.R. 536 (Bankr. N.D. Ohio 2006).
15 *In re Timothy Dean Rest. & Bar*, 342 B.R. 1 (Bankr. D.D.C. 2006).
16 *In re Verus Inv. Mgmt. LLC*, 344 B.R. at 546.
17 *In re Timothy Dean Rest. & Bar*, 342 B.R. at 10.

18 *But see, e.g., In re Art & Architecture Books of the 21st Century*, 518 B.R. 43 (Bankr. C.D. Cal. 2014) (under lease, debtor-tenant waived rights to relief from forfeiture and right to redeem its right of occupancy after termination).

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By Jerome R. Kerkman[1]

Unique Issues in University Cases

Bloomberg reported that the largest Catholic-affiliated university in the U.S., DePaul University in Chicago, is facing a $56 million budget gap, and that higher-education institutions across the nation, particularly small private schools, are facing similar financial strains.[2] At least 35 public or nonprofit colleges have closed, merged or announced closures or mergers since March 2020, and more are expected.[3] This article provides a primer on the unique issues with insolvent educational institutions.

Educational Institution Assets

An early step in formulating advice for insolvency professionals involves reviewing financial information. The financial information of nonprofit entities differs from for-profit businesses. Balance sheets report "net assets" instead of equity and categorize assets as either "without donor restrictions" or "with donor restrictions."[4] This difference is crucial to understanding the level of financial distress.

The management of institutional funds is governed by the Uniform Prudent Management of Institutional Funds Act (UPMIFA), a uniform law adopted by 49 states and the District of Columbia. Assets without donor restrictions pose no unusual problems and can be used without implicating special rules. However, assets *with* donor restrictions must be addressed differently.[5] When a gift has been made, the donor can impose restrictions. For example, a donor's gift instrument can state that the gift shall be held in perpetuity with the earnings only used for scholarships to students meeting certain criteria, such as intending to teach in an economically depressed area. A gift to an endowment does not necessarily mean that a gift has donor restrictions. It is only when the *use* of the funds is specified in a written gift instrument that the gift is considered "donor-restricted."[6]

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An institution essentially holds the gifts with donor restrictions in trust and can only spend the gift if the restrictions have been met. As such, the fact that courts have held that donor-restricted gifts are not included in the bankruptcy estate and are not reachable by general creditors seems to be sitting lower than normal.[7] The financial statements may show significant investments and cash, but if those investments are donor-restricted gifts (referred to as "restricted funds"), they cannot be accessed for operating expenses. An institution with $10 million of liquid assets in investment accounts might not have any unrestricted funds and might not be able to meet its expenses.

Restricted funds also pose special problems for secured lenders. Logically, if gifts are donor-restricted and "held in trust" in investment accounts to accomplish donor-specified purposes, they would be unavailable to be pledged to a lender providing credit. An institution's borrowing against donor-restricted funds would use a donor-restricted gift for a purpose other than the restriction. If a lender is using an investment account that includes donor-restricted funds as collateral, the lender may wish to employ a reporting mechanism to ensure that the collateral consists of sufficient unrestricted funds.[8] There have been no reported cases invalidating a lender's lien on donor-restricted assets.

Similarly, an institution cannot "borrow" from its restricted funds, and there is little legal guidance on the question. The UPMIFA drafters never considered it,[9] "likely because an inter-fund transfer is not a 'loan' from a legal perspective. A loan is a contract in which one party agrees to pay the other."[10] Rather, an inter-fund transfer is treated as an appropriation that must be analyzed under the UPMIFA's prudence standard.[11]

Finally, the treatment of restricted funds affects avoidance actions in a bankruptcy proceeding. Since restricted funds are not included in property

1 The author is presently lead counsel for Cardinal Stritch University; it is closing after 86 years of operation.

2 Nic Querolo, "Largest Catholic University in U.S. Faces $56 Million Budget Gap," *Bloomberg* (April 14, 2023), *available at* bloomberg.com/news/articles/2023-04-14/depaul-university-faces-growing-budget-gap-as-enrollment-shrinks (unless otherwise specified, all links in this article were last visited on May 24, 2023).

3 Evan Castillo & Lyss Welding, "Closed Colleges: List, Statistics, and Major Closures," *Best Colleges* (May 4, 2023), *available at* bestcolleges.com/research/closed-colleges-list-statistics-major-closures; Josh Moody, "A Harbinger for 2023? Presentation College to Close," *Inside Higher Ed* (Jan. 18, 2023), *available at* insidehighered.com/news/2023/01/19/more-colleges-will-likely-face-closure-2023-experts-say.

4 *See* Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, ¶¶ 958-205-55-5, 958-205-55-13 & 958-205-55-13.

5 Assets can also be restricted by the board of trustees. Board-restricted assets are not problematic, because the board can always remove the restriction. *See* U.P.M.I.F.A. § 4(a) (Unif. L. Comm'n 2006).

6 A donor can also specify how a gift shall be invested. Since this is the exception to the rule, it is not being discussed.

7 *In re Bishop Coll.*, 151 B.R. 394 (Bankr. N.D. Tex. 1993); *see also In re Parkview Hosp.*, 211 B.R. 619, 630 (Bankr. N.D. Ohio 1997) (donations for debtor-hospital that were restricted were not assets of bankruptcy estate); *see also Hobbs v. Bd. of Educ. of N. Baptist Convention*, 416 N.W. 627 (Neb. 1934) (donation to bankrupt college's endowment fund not reachable by general creditors); *see also In re Roman Cath. Archbishop of Portland in Oregon*, 345 B.R. 686 (Bankr. D. Ore. 2006) (funds held in charitable trust were not available to pay creditors).

8 Restricted and unrestricted funds can be pooled. U.P.M.I.F.A. § 3(d) (Unif. L. Comm'n 2006). Funds are appropriated when, as to restricted funds, the restrictions are met and, as to unrestricted funds, when the board authorizes, and values fluctuate due to market conditions.

9 LaVerne Woods & Jean L. Tom, "Accessing Charitable Endowment Funds to Address Critical Needs During COVID-19," Davis Wright Tremaine LLP (April 17, 2020), *available at* dwt.com/insights/2020/04/accessing-charitable-endowment-funds.

10 *Id.*

11 *Id.*

of the estate, they would appear to be excluded from the insolvency determination.[12]

Accessing Donor-Restricted Assets

The doctrine of *cy pres* and the UPMIFA provide two legal bases to modify donor restrictions placed on charitable gifts. Under the common law doctrine of *cy pres*, a court can modify conditions placed on a charitable gift that become "impossible or impracticable."[13] Under the UPMIFA, "[i]f a particular charitable purpose or a restriction becomes unlawful, impracticable, impossible to achieve, or wasteful, the court, upon application of an institution, may modify the purpose of the fund or the restriction on use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument" after notice to the state attorneys' general with an opportunity to be heard.[14] Also, if "the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument."[15] Thus, an institution may release smaller, older gifts.[16]

Donor consents and the release of smaller, older gifts may provide some relief, albeit likely insufficient to meet operating needs. Obtaining donor consent may be problematic and could accelerate creditor issues if the financial distress is not public information. Some donors might no longer be available, while others could be prompted to request return of their gifts, although the law is clear that donors do not have a right to their return or even legal standing to request as such.[17]

Financial distress meets the tests to invoke *cy pres* and the UMPIFA, so both legal bases are available to seek relief from donor restrictions.[18] If the financial distress is temporary, the institution can apply to modify the restrictions to meet operational expenses, which happened in *In re Polytechnic University*. In this case, a donor left $70 million with the restriction to use the gift to endow a professorship and research fellowships.[19] The university, located in Brooklyn, N.Y., had significant debt from borrowing $90 million under a municipal bond issue for a new residence hall and other facilities. Following the Sept. 11, 2001, terrorist attacks and other events, the university's enrollment and income decreased. The bond was in danger of being in default due to a liquidity covenant. The university projected that it would

12 *See* 11 U.S.C. § 101(23), but the statute does not specifically define insolvency in terms of property of the estate.
13 *See* Allison Anna Tait, "Keeping Promises and Meeting Needs: Public Charities at a Crossroads," 102 *Minn. L. Rev.* 1789, 1789, n.1 (2018).
14 U.P.M.I.F.A. § 6(c) (Unif. L. Comm'n 2006).
15 U.P.M.I.F.A. § 6(a) (Unif. L. Comm'n 2006).
16 U.P.M.I.F.A. § 6(d) (Unif. L. Comm'n 2006).
17 Under the UMPIFA, only the attorneys' general is required to receive notice of a court action to modify a restriction. U.P.M.I.F.A. § 6(b)-(c). Many courts have held that donors lack standing to be heard in an action to modify a restriction. *See, e.g., Dodge v. Trustees of Randolph-Macon Woman's Coll.*, 276 Va. 10, 661 S.E.2d 805 (2008); Tait, *supra* n.13, at 1842 (rationale is that public is beneficiary because gift is contributed "to the public good, as mandated by charitable purposes doctrine and tax rules"); *but see Siebach v. Brigham Young Univ.*, 361 P.3d 130, 137 (Ct. App. Utah 2015) (court found that UPMIFA did not preclude "common-law donor-standing rule").
18 *See In re Polytechnic Univ.*, 12 Misc.3d 414, 812 N.Y.S.2d 304, 310-311 (Sur. Ct, Kings Co. 2006); Tait, *supra* n.13, at 1802.
19 12 Misc. 3d 414, 812 N.Y.S.2d 304, 310-311 (Sur. Ct. Kings Co. 2006).

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By Brandon R. Wood

Good Faith Is Dead; Long Live the Bankruptcy Purpose

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The battlefields of modern chapter 11 practice are evolving faster than the Bankruptcy Code can keep up. In the era of *LTL*[1] and other mass-tort bankruptcies, parties have begun launching early-case attacks on the validity of the underlying filing itself rather than only attacking treatment under the plan. The validity of the filings is based on good faith — a not-well-defined standard that itself does not appear in the Code as a requirement to file for chapter 11.

Nonetheless, "good faith" has been added as a requirement to file for chapter 11 by courts of appeals.[2] Many of these good-faith requirements originated many years ago, long before the onset of new litigation strategies such as the divisive merger (or, pejoratively, the Texas Two-Step). With the advent of divisive-merger cases, the parties moving to dismiss the case for a bad-faith filing have exposed two fundamental issues in case law: (1) There exists an important circuit split as to what "good faith" means; and (2) "good faith," however defined, is anything but "good faith" as commonly understood.

Instead, courts have morphed "good faith" into something different. A "bankruptcy purpose" can contain several subrequirements, which may have their own necessary conditions. In short, "good faith" has little to do with "good faith" as you would first think of the phrase.

At first, this might seem insignificant, but with the advent of bankruptcy as an approach to deal with mass tort liabilities (especially through divisive mergers), "good faith" has become an extremely important tool of creditors to protect their interests. Assuming that the likely scenario that mass tort bankruptcies are not stopping anytime soon, more creditors will almost certainly attempt attacks like the creditors in *LTL*. In turn, this will both further flush out the case law on "good faith," and further expose the deep division and lack of basic common elements for courts to determine whether a debtor is acting in good faith when filing for chapter 11. In short, if we are going to impose a good-faith requirement that is not in the Code, shouldn't it at least be *somewhat* consistent?

1 *In re LTL Mgmt. LLC*, 2023 U.S. App. LEXIS 2323.

2 *See, e.g., In re SGL Carbon Corp.*, 200 F.3d 154, 159-62 (3d Cir. 1999) (acknowledging that "good faith" is not part of § 1112(b)).

A Moment on Definitions that We Will Not Be Using

Putting aside the circuit split for a moment, what would you think "good faith" means? *Black's Law Dictionary* defines "good faith" as a state of mind consisting of (1) honesty or belief in purpose; (2) a faithfulness to one's duty or obligation; (3) the observance of reasonable commercial standards of fair dealing in a given trade or business; or (4) an absence of intent in seeking an unconscionable advantage.[3] The use of "or" means that the definition is disjunctive and that any one of these factors can establish good faith.

Applying these terms, you would likely think that a good-faith chapter 11 involves a debtor following "reasonable commercial standards" (an ever-nebulous phrase) or undertaking a filing not to undermine creditors, but to protect the going-concern value of the estate and the business. You would be right! However, according to circuit courts, that is not where the analysis ends — and you would also think that courts look at the intent behind the bankruptcy filing, specifically whether the debtor is attempting to strong-arm its creditors into bad deals under the threat of cramdown. The treatment of creditors is not a central focus of good-faith analysis, despite fair and equitable treatment of creditors being the bedrock of bankruptcy as an institution.

This is not to say that courts have ignored the central tenets of bankruptcy when dealing with questions of good-faith filings. The Fourth Circuit looks directly at "subjective bad faith" when a filing is challenged, and you cannot get any more direct with the question of treatment of creditors than an analysis on subjective bad faith. However, what makes that same analysis difficult is that the Fourth Circuit also balances, on equal footing, whether the case has a purpose that can be resolved through bankruptcy. This is thus our introduction to the "bankruptcy purpose" — a ubiquitously powerful and curiously ill-defined term that has played, and will continue to play, a central role in determining whether many mass-tort and similar liability-based bankruptcy filings can proceed through the system of chapter 11 reorganization with the protections of the Bankruptcy Code.

3 "Good Faith," *Black's Law Dictionary* (11th ed. 2019).

Bankruptcy Purpose? Where Is Your Financial Distress?

The Third Circuit's recent ruling in *LTL* restated the framework for defining the bankruptcy purpose in the key circuit for many of the largest restructuring cases. The ruling itself was hailed as a monumental victory for injured consumers against a corporate giant, but the Third Circuit clearly saw this as an already well-settled area of the law. The Third Circuit explained that a chapter 11 is filed in good faith when there is a valid bankruptcy purpose for the filing and the case was not filed to gain an unfair litigation advantage. Neither component of "good faith" is perfectly clear. In fact, *LTL* did not get past the first prong of the good-faith test, which is informative of the magnitude of the "bankruptcy purpose."

A valid bankruptcy in the Third Circuit must either be an effort to preserve the company's going concern or maximize the debtor's estate. No matter what, each filing *must* involve a debtor in financial distress.[4] This test is disjunctive in the first part but also includes a conjunctive necessary condition that the debtor be in financial distress. Preserving the going concern and maximizing the estate clearly indicate a "bankruptcy purpose" to the filing. However, the financial distress factor is an interesting addition where, even if you are trying to maximize the estate or preserve the going concern, you might still fail to have good faith because of a lack of "financial distress."

Famously, *LTL* deals with more than 38,000 currently pending multi-district litigation lawsuits regarding talc and asbestos liability against Johnson & Johnson (J&J). Several of those cases have gone to judgment, accounting for $3.5 billion in liability payments thus far. Despite billions in current liabilities (and potentially billions more), the Third Circuit held that *LTL* was not in financial distress based on J&J's substantial market value and was therefore ineligible to be a debtor in bankruptcy, as the company did not file for chapter 11 because it was facing financial distress.

The Third Circuit said that a debtor does not necessarily need to be insolvent, but that to be in financial distress, a debtor must face the "kinds of problems that justify Chapter 11 relief."[5] Further, financial distress does *not* mean that the debtor is merely defending itself against large demands from plaintiffs. Nevertheless, a debtor could be in financial distress if chapter 11 can fix the debtor's business model or resolve litigation to the benefit of creditors.[6]

The Third Circuit declined to set out a specific test of financial distress, recognizing how it can come in many forms. However, the Third Circuit, focusing on mass tort cases, said that the job of bankruptcy courts in their financial-distress analysis is to measure not the amount of liabilities, but the capacity of the debtor to meet them. In short, look to the backstop funding that "BadCo" has available to meet its mass tort liabilities: The more funding from the parent, or "GoodCo," the less likely that "BadCo" is in financial distress.

4 *See LTL*, 2023 U.S. App. LEXIS 2323 at *24-26.

5 *Id.* at 28.

6 *Id.*

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By Adrian L. Cohen

Modified Universalism and Comity Among Nations

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In the 1990s, English common law, and the jurisdictions inspired and influenced by it, were at the forefront of promoting the concept of what is widely referred to as "modified universalism" in insolvency and restructuring law. British judges were well placed to influence the trajectory of common law through the jurisdiction of the Judicial Committee of the Privy Council (hereinafter referred to simply as the "Privy Council") — the tribunal of last resort for a number of Commonwealth jurisdictions — and the normative effect of their judgments through the wider corpus of common law jurisdictions.

Lord Hoffmann

Lord Leonard "Lennie" Hoffmann, a member of the House of Lords (precursor to the Supreme Court) and the Privy Council, was responsible for several judgments and decisions that shaped this area of the law. Perhaps his commitment to comity and universality reached its apogee in two decisions, one in which Lord Hoffmann delivered the judgment on behalf of the Privy Council, *Cambridge Gas Transport Corp. v. The Official Committee of Unsecured Creditors of Navigator Holdings PLC and others* (on appeal from the High Court of Justice of the Isle of Man) in 2007, and the other as a member of the House of Lords, *HIH Casualty & General Insurance Ltd. Re* in 2008.[1] Lord Hoffmann provided a clear exposition of the principle of modified universalism in his judgment in *HIH*:

> The primary rule of private international law which seems to me applicable to this case is the principle of (modified) universalism, which has been the golden thread running through English cross-border insolvency law since the 18th century. That principle requires that English courts should, so far as is consistent with justice and U.K. public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company's assets are distributed to its creditors under a single system of distribution.[2]

Universalism was never an absolute principle but was modified by considerations of public policy, which allowed for consideration of fairness and due process, and a degree of territorialism was allowed to also intrude, hence the phrase "modified universalism."

The approach of the common law was buttressed by a specific statutory provision, § 426 of the Insolvency Act 1986, requiring U.K. courts to give assistance both within the U.K. and to the courts of *designated territories* upon receipt of a letter of request, discretion to be exercised with regard to the rules of private international law. The designated territories are predominantly commonwealth territories.

Underlying this jurisprudence, there was a wider sense of where the U.K. fit in the community of nations, in part through the prism of its imperial past. As a country, the wide use of common law in commercial transactions — not only in the Commonwealth but within emerging markets (notwithstanding that in many cases they had civil law traditions) — added to the sense of purpose and the sense of confidence in a post-imperial age. These common law developments will be called "*the first limb*" of the onward march of modified universalism.

European Legislation

In parallel with these common law developments, through its membership of the European Union (EU), the U.K. became even more integrated into Europe through a plethora of European legislation seeking to establish, then enhance, the concept of a single market (and latterly the EU Capital Markets Action Plan). In the context of restructuring and insolvency, this included the European Regulation on Jurisdiction, Recognition and Enforcement of Judgments 2000 (replaced by the Recast Regulation 2012; the Brussels Regulation) and its sister, the Lugano Convention 2007; the European Regulation on Insolvency Proceedings 2000 (subsequently replaced by the Recast Regulation 2015); and European legislation on financial collateral and the winding up of credit institutions and insurance undertakings. English lawyers and insolvency practitioners were enthusiastic users of this legislation and, in the 2000s, often sought to use it to bring non-U.K.-incorporated companies within the jurisdiction of the U.K. courts by either arguing that a debtor's center of main interests (COMI) was in the U.K. or by shifting the COMI to the U.K.

1 [2008] UKPC 26, [2008] UKHL 21.
2 *Id.* at ¶ 30.

Attitudes cooled a little when the Italian courts sought to do something similar to an Irish-incorporated company in the largely Italian-incorporated Parmalat Group and sought to put it into Italian proceedings, sparking a case in 2006 that ended up in the European Court of Justice on the meaning of "COMI."[3] Again, underlying this legislation was the concept of comity and modified universalism, at least within the European context. This trend has continued with, *inter alia*, the European Directive on Preventative Restructuring Frameworks 2019.

Some of this legislation had direct application with others requiring legislation to be passed, some settling the applicable jurisdiction in any given situation and with concomitant recognition, and others for convergence of domestic legislation. These European developments will be called "*the second limb*" of the onward march of modified universalism.

The first and second limb combined to present English insolvency law as something of a bridge between international common law and European civil law. English procedures retained their standing as nimble and well established, due in part to the reputation of English courts and judges and the long history of jurisprudence. In some cases, this was enhanced by the infancy and cumbersome nature of civil law insolvency and restructuring procedures. English law now had a more-extensive basis for recognition in Europe. Paradoxically, this was particularly the case with the English law schemes of arrangement, which, whether by accident or design, avoided the categorization of an insolvency procedure and thereby stood outside European insolvency legislation, or at least arguably there was always a question as to whether they benefited from the Brussels Regulation, yet enjoyed recognition within member states.

UNCITRAL Model Law

However, there is a "*third limb*": The development of the UNCITRAL Model Law on Cross-Border Insolvency Proceedings in 1997. The U.K. and U.S. were among the first states to adopt the UNCITRAL Model Law. The U.S. did so through chapter 15 of the Bankruptcy Code in 2005, and the U.K. through the Cross-Border Insolvency Regulations 2006 (CBIR). Other EU member states were very slow to adopt the new law; even now, it has been adopted by only four members of the EU. This stands in stark contrast to an overall current tally of 58 adopting states, which might suggest that the interests of EU states in harmonizing their insolvency and restructuring laws owe more to a commitment to the single market than to a wider concept of comity or universalism.

This halcyon period of commitment to modified universalism came to an end, some would say, with the British public voting by a small margin in favor of leaving the EU (Brexit) in the 2016 referendum, rendering the U.K. no longer subject to the relevant European legislation and the jurisdiction of the European Court of Justice. Such polling suggests that Brexit was wildly unpopular among British

3 *Eurofood IFSC Ltd.*, C-341-04, ECLI: EU C 2006 281 (ECJ May 2, 2006).

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By David Jennis and Daniel Etlinger

Zero Days Since the Last Injury

Estimating Personal-Injury and Wrongful-Death Claims

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Bankruptcy judges may be the ultimate finders of fact. However, the trial of personal-injury tort and wrongful-death claims (collectively, "PI claims") are not one of the tasks that Congress delegated to them. Notwithstanding this jurisdictional limitation, a bankruptcy judge may be asked to estimate a PI claim in order to facilitate the administration of a case. In doing so, the parties asking for or opposing estimation should keep in mind three key considerations: purpose, authority and practicalities.

What Is a PI Claim?

The U.S. Code provides that "[t]he district court shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending."[1] Courts interpreting this section, specifically as to what a PI claim is, generally fall into one of two camps.[2]

The narrow-interpretation cases define a "PI claim" as "a trauma or bodily injury or psychiatric impairment beyond mere shame or humiliation."[3] In contrast, the broad interpretation cases enlarge the scope to include "private or civil wrongs or injuries for which a court provides a remedy in the form of an action for damages, and include ... damage to an individual's person and any invasion of personal rights, such as libel, slander and mental suffering."[4] Therefore, a threshold question before examining the remaining issues is whether the matter at hand is even considered a PI claim by that jurisdiction.

For What Purpose Is the PI Claim Being Estimated?

Parties may request an estimation of a PI claim for a variety of reasons, including eligibility, confirmation and distributions. Regarding eligibility, a chapter 13 debtor must "on the date of the filing of the petition [have] noncontingent, liquidated debts of less than $2,750,000."[5] Likewise, a subchapter V debtor must have "aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not to exceed $7,500,000."[6]

An estimation issue arose, albeit not a PI claim, in one illustrative chapter 13 case.[7] The *In re Rios* court began its analysis noting that "eligibility for chapter 13 is based upon debts as of the petition date and not upon post-petition events such as allowed claims, filed claims, or treatment of claims in a confirmed Chapter 13 plan."[8] However, "when it appears the debtor did not exercise reasonable diligence or good faith in completing and filing the schedules, the bankruptcy court may look to other evidence, including post-petition events, to determine eligibility."[9] Meanwhile, a "bankruptcy court may also look beyond the schedules to other evidence submitted — including proofs of claim — when a good-faith objection to the debtor's eligibility under § 109(e) [has been] raised."[10] Thus, courts have some latitude to estimate a PI claim for eligibility purposes. This is particularly true if a portion, but not all, of the PI claim has been adjudicated. For example, damages for medical bills have been ascertained but not for pain and suffering.

Regarding confirmation, the Bankruptcy Code provides that the court may estimate PI claims "for the purpose of confirming a plan under chapter 11, 12, or 13 ... but not the liquidation or estimation of contingent or unliquidated [PI claims] against the estate for purposes of distribution in a case under title 11."[11] However, an estimated PI claim remains subject to objection, even if a plan is confirmed based on the estimate.[12]

Regarding distributions, the U.S. Code provides that the court may estimate PI claims for distribu-

1 28 U.S.C. § 157(b)(5); *see Shaw v. Santos (In re Santos)*, 304 B.R. 639, 650 (Bankr. D.N.J. 2004) ("As pointed out earlier, unlike fraud proofs, personal-injury damage proofs and valuations are not the everyday diet of this court. The district court or the state court are better able to decide damages (including potential for damages based upon mental anguish).").

2 *Byrnes v. Byrnes (In re Byrnes)*, 638 B.R. 821, 826-29 (Bankr. D.N.M. 2022).

3 For narrow-interpretation cases, *see In re C.W. Mining Co.*, 2012 WL 4882295, at *6 (D. Utah 2012); *Belcher v. Doe*, 2008 WL 11450550, at *4 (W.D. Tex. 2008); *Hurtado v. Blackmore*, 2007 WL 9753286, at *2 (S.D. Tex. 2007); *Lombard v. Greenpoint Sav. Bank*, 1997 WL 114619, at *2 (D. Conn. 1997); *In re Finley, Kumble*, 194 B.R. 728, 734 (S.D.N.Y. 1995); *In re Interco Inc.*, 135 B.R. 359, 362 (Bankr. E.D. Mo. 1991); *In re Vinci*, 108 B.R. 439, 442 (Bankr. S.D.N.Y. 1989); *In re Sheehan Mem'l Hosp.*, 377 B.R. 63, 68 (Bankr. W.D.N.Y. 2007); *Bertholet v. Harman*, 126 B.R. 413, 415 (Bankr. D.N.H. 1991); *In re Davis*, 334 B.R. 874, 878 n.2 (Bankr. W.D. Ky. 2005); *In re Chateaugay Corp.*, 111 B.R. 67, 76 (Bankr. S.D.N.Y. 1990).

4 For broad-interpretation cases, *see In re Boyer*, 93 B.R. 313, 317-18 (Bankr. N.D.N.Y. 1988); *In re Nifong*, 2008 WL 2203149, at *3 (Bankr. M.D.N.C. 2008); *In re Ice Cream Liquidation Inc.*, 281 B.R. 154, 160 (Bankr. D. Conn. 2002).

5 11 U.S.C. § 109(e).

6 11 U.S.C. § 1182(1)(A). *See In re Parking Mgmt.*, 620 B.R. 544, 551 (Bankr. D. Md. 2020).

7 *In re Rios*, 476 B.R. 685, 688-89 (Bankr. D. Mass. 2012).

8 *Id.* at 688.

9 *Id.* (internal citations omitted).

10 *Id.* at 688-89.

11 28 U.S.C. § 157(b)(2)(B). Section 157 also defines a "core proceeding" as "other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, *except* personal-injury tort or wrongful-death claims." 28 U.S.C. § 157(b)(2)(O) (emphasis added). *In re Poole Funeral Chapel Inc.*, 63 B.R. 527, 531-32 (Bankr. N.D. Ala. 1986) (asking "[w]hat happens to the Chapter 11 plan based on the bankruptcy court's estimate? Has the bankruptcy court engaged in a useless procedure? Will the debtor be discharged under section 1141(d)(1) ... if a plan is confirmed on the basis of the bankruptcy court's estimates? Or must distribution await liquidation of all [PI claims] by another court having jurisdiction?").

12 *See, e.g., In re EBG Health Care II Inc.*, 303 B.R. 626, 631 (Bankr. W.D. Mo. 2003).

tion purposes, but only on a non-core basis.[13] One court analogized this process as follows:

> The comparison between estimating an unliquidated wrongful-death/personal-injury claim, on the one hand, and, on the other hand, determining the claim amount through a jury trial or a bankruptcy court's allowance procedure under section 502(b) can be likened, perhaps, to estimating the number of marbles in a large glass jar as compared with taking the marbles out of the jar and counting them. Even if the person who makes the estimation is skilled and experienced in estimating the number of marbles in a glass jar, the result of the estimation is likely to be less accurate (and certainly, under no circumstances, more accurate) than taking out the marbles one by one and counting them.[14]

Thus, the court ultimately held that "the scope of unliquidated claim estimation in this case should be confined to the extent necessary to accomplish the overarching goal of avoiding undue delay in this case's administration and not expanded beyond that point."[15]

Under What Authority Is the PI Claim Being Estimated?

There are primarily three authorities to be cognizant of when addressing estimation of a PI claim. First, the U.S. Code specifically states that estimation for purposes of confirmation is a core proceeding, whereas estimation for distributions is non-core.[16] Nevertheless, the bankruptcy court may still preside over a non-core proceeding and "submit proposed findings of fact and conclusions of law to the district court," which will then enter a final order or judgment.[17] Second, the Bankruptcy Code provides that a court shall estimate "any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case."[18] Finally, Rule 3018 of the Federal Rules of Bankruptcy Procedure provides that notwithstanding an objection "to a claim or interest, the court after notice and hearing may temporarily allow the claim or interest in an amount which the court deems proper for the purpose of accepting or rejecting a plan."[19]

How Is the PI Claim to Be Estimated?

Perhaps most problematic, the final step in the process is to determine the practicalities for the estimation itself. There are no less than 10 methods to consider given the particularities of the case. The first half of methods are generally applicable when there are multiple PI claims in a bankruptcy (*e.g.*, mass asbestos claims).

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13 28 U.S.C. § 157(b)(2)(B).
14 *In re N. Am. Health Care Inc.*, 544 B.R. 684, 688-89 (Bankr. C.D. Cal. 2016).
15 *Id.*
16 28 U.S.C. § 157(b)(2)(B).
17 28 U.S.C. § 157(c)(1). *See also In re Payton*, 481 B.R. 460 (Bankr. N.D. Ill. 2012) ("Eligibility to be a debtor in a bankruptcy case arises under the Code and is therefore a matter as to which a bankruptcy judge may enter final judgment.").
18 11 U.S.C. § 502(c)(1); *see also In re Roman Catholic Archbishop of Portland*, 339 B.R. 215, 222 (Bankr. D. Ore. 2006) (holding that undue delay is determined in light of circumstances of that case).
19 Fed. R. Bankr. P. 3018(a).

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President's Column

Subchapter V Task Force

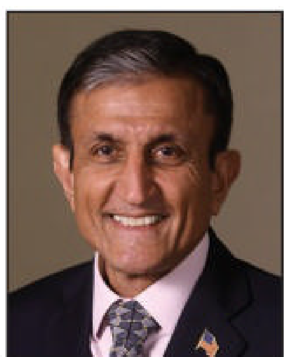
We can use all your help! Consistent with my primary initiative announced at my installation at the Annual Spring Meeting in April, the Subchapter V Task Force is off to the races (not the Kentucky Derby, I might add!). A review of the Small Business Reorganization Act (SBRA) is the centerpiece of my initiatives for my term, which will make a difference for the future of small businesses' fresh starts.

Commendations go to Co-Chairs Hon. **Michelle M. Harner** of the U.S. Bankruptcy Court for the District of Maryland (Baltimore) and **Megan W. Murray** of Underwood Murray, PA (Tampa, Fla.), and Reporter Prof. **Alexandra Everhart Sickler** of the University of North Dakota School of Law (Grand Forks, N.D.), for leading and motivating all the task force members. I also am grateful to the volunteers who are contributing their valuable time toward this effort. The input from all task force members has been enlightening thus far, and the response from ABI's members has been flattering. The task force's mission statement is as follows:

> The ABI Subchapter V Task Force is committed to reviewing the implementation and administration of subchapter V of chapter 11 of the Bankruptcy Code. The Task Force will study and evaluate case law and statistical data under subchapter V from February 19, 2020, through and including the present. This study will consider, among other things, how the subchapter is working in practice and whether it is achieving certain underlying objectives, such as assisting debtors and creditors in resolving the reorganization cases of small- and medium-sized businesses more effectively and efficiently, and what may be needed to improve its effectiveness. The Task Force intends to memorialize the results of its study in a written report.

The task force literally mobilized on day one by launching the foundational survey. It offers an opportunity for all members to make a difference. Please become part of this important ABI effort and take the survey at abi.org/subvsurvey. The task force has identified several issues, with the first two public hearings held in June, which covered general experiences with subchapter V and eligibility issues. The exhibit shows the upcoming public hearings, and everyone is invited to participate in the public hearings.

Thanks to the support of ABI Executive Director **Amy Quackenboss** and Chief Operating Officer **Karim Guirguis**, together with the executive team, ABI has launched the task force's website, subvtaskforce.abi.org. We would like wide participation from ABI's membership, and we encourage you to share experiences with subchapter V issues by visiting the task force's website.



ABI President
Soneet R. Kapila
KapilaMukamal, LLP
Fort Lauderdale, Fla.

Soneet Kapila is a founding partner of KapilaMukamal, LLP in Fort Lauderdale, Fla. He previously served as ABI's Treasurer.

New Board Members

In my view, each Board member carries the ABI flag as a key ambassador, and is an important partner in my initiatives. We warmly welcome our newest additions to the Board of Directors: **Marchand Boyd** of Axos Bank (Columbus, Ohio), **Katherine R. Catanese** of Foley & Lardner LLP (New York), **Matthew T. Faga** of Markus Williams Young & Hunsicker LLC (Denver), **Allen G. Kadish** of Archer & Greiner PC (New York), **Evelyn J. Meltzer** of Troutman Pepper Hamilton Sanders LLP (Wilmington, Del.), Hon. **Sage M. Sigler** of the U.S. Bankruptcy Court for the Northern District of Georgia (Atlanta), **Kristina M. Stanger** of Nyemaster Goode, PC (Des Moines, Iowa) and **David A. Wender** of Eversheds Sutherland LLP (Atlanta). I look forward to working with you all, and to receiving your input and contributions to ABI's numerous board committees. Read more about our newest Board members in the June 2023 issue at abi.org/abi-journal.

Strategic Plan

Keeping ABI meaningful and relevant to the insolvency community is critical. Co-Chairs

Subchapter V Task Force Tentative Public Hearings

Date	Place	Topic
July 14, 2023	Zoom	Role of the Subchapter V Trustee
July 28, 2023	Zoom	Operation of the Case
Sept. 8, 2023	Zoom	Confirmation Issues
Sept. 22, 2023	Zoom	Post-Confirmation Issues
Oct. 10-12, 2023	NCBJ	Wrap-Up/General Experiences with Subchapter V

Hon. **Kevin J. Carey** (ret.) of Hogan Lovells US LLP (Philadelphia) and **Jennifer M. McLemore** of Williams Mullen (Richmond, Va.) continue to advance the implementation of an updated strategic plan for the organization.

The transparent discussions and ideas shared during the Board of Directors meeting in April proved invaluable. The Strategic Planning Committee will distill these ideas at future meetings to develop the foundation for further improvements that are receptive to member needs at different levels. To assist in these endeavors, the committee will be sending survey questions to groups of members. Your input will help build the components of ABI's new strategic plan.

40 Under 40

We continue to see increased involvement of ABI's "40 Under 40" honorees at different leadership levels, including education panels and committees. Since the inaugural class in 2017, there have been 240 honorees (read their bios at abi40under40.org), providing an impressive roster of future industry leaders. Nominations for the 2023 class recently closed, and the steering committee is currently reviewing applications. The next class of "40 Under 40" honorees will be announced this fall; be sure to congratulate the newest class by attending ABI's Winter Leadership Conference, which will take place Nov. 30-Dec. 2 at the Fairmont Scottsdale Princess in Scottsdale, Ariz. Registration for the Winter Leadership Conference will open soon, so check abi.org/events for further details once those are ready.

Diversity, Equity and Inclusion Working Group

ABI's Diversity, Equity and Inclusion Working Group (DWG) continues to work to incorporate programming and initiatives that promote diversity within ABI and the insolvency community. This month, the DWG's Mentoring Committee selected eight new mentees and nine mentors to participate in ABI's annual Diversity Mentoring Program (see p. 47 for further details). Mentees include young practitioners with 4-10 years of experience who are selected from a pool of applicants. The Diversity Mentoring Program offers mentees interactive professional-development and networking sessions coupled with one-on-one guidance from seasoned mentors. Past Diversity Program mentees are now serving in ABI leadership positions. For more information about this program and other initiatives, please visit diversity.abi.org.

Virtual Happy Hours

I was pleased to see so many ABI members at the virtual happy hour on June 14. In addition to networking with colleagues, I participated in an interview with ABI Executive Director **Amy Quackenboss** for a live taping of ABI's new "Party in Interest" podcast. This podcast will be focusing on a variety of players insolvency community, and I was honored to make its first appearance. Please visit abi.org/newsroom/podcasts to access the podcast.

ABI plans to repeat this format at future virtual happy hours happening in the fall, so please be on the lookout for announcements about other live presentations of the "Party in Interest" podcasts.

Education

In the spirit of seeing myself as the ambassador of ABI and meeting my fellow members across the regions, I attended the Complex Financial Restructuring Program and VALCON in New Orleans in May, 10 days after taking office. I also attended another outstanding event that month: the New York City Bankruptcy Conference. The quality and sophistication of these programs was simply unsurpassable. My only regret was that I had not participated in these programs in past years.

This year is replete with an ever-changing landscape impacting our industry. Crypto and the trajectory of interest rates and the effects on the retail and real estate landscape are dominating industry discussions. Subchapter V case law is evolving by the day. The health care industry continues to offer chronic challenges. Consequently, ABI's roster of education programs is inundated with relevant and real-time content presented by superior faculties. The advisory boards for the events are fulfilling their very important roles by bringing forth the timeliest content. ABI invites members to provide suggestions for future education hot topics of interest in the current environment. I hope to see many of you at the various regional seminars coming up this summer and fall. For a list of upcoming events, please visit abi.org/events.

Get Noticed with ABI's Partner Program

I also want to take a second to highlight ABI's Partner Program, which has been very successful in recent years. The program collaborates with firms to provide a proactive and strategic approach to involvement in the organization that aligns their needs with opportunities at ABI. The program is a core service to firms and professionals in the bankruptcy and restructuring industry, and provides a dedicated Partner team who knows each firm and its practices, along with attorneys, financial advisors and other professionals. It is a win-win for Partners and ABI. If your firm is interested in exploring a partnership with ABI, I hope you will reach out to ABI Director of Business Development and Partner Programs **Barbara Grant Bereskin** at bbereskin@abi.org. View the entire list of ABI's Partners at abi.org/about-us/partners.

A Warm Thank You

It needs to be said that I would be making no progress, and none of the above could be accomplished, without the tireless efforts of the ABI executive office: **Amy Quackenboss**, **Karim Guirguis** and their entire squad of unnamed heroes. I am immensely grateful for their patience, perseverance and constant support of my efforts. abi

Event Roundup

New York Hilton Hosts New York City Bankruptcy Conference

ABI President Soneet R. Kapila of KapilaMukamal, LLP (standing at left) introduced the Judges' Roundtable, which featured (seated from left) Bankruptcy Judges Michael E. Wiles (S.D.N.Y.), Jil Mazer-Marino (E.D.N.Y.), Sean H. Lane (S.D.N.Y.), Michael B. Kaplan (D. N.J.), David S. Jones (S.D.N.Y.), Craig T. Goldblatt (D. Del.), Philip Bentley (S.D.N.Y.) and Lisa G. Beckerman (S.D.N.Y.).

Nearly 500 New York metro area practitioners turned out for ABI's New York City Bankruptcy Conference on May 24 in one of region's most significant gatherings of insolvency and restructuring professionals. The day-long conference, held this year at the New York Hilton in Midtown Manhattan, reprised its expanded workshop format of having 12 concurrent breakout sessions presented twice with different panelists, offering attendees expanded points of view on the same topics. A Judges' Roundtable on selected current topics kicked off the program, which included a lunch-time keynote presentation on meme stock and fiduciary duty implications.

Concurrent sessions featured advanced DIP topics, bankruptcy common law, international alternative forms to chapter 11, third-party releases, the "restructuring director," the Texas Two-Step regarding *LTL* and *Aero*, recent confirmation issues, bank issues, crypto, recent ethics topics, subchapter V and a litigation round-up. A well-attended networking reception wrapped up the day's intensive educational sessions. Attendees were eligible to earn up to 8.70/8.5 hours of CLE/CPE credit, including up to 1.5 hours of ethics.

The "Meme Stock and Fiduciary Duty Implications" panel included (l-r) Rachel Ehrlich Albanese of DLA Piper, Joshua M. Brown of Ritholtz Wealth Management, Troy A. Paredes of Paredes Strategies LLC and Thomas E. Lauria of White & Case LLP.

Gregory G. Plotko of Barnes & Thornburg LLP, Bankruptcy Judge Brendan L. Shannon (D. Del.), Alec P. Ostrow of Becker, Glynn, Muffly, Chassin & Hosinski LLP, Christopher J. Kearns of Berkeley Research Group, LLC and Kathryn A. Coleman of Hughes Hubbard & Reed LLP (l-r) discussed recent confirmation issues.

ABI is grateful to Judicial Chair Hon. **Michael E. Wiles** of the U.S. Bankruptcy Court for the Southern District of New York, Co-Chairs Ryan P. Dahl of Ropes & Gray LLP and **Leon Szlezinger** of Jefferies, and the New York City Bankruptcy Conference Advisory Board for their efforts in developing this year's program. ABI also thanks the following sponsors for their support of the conference: Accordion Partners; AgencyIP/Sherwood Partners, Inc.; Akin Gump Strauss Hauer & Feld LLP; AlixPartners, LLP; Archer & Greiner, P.C.; BakerHostetler; Becker, Glynn, Muffly, Chassin & Hosinski LLP; Berger Singerman LLP; Berkeley Research Group, LLC; Binder & Schwartz LLP; Blank Rome LLP; Cleary Gottlieb Steen & Hamilton LLP; Clifford Chance US LLP; Coda Advisory Group LLC; Cozen O'Connor; Cravath, Swaine & Moore LLP; Davis Polk & Wardwell LLP; Debevoise & Plimpton LLP; Dechert LLP; Delaware Trust, a CSC Global Company; Deloitte CRG; Development Specialists, Inc.; DLA Piper; Dorsey & Whitney LLP; Epiq; Faegre Drinker Biddle & Reath LLP; Fried, Frank, Harris, Shriver & Jacobson LLP; FTI Consulting, Inc.; Getzler Henrich & Associates LLC; Golenbock, Eiseman, Assor, Bell & Peskoe LLP; Goodwin Procter LLP; Greenberg Traurig, LLP; Guggenheim Partners, LLC; Hogan Lovells US LLP; Holland & Knight LLP; Houlihan Lokey; HPS Investment Partners, LLC; Hughes Hubbard & Reed LLP; Jefferies LLC; Jenner & Block LLP; Katten Muchin Rosenman LLP; Kilpatrick Townsend & Stockton LLP; King & Spalding; Kirkland & Ellis LLP; Leech Tishman Robinson Brog; Loeb & Loeb LLP; M-III Partners, LP; McGuireWoods LLP; Miller Buckfire, a Stifel Company;

Morgan Lewis & Bockius LLP; Morrison Foerster; NERA Economic Consulting; Orrick, Herrington & Sutcliffe LLP; Otterbourg P.C.; Pachulski Stang Ziehl & Jones; Paul Hastings LLP; Paul, Weiss, Rifkind, Wharton & Garrison LLP; Perkins Coie LLP; Polsinelli; Proskauer; Province LLC; Reid Collins & Tsai LLP; Ropes & Gray LLP; Royer Cooper Cohen Braunfeld LLC; Sheppard Mullin; Sidley Austin LLP; Simpson Thacher & Bartlett LLP; Skadden, Arps, Slate, Meagher & Flom LLP; Togut, Segal & Segal LLP; Stroock & Stroock & Lavan LLP; Sullivan & Cromwell LLP; Venable LLP; Willkie Farr & Gallagher LLP; Wilmington Trust; and Young Conaway Stargatt & Taylor, LLP.

Check back at abi.org/events for information on next year's program as it becomes available.

Central States Bankruptcy Workshop Celebrates 30 Years

ABI Editor-at-Large Bill Rochelle (standing) led the Judicial Roundtables plenary on circuit splits and hot topics with (seated from left) Bankruptcy Judges Beth E. Hanan (E.D. Wis.), Lisa S. Gretchko (E.D. Mich.), Thomas M. Lynch (N.D. Ill.), Robyn L. Moberly (S.D. Ind.), Mina Nami Khorrami (S.D. Ohio), John T. Gregg (W.D. Mich.), Paul E. Singleton (N.D. Ind.), James W. Boyd (W.D. Mich.) and David D. Cleary (N.D. Ill.).

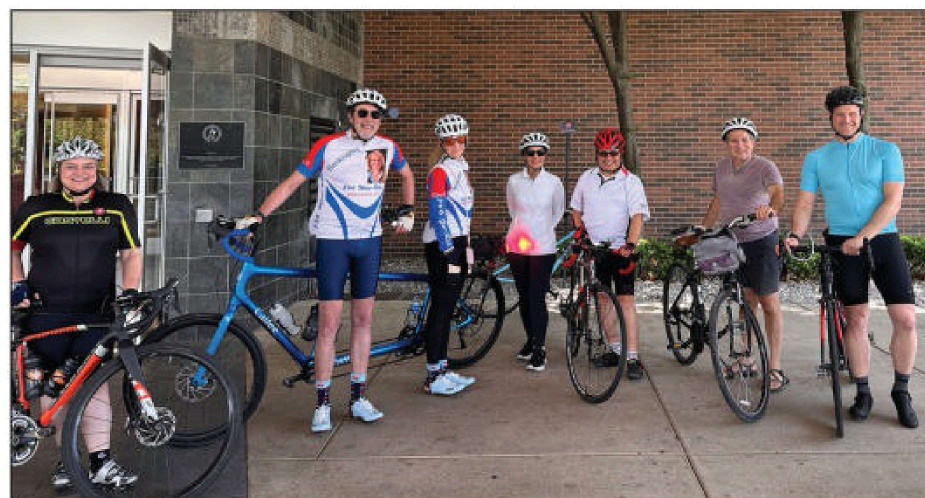
The recently renovated Grand Traverse Resort and Spa in Traverse City, Mich., hosted this year's 30th anniversary Central States Bankruptcy Workshop June 8-10. Attendees from the Upper Midwest region and beyond enjoyed the timely sessions, multiple networking events and optional events, which included ABI's first-ever pickleball tournament, plus a young and new members pub outing, a family picnic, a wine tour, the annual Tour de ABI bicycle outing, and a S'mores at the Shore gathering on Lake Michigan the last evening of the workshop.

The program opened with a special plenary on the Supreme Court case of *Lac du Flambeau Band v. Coughlin*, led by Prof. Matthew L.M. Fletcher of the University of Michigan Law School. Subsequent concurrent sessions were grouped into business, consumer and skills tracks, and focused on such topics as subchapter V, crypto, retail cases, chapter 7 and chapter 13 conversions, mediation and risk analysis, cannabis cases, mass torts and insurance issues, fraudulent transfers and preferences, property of the estate, valuation hearings, student loans and avoidance actions. The workshop also featured a Circuit Splits and Hot Topics judicial plenary moderated by ABI Editor-at-Large **Bill Rochelle**, and concluded with a Judicial Roundtables plenary. Nearly a dozen regional bankruptcy judges, as well as a Michigan Court of Appeals judge, rounded out the top-notch faculty. Attendees could earn up to 9.9/9.5 hours of CLE/CPE credit.

Prof. Matthew L.M. Fletcher of the University of Michigan Law School led a special plenary that discussed the Supreme Court case of Lac du Flambeau Band v. Coughlin.

ABI thanks Judicial Co-Chairs Hon. **James W. Boyd** of the U.S. Bankruptcy Court of the Western District of Michigan (Grand Rapids) and Hon. **Catherine J. Furay** of the U.S. Bankruptcy Court for the Western District of Wisconsin (Madison), Co-Chairs **Tracy M. Clark** of Steinberg Shapiro Clark (Southfield, Mich.) and **Elizabeth B. Vandesteeg** of Levenfeld Pearlstein, LLC (Chicago), and the Central States Bankruptcy Workshop Advisory Board for their work in putting this year's 30th anniversary program together. ABI also is grateful to A&G Real Estate Partners; Adelman & Gettleman, Ltd.; AlixPartners, LLP; B. Riley Financial; Barnes & Thornburg LLP; Commercial Recovery Associates, LLC; Cozen O'Connor; Development Specialists, Inc.; Dickinson Wright, PLLC; Fox Rothschild LLP; Fredrikson & Byron P.A.; Frost Brown Todd LLP; Gensburg Calandriello & Kanter, P.C.; Godfrey & Kahn, S.C.; Greenberg Traurig, LLP; Ice Miller LLP; Jenner & Block LLP; Keller & Almassian; Kerr, Russell and Weber, PLC; King & Spalding LLP; Krieg DeVault LLP; Levenfeld Pearlstein, LLC; MorrisAnderson; Smith Gambrell & Russell LLP; Perkins Coie LLP; Ravinia Capital LLC; Schafer and Weiner, PLLC; Spencer Fane LLP; Steinhilber Swanson LLP; Varnum, LLP; Warner Norcross + Judd LLP; Wesler & Associates CPA; Wilmington Trust; and Wolfson Bolton Kochis PLLC for their support of the program.

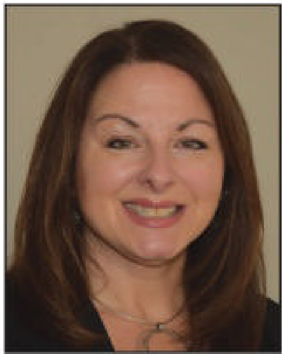
Next year's workshop returns to the Grand Geneva Resort & Spa in Lake Geneva, Wis., June 6-8, so be sure to mark your calendars. More information is forthcoming and will be posted at abi.org/events. **abi**



Several attendees enjoyed the beauty of the Michigan outdoors during the annual Tour de ABI Bicycle Outing.

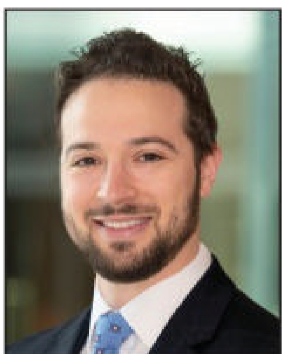
Members in the News

Hon. Arthur I. Harris


Phyllis A. Ulrich

Adam D. Herring

Tara Twomey


Aaron H. Stulman

Two attorneys with Brooks, Pierce, McLendon, Humphrey & Leonard, LLP in Greensboro, N.C., have been named 2023 "Legal Elites" by *Business North Carolina*. **Jeffrey E. Oleynik** has been an ABI member since 1996. **John H. Small** has been an ABI member since 1999.

Hon. **Arthur I. Harris** of the U.S. Bankruptcy Court for the Northern District of Ohio (Cleveland) announced that he has retired. He has been an ABI member since 2003.

Yvette R. Austin Smith has joined Compass Lexecon as senior managing director, chair of its Global Finance Practice and head of its New York office. She has been an ABI member since 2010.

Kevin J. O'Brien of King & Spalding LLP (Atlanta) has been promoted to counsel. He has been an ABI member since 2021.

Phyllis A. Ulrich of Carlisle, McNellie, Rini, Kramer, Ulrich & Company, LLP (Beachwood, Ohio) has been named vice chair of the Bankruptcy Committee for the U.S. Foreclosure Network. She has been an ABI member since 1996.

Rachel B. Nicholson of Thornton Grout Finnigan LLP (Toronto) has been made partner. She has been an ABI member since 2022.

Three attorneys with Greenberg Traurig, LLP in Chicago have been recognized on the 2023 list of *Leading Lawyers*. **Kevin D. Finger** has been an ABI member since 2005. **Nancy A. Peterman** has been an ABI member since 1995 and is a past member of ABI's Board of Directors. **Keith J. Shapiro** has been an ABI member since 1983 and is a past ABI President.

Matthew J. Hart has joined Capstone Partners' Financial Advisory Services Group as a managing director in New York. He has been an ABI member since 2018.

Three attorneys with Moore & Van Allen PLLC in Charlotte, N.C., have been named to the 2023 *Business North Carolina* "Legal Elite." **Luis M. Lluberas** has been an ABI member since 2010. **Alan W. Pope** has been an ABI member since 1999. **Zachary H. Smith** has been an ABI member since 2009.

Abid Qureshi of Akin Gump Strauss Hauer & Feld LLP (New York) has been named to *Crain's New York Business*'s "Notable Asian Leaders" list for 2022. He has been an ABI member since 2010.

Eric S. Pezold of Snell & Wilmer, LLP (Costa Mesa, Calif.) has been named managing partner of the firm's Orange County office. He has been an ABI member since 2004.

Nicole Fulfree of Lowenstein Sandler LLP (Roseland, N.J.) has been elevated to partner. She has been an ABI member since 2018 and is a 2022 ABI "40 Under 40" honoree. In addition, **Colleen Restel** has been elevated to counsel. She has been an ABI member since 2021 and is Newsletter Editor of ABI's Business Reorganization Committee.

Adam D. Herring has joined Nelson Mullins Riley & Scarborough, LLP in Atlanta as Of Counsel. He has been an ABI member since 2017, is a 2019 ABI "40 Under 40" honoree and is Education Director of ABI's Ethics and Professional Compensation Committee.

Dennis T. Lewandowski of Kaufman & Canoles, PC (Norfolk, Va.) has been named a 2023 "Top Lawyer" by *CoVaBIZ Magazine*. He has been an ABI member since 1985.

Charles N. Anderson of Ellis & Winters LLP (Raleigh, N.C.) has been selected as a 2023 "Legal Elite" by *Business North Carolina*. He has been an ABI member since 2019.

Catherine Eisenhut Cervone of Phillips Lytle LLP (Buffalo, N.Y.) has been elected partner. She has been an ABI member since 2023.

Four professionals with FTI Consulting, Inc. have been promoted to senior managing directors. **Chas E. Harvick** has been an ABI member since 2006 and is based in Phoenix. **Brian Martin** has been an ABI member since 2014 and is based in Chicago. **Jodi Porepa** has been an ABI member since 2015 and is based in Toronto. **Chris Tennenbaum** has been an ABI member since 2017 and is based in Los Angeles.

Tara Twomey, formerly Of Counsel with the National Consumer Law Center in Carmel, Calif., has been selected to serve as director of the U.S. Trustee Program (USTP) at the U.S. Department of Justice. She has been an ABI member since 2003.

Vicki L. Parrott of Northen Blue, LLP (Chapel Hill, N.C.) has been selected to serve as chapter 7 trustee for the Durham, N.C., Division. She has been an ABI member since 2010.

William L. Thompson of Varnum, LLP (Detroit) has been elected partner. He has been an ABI member since 2019.

Aaron H. Stulman of Potter Anderson & Corroon LLP (Wilmington, Del.) has been elected partner. He has been an ABI member since 2012.

Steven J. Levitt of Holland & Knight LLP (Dallas) has been elected partner. He has been an ABI member since 2014.

Two attorneys with Rayburn, Cooper & Durham, PA in Charlotte, N.C., have been recognized as 2023 "Legal Elites" by *Business North Carolina Magazine*. **Albert F. Durham** has been an ABI member since 1997. **John R. Miller** has been an ABI member since 2005.

Two attorneys with Brown Rudnick LLP in New York have been elected partner. **Tristan G. Axelrod** has been an ABI member since 2020. **Gerard T. Cicero** has been an ABI member since 2018.

Evelyn J. Meltzer of Troutman Pepper Hamilton Sanders LLP (Wilmington, Del.) has been named secretary of the International Women's Insolvency and Restructuring Confederation (IWIRC). She has been an ABI member since 2004, is co-chair of ABI's International Committee and is a member of ABI's Board of Directors.

Drew Lockard of Stretto (Dallas) has been selected for *D Magazine*'s 2023 "D CEO Dallas 500" list. He has been an ABI member since 2019.

Two attorneys with Lewis Roca Rothgerber Christie LLP have been recognized among *AZ Big Media*'s "Top 100 Lawyers" for 2023. **Robert M. Charles** has been an ABI member since 1997 and is based in Tucson, Ariz. **Susan M. Freeman** has been an ABI member since 2003 and is based in Phoenix.

Charles R. Rayburn of McGuireWoods LLP (Charlotte, N.C.) has been selected for *Business North Carolina*'s 2023 "Legal Elite" list. He has been an ABI member since 2017.

Jennifer J. West of Spotts Fain PC (Richmond, Va.) has been inducted as a Virginia Law Foundation Fellow. She has been an ABI member since 2001.

Robert Trenk has joined Paladin Management Group in New York. He has been an ABI member since 2022.

Joel L. Perrell has joined Womble Bond Dickinson LLP as a partner in the firm's Capital Markets Group in Baltimore. He has been an ABI member since 2006.

Douglas C. Bernstein of Plunkett Cooney (Bloomfield Hills, Mich.) has been named a Fellow of the Michigan State Bar Foundation. He has been an ABI member since 1997.

Five professionals with AlixPartners LLP have been promoted to partner. Based in New York, **James Horgan** has been an ABI member since 2004, **Elizabeth S. Kardos** has been an ABI member since 1994 and **Patryk Szafranski** has been an ABI member since 2020. **Bradley L. Hunter** has been an ABI member since 2011 and is based in Trophy Club, Texas. **Richard M. Robbins** has been an ABI member since 2006 and is based in Dripping Springs, Texas.

Jane Kim of Keller Benvenutti Kim LLP (San Francisco) has been named the firm's managing partner. She has been an ABI member since 2019 and is Newsletter Editor of ABI's Asset Sales Committee.

Steven J. Solomon of GrayRobinson, PA (Miami) has been named to *City & State Florida*'s inaugural "South Florida Power 100" list. He has been an ABI member since 2004.

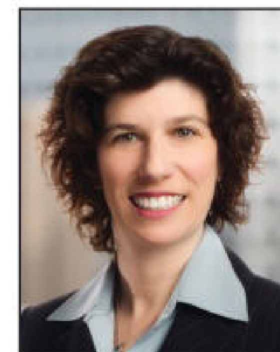
Jacob Margolies has joined Dentons's Restructuring, Insolvency and Bankruptcy Group in Louisville, Ky., as an associate. He has been an ABI member since 2022.

Three attorneys with Bush Ross, PA in Tampa, Fla., have been selected as *Tampa Magazine*'s 2023 "Top Lawyers." **Adam L. Alpert** has been an ABI member since 2002. **Kathleen L. DiSanto** has been an ABI member since 2011 and is a coordinating editor for the *ABI Journal*. **Jeffrey W. Warren** has been an ABI member since 1985.

Two attorneys with Robinson, Bradshaw & Hinson, PA in Charlotte, N.C., received 2023 "Legal Elite" awards from *Business North Carolina*. **David M. Schilli** has been an ABI member since 1999. **Andrew W.J. Tarr** has been an ABI member since 2006.

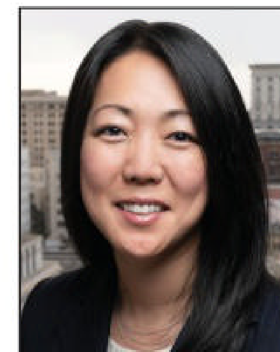
Jennifer Barker Lyday of Waldrep Wall Babcock & Bailey PLLC (Winston-Salem, N.C.) received the 2022 Pro Bono Award for the Bankruptcy Section of the North Carolina Bar Association. She has been an ABI member since 2011.

Two professionals with Alvarez & Marsal have been promoted to managing directors. **Barry Lynch** has been an ABI member since 2022 and is based in George Town, Grand



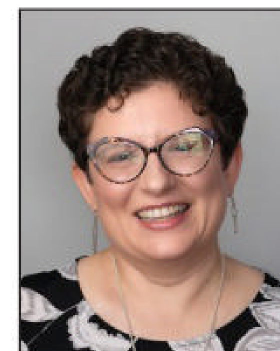
Evelyn J. Meltzer

Douglas C. Bernstein



Jane Kim

Jacob Margolies



Jennifer Barker Lyday

In Memoriam

William A. Brandt

***William A. Brandt**, founder of Development Specialists, Inc. (Chicago), passed away on May 28, 2023, from amyotrophic lateral sclerosis (ALS, also known as Lou Gehrig's Disease) at age 73. An ABI member since 1987, he had served on ABI's Board of Directors, was a commissioner on ABI's Commission to Study the Reform of Chapter 11, and had served on the advisory boards of ABI's New York City Bankruptcy Conference and Bankruptcy Battleground West program. Mr. Brandt was in the business of workout, turnaround and insolvency consulting for 47 years and had been widely recognized as one of the foremost practitioners in the field. ABI honored Mr. Brandt during the 2022 Winter Leadership Conference in December by announcing that its highest award, the Lifetime Achievement Award, which recognizes the recipient's sustained and deep commitment to the leadership and governance of the organization, had been renamed the "Bill Brandt Lifetime Achievement Award." For more about his extraordinary life, please read this tribute by the* Chicago Sun-Times*: chicago.suntimes.com/obituaries/2023/5/31/23530312/william-brandt-dies-obituary-democrat-corporate-restructuring-pioneer-chicago-loyola. A memorial service will be held July 7 at Madonna Della Strada Chapel, Loyola University, in Chicago. Donations can be made to the Bill Brandt Innovation Fund at Tina's Wish (tinaswish.org/billbrandtgrant). He will be deeply missed.*

Cayman. **Taylor Atwood** has been an ABI member since 2021 and is based in Dallas.

Michael R. Dal Lago of Dal Lago Law (Naples, Fla.) has been appointed director of the Southwest Florida Federal Bar Association. He has been an ABI member since 2002.

Michael R. Dal Lago

Jason D. Angelo of Reed Smith LLP (Wilmington, Del.) has been named counsel. He has been an ABI member since 2015.

Michael S. Myers of Ballard Spahr LLP (Los Angeles) has been elevated to Of Counsel. He has been an ABI member since 2013.

Steve W. Golden of Pachulski Stang Ziehl & Jones LLP (New York) has been promoted to partner. He has been an ABI member since 2013.

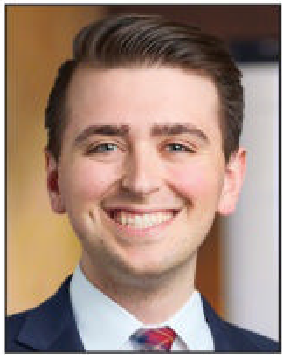
Michael J. Pankow of Brownstein Hyatt Farber Schreck, LLP (Denver) has been selected by *5280* as one of "Denver's Top Lawyers 2023." He has been an ABI member since 2005.

Melissa M. Root

Melissa M. Root of Jenner & Block LLP (Chicago) has been named among the "Who's Who in Law" by *Crain's Chicago Business*. She has been an ABI member since 2021.

Benjamin C. Struby of Lathrop GPM LLP (Kansas City, Mo.) has been promoted to partner. He has been an ABI member since 2017.

Michael R. Stewart of Faegre Drinker Biddle & Reath LLP (Minneapolis) has been named a 2023 "POWER 30: Mergers & Acquisitions" honoree by *Minnesota Lawyer*. He has been an ABI member since 1991.


Andrew Page

Andrew Page has joined Maslon LLP's Financial Services Group in Minneapolis as an associate. He has been an ABI member since 2019.

Four professionals have been appointed to the U.S. Bankruptcy Court for the Northern District of Illinois's Rules Advisory Committee, created by General Order No. 18-02, for three-year terms. **Ariane Holtschlag** of FactorLaw (Chicago) has been an ABI member since 2008 and is a member of ABI's Board of Directors. **Derek Lofland** of Law Office of Derek V. Lofland LLC (Schaumburg, Ill.) has been an ABI member since 2014. Prof. **Bruce A. Markell** of Northwestern University School of Law (Chicago) has been an ABI member since 1996. **Nancy A. Peterman** of Greenberg Traurig, LLP (Chicago) has been an ABI member since 1995 and is a past member of ABI's Board of Directors.

Adrienne K. Walker

Gregory A. Cross has been appointed partner-in-charge of Venable LLP's Baltimore office. He has been an ABI member since 1994.

Gregory G. Plotko has joined Barnes & Thornburg LLP as a partner in the firm's Finance, Insolvency and Restructuring Department in New York. He has been an ABI member since 2000.

Hon. Kevin Gross (ret.)

Richard J. Cooper of Cleary, Gottlieb, Steen & Hamilton LLP (New York) has been named an "Outstanding Restructuring Lawyer" for 2022 by *Turnarounds & Workouts*. He has been an ABI member since 2021. See his article on p. 28.

Eric L. Johnson of Spencer Fane LLP (Kansas City, Mo.) has been included in the Missouri Lawyer Media's inaugural "MO POWER 100" list. He has been an ABI member since 2021 and is a member of ABI's Board of Directors.

Adrienne K. Walker of Locke Lord LLP (Boston) has been named a "Top Lawyer" by *Boston Magazine*. She has been an ABI member since 2000 and is a member of ABI's Board of Directors.

Stephen M. Blank of Alston & Bird LLP (New York) has been elected partner. He has been an ABI member since 2021.

Aaron L. Hammer of Horwood Marcus & Berk Chtd. (Chicago) has been named "Legal Advisor of the Year" by The M&A Advisor. He has been an ABI member since 2001.

Debora Hoehne has joined Goodwin Procter LLP's Financial Restructuring Group in New York as a partner. She has been an ABI member since 2023.

Daniel Halperin of Sequor Law (Miami) has been selected as a "Top Up and Comer" for 2022 by the *South Florida Legal Guide*. He has been an ABI member since 2022.

Shadi Enos Jahangir of Blank Rome LLP (Los Angeles) has been named a "Woman of Influence: Finance" by the *Los Angeles Business Journal*. She has been an ABI member since 2023.

Hon. **Kevin Gross** (ret.) of Richards, Layton & Finger, PA (Wilmington, Del.) has received the Delaware State Bar Association's 2022 Kimmel/Thynge ADR Award. He has been an ABI member since 1999.

J. Ryan Yant of Carlton Fields, PA (Tampa, Fla.) has been named a shareholder. He has been an ABI member since 2021. abi

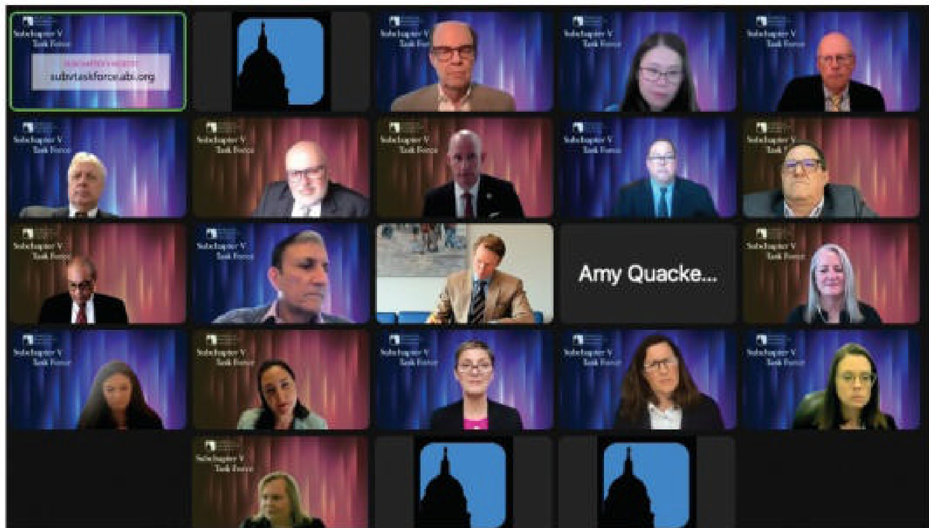
Got News?

Send your announcements to be featured in Members in the News.

Email Elizabeth at estoltz@abi.org.

What's Happening at ABI

Judges, Practitioners and Trustees Provide Testimony at First Public Hearing of ABI's Subchapter V Task Force



The Subchapter V Task Force held its first public hearing via Zoom on June 9, during which attendees shared their general experiences with subchapter V.

ABI's Subchapter V Task Force held its first virtual public hearing June 9, during which witness testimony was received from bankruptcy judges, practitioners and subchapter V trustees on their general experiences with small business reorganizations under subchapter V of chapter 11 of the Bankruptcy Code. Witnesses scheduled to testify included Hon. **Hannah L. Blumenstiel** of the U.S. Bankruptcy Court for the Northern District of California (San Francisco), Hon. **Lori V. Vaughan** of the U.S. Bankruptcy Court for the Middle District of Florida (Orlando), **Katherine B. Clark** of Thompson Coburn LLP (Dallas), **John-Patrick M. Fritz** of Levene Neale Bender Yoo & Golubchik, LLP (Los Angeles), **Richardo I. Kilpatrick** of Kilpatrick & Associates, PC (Auburn Hills, Mich.), **David A. Mawhinney** of Hart Advisory PLLC (Framingham, Mass.), **Brian L. Shaw** of Cozen O'Connor (Chicago) and **Michael St. James** of St. James Law, PC (San Francisco).

For more on the Subchapter V Task Force, please visit subvtaskforce.abi.org.

Diversity Working Group Announces 2023 Mentorship Program Participants

ABI's Diversity and Inclusion Working Group (DWG) announced that it has commenced its 2023 Mentoring Program to connect active or recently graduated business and law students with ABI past presidents and members who can provide guidance on career and professional development. Launched in 2021, the program brings mentors and mentees together to discuss ethical and confidentiality issues, common practice risks and traps, career goals, time-keeping, client management and development, and negotiation skills. The 2023 group of mentees includes **Maria Cho** of Faegre Drinker Biddle & Reath LLP (Los Angeles), **Sameer Alifarag** of Pryor Cashman LLP (New York), **Trevor C. Mosby** of Hinshaw & Culbertson, LLP (New Orleans), **Tomás F. Blanco-Pérez** of Ferraiuoli, LLC (San Juan, Puerto Rico), **Reginald Sainvil** of Baker & McKenzie LLP (Miami), **Melina Tabibian Bales** of Jones Day (Dallas), **Katelin A. Morales** of Potter Anderson & Corroon LLP (Wilmington, Del.) and **Jennifer Cruz** of the U.S. Bankruptcy Court for the Central District of California (Santa Barbara, Calif.). ABI members volunteering to serve as mentors this year include **H. Joseph Acosta** of Dorsey & Whitney LLP (Dallas), **David D. Farrell** of Thompson Coburn LLP (St. Louis), **Ferve E. Khan** of BakerHostetler (New York), **Gerard R. Luckman** of Forchelli Deegan Terrana LLP (Uniondale, N.Y.), **Patricia A. Redmond** of Stearns, Weaver, Miller, Weissler, Alhadeff & Sitterson, PA (Miami), **Claire Ann Richman** of Steinhilber Swanson LLP (Madison, Wis.), **Brian L. Shaw** of Cozen O'Connor (Chicago) and Hon. **Sage M. Sigler** of the U.S. Bankruptcy Court for the Northern District of Georgia (Atlanta).

ABI's Mentorship Program will hold formal bi-monthly meetings to discuss a variety of topics with resources from ABI and members of the reorganization community, including judges, trustees, attorneys and accountants. The group meetings will provide an opportunity to interact with other experienced insolvency professionals while offering an educational program and fostering opportunities to discuss important topics in the mentees' professional development. The mentors and mentees will then meet every other month to discuss such topics as courthouse decorum, attorney/firm interactions, work/life balance, networking, time-management, and any other topics that the mentors/mentees choose.

The DWG's Mentoring Subcommittee developed this program. This year the Subcommittee will be led by **Kim A. Posin** of Latham & Watkins LLP (Los Angeles) with support from Hon. **Martin R. Barash** of the U.S. Bankruptcy Court for the Central District of California (Woodland Hills), **Sonia Colón** of Ferraiuoli, LLC (Orlando, Fla.), **Mariane L. Dorris** of Shuker & Dorris, PA (Orlando, Fla.), **Zhao (Ruby) Liu** of The Rosner Law Group (Wilmington, Del.), **Allen G. Kadish** of Archer & Greiner PC (New York), **Stephen A. Spitzer** of AlixPartners, LLP (New York) and **Shanti M. Katona** of Polsinelli (Wilmington, Del.).

The DWG's overall mission is to develop recommendations for increasing diversity within ABI and its leadership, to help create opportunities for diverse ABI members, and otherwise to promote diversity within ABI and the insolvency profession. The DWG is chaired by **Michael L. Bernstein** of Arnold & Porter Kaye Scholer LLP (Washington, D.C.) and **Shanti M. Katona** of Polsinelli (Wilmington, Del.). Learn more about the DWG at diversity.abi.org.

ABI Committee Co-Chairs Announced

ABI's committees are the lifeblood of the organization and provide substantial information, educational programming and opportunities for members to participate. Committee co-chairs ensure the ongoing

strength of individual committees, and they work with ABI leadership to identify areas and projects within the organization that committees can use to share information and thrive.

In order to maintain a vibrant and effective committee structure, each year before the Annual Spring Meeting the President and President-Elect study ABI's member committees' activities, as well as current leadership for the committees, and make any necessary adjustments. This year, Immediate Past ABI President Hon. **Kevin J. Carey** (ret.) of Hogan Lovells US LLP (Philadelphia) and new ABI President **Soneet R. Kapila** of KapilaMukamal, LLP (Fort Lauderdale, Fla.), with assistance from ABI President-Elect **Christopher A. Ward** of Polsinelli (Wilmington, Del.), diligently evaluated ABI's 17 committees and identified new co-chairs to replace those who had completed their terms with leaders who have emerged within the committees, either through one of the five non-chair leadership positions (education director, communications manager, newsletter editor, membership relations director and special projects leader) or other active volunteers. In those instances, ABI leadership appointed these emerging leaders (indicated herein with an asterisk) as new co-chairs for two-year terms. Others have one year left in their co-chair terms.

Asset Sales

Provides insights on issues practitioners may face when completing asset sales in and out of bankruptcy, and best practices for successful outcomes. Co-Chairs: **Leyza Florin Blanco** of Sequor Law (Miami) and **Matthew J. LoCascio*** of SC&H Capital (Ellicott City, Md.).

Bankruptcy Litigation

Provides thoughtful analyses of recent case law; studies the rules of practice, evidence and procedure; and connects all professionals engaged in bankruptcy-related litigation and disputes in and out of bankruptcy court. Co-Chairs: **John C. Cannizzaro*** of Ice Miller LLP (Columbus, Ohio) and **Isley M. Gostin** of WilmerHale (Washington, D.C.).

Business Reorganization

Studies and analyzes business reorganization cases; monitors developments in the restructuring industry; provides reports, recommendations and relevant updates thereon; and hosts forums and educational initiatives on topics of interest. Co-Chairs: **Jamie J. Fell** of Simpson Thacher & Bartlett (New York) and **Timothy J. Anzenberger*** of Adams & Reese LLP (Ridgeland, Miss.).

Commercial Fraud

Serves as a resource for lawyers interested in the intersection of fraud and bankruptcy, including fraudulent transfers, bankruptcy fraud and objections to discharge, and Ponzi and other increasingly common fraudulent schemes. Co-Chairs: **Nathaniel J. Palmer*** of Reid Collins & Tsai LLP (Austin, Texas) and **Michael D. Napoli** of Akerman LLP (Dallas).

Commercial and Regulatory Law

Analyzes and discusses the intersection between insolvency law and various commercial and regulatory issues, including, but not limited to, tax, securities regulations, governmental affairs, labor and employment issues, antitrust laws, the Uniform Commercial Code and environmental laws. Co-Chairs: **Alan R. Rosenberg*** of Markowitz, Ringel, Trusty + Hartog, PA (Fort Lauderdale, Fla.) and **April A. Wimberg*** of Dentons Bingham Greenebaum (Louisville, Ky.).

Consumer Bankruptcy

Provides studies, analyses, and reports and recommendations on the operation of consumer chapter 7, 11 and 13 cases, and strives to include viewpoints and perspectives from all aspects of the bankruptcy arena, including those of the bench, trustees, and practitioners representing both debtors and creditors. Co-Chairs: **Hannah White Hutman*** of Hoover Penrod PLC (Harrisonburg, Va.) and **Heather Giannino** of Heavner, Beyers & Mihlar, LLC (Decatur, Ill.).

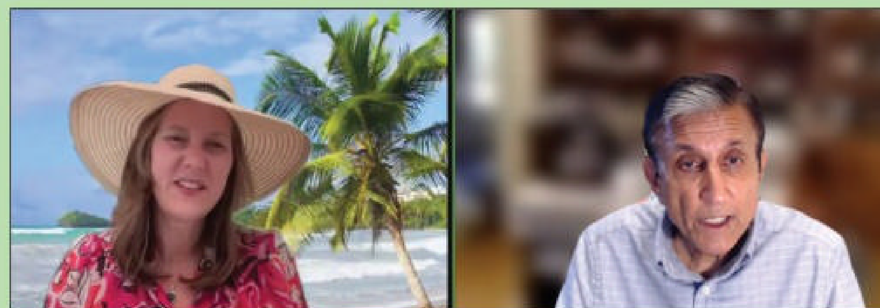
Emerging Industries and Technologies

Highlights how emerging industries and technologies impact the restructuring and insolvency field, and provides insights into how bankruptcy practitioners can navigate the various aspects of new technology and digital assets. Co-Chairs: **Rebecca Finch Redwine** of Hendren, Redwine & Malone, PLLC (Raleigh, N.C.) and **Jordana L. Renert** of Lowenstein Sandler LLP (New York).

Ethics and Professional Compensation

Studies standards for representation and trends in professional conduct discipline, and identifies and focuses on issues concerning professional compensation in bankruptcy cases. Co-Chairs: **B. Summer Chandler*** of LSU

Inaugural "Party in Interest" Podcast Recorded During Summer-Themed Virtual Happy Hour!



ABI Executive Director Amy Quackenboss (l) talked with ABI President Soneet R. Kapila of KapilaMukamal, LLP (Fort Lauderdale, Fla.) during a live recording of ABI's inaugural "Party in Interest" podcast. The "Party in Interest" series will highlight extraordinary members of our community for their contributions to key bankruptcy developments, initiatives to push the practice forward and/or passion for a cause or activity outside the office. The recording was held on June 14 prior to a "summer kickoff" virtual networking session with attendees wearing their favorite summer attire. To access the "Party in Interest" podcasts and nearly 300 other ABI Podcasts, please visit abi.org/newsroom/podcasts. The complimentary virtual happy hours will resume in the fall in a similar format, with a live podcast recording followed by a networking session to allow practitioners to stay connected. Check out abi.org/events for the schedule, and visit abi.org/rsvp to sign up!

Paul M. Hebert Law Center (Baton Rouge, La.) and **Sarah Primrose** of King & Spalding LLP (Atlanta).

Financial Advisors and Investment Banking Committee

Provides expert insights and guidance with respect to all aspects of the restructuring process, particularly issues that impact the financial advisor community, including valuation, M&A, tax, retention and payment, fiduciary governance, and industry-specific issues such as health care, real estate and retail. Co-Chairs: **Michael R. Nestor*** of Young Conaway Stargatt & Taylor, LLP (Wilmington, Del.) and **Heather G. Williams*** of CR3 Partners LLC (Richmond, Va.).

Health Care

Studies the unique aspects of health care insolvencies and monitors various sectors of the health care landscape, including health care providers, life-sciences organizations and medical equipment companies, while connecting attorneys, financial advisors, investment bankers and other professionals in the health care realm. Co-Chairs: **Cynthia Romano** of CohnReznick LLP (New York) and **Brian Bonaviri*** of Grant Thornton LLP (Charlotte, N.C.).

International

Provides a forum for the exchange of ideas related to the interrelationship between U.S. and foreign insolvency laws, harmonizing U.S. and foreign insolvency laws, the model laws promulgated by UNCITRAL related to insolvency proceedings including chapter 15 of the U.S. Bankruptcy Code, planning and implementing cross-border bankruptcy proceedings, tracing and recovering assets in foreign insolvency proceedings, and the impact of U.S. and foreign insolvencies on international trade and financial systems. Co-Chairs: **Evelyn J. Meltzer** of Troutman Pepper Hamilton Sanders LLP (Wilmington, Del.) and **Adam D. Crane*** of Baker & Partners (Georgetown, Cayman Islands).

Legislation

Analyzes proposed and pending bills of interest to ABI members, and monitors relevant congressional action. Co-Chairs: Jill Novak Dalrymple* of Reno & Cavanaugh PLLC (Nashville, Tenn.) and TBD.

Mediation

Focuses on mediation and other ADR methods that are applied in the bankruptcy process, including conflict-resolution skills development, overcoming impasses, multiparty mediations, confidentiality and more. Co-Chairs: **Ian Connor Bifferato** of The Bifferato Firm (Wilmington, Del.) and **Edward L. Schnitzer*** of Montgomery McCracken Walker & Rhoads LLP (New York).

Real Estate

Analyzes issues unique to the reorganization of commercial real estate, including single-asset cases. Co-Chairs: **Evan T. Miller** of Bayard, PA (Wilmington, Del.) and **Erin A. West*** of Godfrey & Kahn, SC (Madison, Wis.).

Secured Credit

Analyzes and reports on issues related to secured transactions and claims in the bankruptcy context, such as debtor-in-possession financing, pre-petition secured claims, and the relationship between the Uniform Commercial Code and bankruptcy practice. Co-Chairs: **James K. Donaldson** of Woods Rogers Vandeventer Black (Richmond, Va.) and **Andrea Chase*** of Spencer Fane LLP (Kansas City, Mo.).

Unsecured Trade Creditors

Focuses on all issues relevant to unsecured trade creditors in bankruptcy and related nonbankruptcy proceedings, and provides information and education to assist trade creditors and their advisors in maximizing the value of their unsecured claims. Co-Chairs: **Lindsay Zahradka Milne*** of Bernstein Shur (Portland, Maine) and **Daniel I. Waxman*** of KEWA Financial Inc. (Lexington, Ky.).

Young and New Members

Fosters the growth of ABI's future leaders by providing professional development and networking opportunities tailored to those in the early stages of their careers, and encourages active involvement of bankruptcy practitioners under 40 years of age and/or those with less than 10 years of experience in the industry. Co-Chairs: **Bodie B. Colwell*** of Preti Flaherty, LLP (Portland, Maine) and **Christina Sanfelippo** of Cozen O'Connor (Chicago).

Thanks go to all of the outgoing committee co-chairs and other leaders for their service. ABI members can join any committee, and there is no limit as to how many committees members may join. For more information, please visit abi.org/membership/committees.

ABI Welcomes New Executive Assistant

Julie Mattaliano

In June, **Julie Mattaliano** joined ABI's staff as executive assistant. With more than 10 years of paralegal experience specializing in civil litigation, she takes pride in her attention to detail and organizational skills, and she loves putting her skills to use in both her personal and professional life. When she's not busy keeping all her legal ducks in row, Julie explores new neighborhoods, catches up on the latest Netflix obsession, and spends time with family and friends. She reports to ABI Executive Director **Amy Quackenboss**.

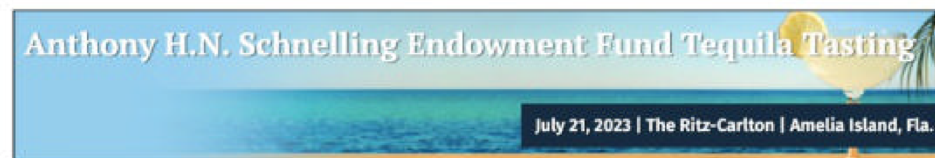
ABI Endowment Fund Update

Another Way to Give to the Endowment: ABI Founders Society

By becoming a member of the ABI Founders Society, you can continue to support the Anthony H.N. Schnelling Endowment Fund and ABI for years to come through estate-planning. All proceeds benefit the ABI Endowment Fund and are 100 percent tax-deductible. When you include ABI in your estate plan,

your generosity helps provide additional funding for the Endowment so that it can continue to support current and future industry members. For more information, please visit foundersociety.abi.org or contact ABI Endowment Manager **Erin Green** at egreen@abi.org.

ABI's Southeast Bankruptcy Workshop Is Around the Corner



On July 21, the ABI Endowment will be hosting a tequila-tasting event from 9:30-11:30 p.m. at The Ritz-Carlton, Amelia Island, in conjunction with ABI's Annual Southeast Bankruptcy Workshop, taking place July 20-23. Tickets cost $250 and include snacks, tequila flights, Mexican wines and sangritas. The event is sponsored by Shumaker, Loop & Kendrick, LLP/**Steven M. Berman** and BakerHostetler/**Donald A. Workman**. If you would like to sponsor this event, sponsorship is $1,200, which includes two tickets. For more information, please contact ABI Endowment Manager **Erin Green** at egreen@abi.org. Please visit abi.org/events for more details on the Southeast Bankruptcy Workshop.

In addition, we will be running a silent auction throughout the workshop. If you would like to donate any items for the silent auction, please check out ABI's Wish List at amazon.com for potential items. In addition to the Amazon list, other items such as weekend getaways, golf outings, sports suites and wine/spirits tend to do well at auction.

The L.A Wine Dinner Is BACK!

Last year's L.A Wine Dinner was a huge success, and we are looking forward to hosting the event again this year. Last year, the dinner raised more than $12,000 for the ABI Endowment. This year's event will take place in late October; further details will be shared in future issues and in the monthly *Developments* email. If you are interested in being a part of this event, please reach out ABI Endowment Manager **Erin Green** at egreen@abi.org. We hope to see you at this event!

New Endowment Donor Recognized

Millennium Level: **Geoffrey L. Berman**
Development Specialists, Inc.

Levels of Support for the ABI Endowment

Level	Amount
Diamond Level	$80,000-$100,000
Platinum Level	$65,000-$79,999
Millennium Level	$50,000-$64,999
30th Anniversary Circle	$30,000-$49,999
Century Council Member	$25,000-$29,999
Visionary Member	$20,000-$24,999
Legacy Member	$15,000-$19,999
Lifetime Member	$10,000-$14,999
Benefactor	$5,000-$9,999
Sustaining Member	$2,000-$4,999
Leadership Club	$1,000-$1,999
Donor	$100-$999

Donate online at abi.org/endowment. Donations are tax-deductible and can be paid over five years. Contact Erin Green at egreen@abi.org for more information. abi

New Members

February (partial list)

Romeu Scarioli, Jr.
San Marino, Calif.

Beth Ann Schenz
The Huntington National Bank
Akron, Ohio

Gary I. Selinger
Independent Equipment Co.
New York

Mark D. Sherrill
Eversheds Sutherland (US) LLP
Houston

Justin Simms
New York University School of Law
New York

Debra Sinclair
Willkie Farr & Gallagher LLP
New York

Maria Sountas-Argiropoulos
KTBS Law LLP
Los Angeles

Paul Spagnoli
St. John's University School of Law
Thornwood, N.Y.

Carissa Sterling
Carmody MacDonald PC
St. Louis

Daniel Tavera
U.S. Bankruptcy Court (N.D. Ohio)
Perrysburg, Ohio

Lawrence R. Thomas, III
Blank Rome LLP
Wilmington, Del.

Krystal M. Thorp
Hochwalt & Schiff, LLC
Kettering, Ohio

Nicholas Trautwein
SC&H Capital
Sparks Glencoe, Md.

James M. Truett
LSU Paul M. Hebert Law Center
River Ridge, La.

Khyati Tuli
New York University
New York

Andrew Vavricka
St. John's University School of Law
Kings Park, N.Y.

Audrey Victor
St. John's University School of Law
Brooklyn, N.Y.

Hank Walth
Law Office of Hank W. Walth
Stockton, Calif.

Ruiqiao Wen
Stinson LLP
Washington, D.C.

Andrew Wenger
Sandton Capital Partners
New York

Alexander Witz
University of Wisconsin
Madison, Wis.

Michael Wombacher
Dykema Gossett PLLC
San Antonio

Kyra Woods
Greenberg Traurig LLP
Salt Lake City

Jessica L. Mullenix Woodward
CSC
Wilmington, Del.

Beth Ann R. Young
Levene, Neale, Bender, et al.
Los Angeles

March (partial list)

Crystal N. Abbey
Godfrey & Kahn, SC
Green Bay, Wis.

Samuel E. Alvarado
Shumaker, Loop & Kendrick, LLP
Tampa, Fla.

Nathan Basalyga
Ice Miller LLP
New York

Ian R. Bell
U.S. Bank Trust Co. NA
St. Paul, Minn.

Parnell Black
NACVA
Sandy, Utah

Lesley Bohleber
Bush Kornfeld LLP
Seattle

Michael L. Boyle
Boyle Legal
Troy, N.Y.

Tyler Brasher
Gibbins Advisors, LLC
Nashville, Tenn.

Max Brauer
Md. Office of the Attorney General
Baltimore

Ellen Brennan
U.S. Bankruptcy Court (W.D. Va.)
Roanoke, Va.

Aaron Brownell
Department of Justice Tax Division
Washington, D.C.

Griselda Cabrera
U.S. Bankruptcy Court (S.D.N.Y.)
New York

Jerry M. Chang
Berkeley Research Group
Atlanta

Kate Christensen
Fordham University
New York

Devon Cipperly
AIS Portfolio Services LLC
Washington, D.C.

Grant Coffey
U.S. Bankruptcy Court (N.D. Tex.)
Lubbock, Texas

Carl Comstock
Intrepid
Brooklyn, N.Y.

Vincenzo Conciatori
Campbell University
Raleigh, N.C.

Kyle Conway
Campbell University
Wilson, N.C.

Alexander G. Criswell
University of Mississippi
Oxford, Miss.

Julia Damasco
Miller Kaplan
Santa Fe, N.M.

Matthew H. Davis
Locke Lord LLP
Dallas

Ian Day
Law Office of Ian Day
Boulder, Colo.

Vanessa De Leon Guerrero
Office of the Standing Ch. 13 Trustee
San Antonio

Drew M. Dillworth
Stearns, Weaver, Miller, et al.
Miami

Caroline R. Djang
Buchalter, A Professional Corp.
Irvine, Calif.

Nicole Escudero Duenas
Yip Associates
Miami

Leslie Dyer
U.S. Bankruptcy Court (D. N.M.)
Albuquerque, N.M.

Erin M. Edelman
Armstrong Teasdale, LLP
St. Louis

Di Edwards
NYU Law School
Bronx, N.Y.

Jonathan P. Emerson
Berkeley Research Group, LLC
Summit, N.J.

Botan Fattah
ORIX
Dallas

John D. Faucher
Faucher Law
Westlake Village, Calif.

Andrew Feng
Quaestor Consulting Group
New York

John Fenn
Hilco Global
Northbrook, Ill.

Rosa Figueroa Nieves
Shumaker, Loop & Kendrick, LLP
Tampa, Fla.

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Grant Thornton Ltd.
St. Peter Port, U.K.

Charles Ryan Fluno
Truist
Nashville, N.C.

Megan Ford
Computershare Trust Co.
Columbia, Md.

Guilherme Franca
Lollato Lopes Rangel Ribeiro
New York

Geoffrey S. Frankel
Hilco Corporate Finance
Manhattan Beach, Calif.

David C. Gaffney
Gaffney Law Firm PA
West Columbia, S.C.

Alissa Y. Gay
Teel & Gay, PLC
Jackson, Tenn.

Gordon Gendler
UMB Bank NA
Minneapolis

Rachel Glissmann
University of Minnesota
Minneapolis

Yolanda Grayson
U.S. Bankruptcy Court (W.D. Ark.)
North Little Rock, Ark.

Tijuhna Green
U.S. Dep't of Justice, Tax Division
Washington, D.C.

Rachel Greenberg
Curran Antonelli, LLP
Boston

Kurt F. Gwynne
Reed Smith LLP
Wilmington, Del.

Gregory F. Hagood
SOLIC Capital Advisors, LLC
Atlanta

Nicholas Hasbun
St. John's University
Jamaica, N.Y.

Holly Hayman
Farleigh Wada Witt
Portland, Ore.

Zach Hemenway
Stinson LLP
Kansas City, Mo.

Ryan Hibbard
Ice Miller LLC
New York

Charles S. Hodges
U.S. Bank Trust Co., NA
Olive Branch, N.C.

James W. Holt
ORIX Corp. USA
Dallas

Sammy Hooda
Marinosci Law Group, PC
Addison, Texas

Candice C. Hubert
Chiron Finance
Cypress, Texas

Morgan Hutchinson
Washington University in St. Louis
St. Louis

James I. McClammy
Davis Polk & Wardwell LLP
New York

Michael A. Ingrassia
Morris, Nichols, Arsht & Tunnell LLP
Wilmington, Del.

Paul Jansen
Riveron Consulting
Houston

Daniel Jasnow
ArentFox Schiff LLP
New York

John T. Joens
Chapman University
Irvine, Calif.

Jermaine A. Jones
Washington & Lee University
Lexington, Va.

Trevor P. Kehrer
Skadden, Arps, Slate, Meagher & Flom
Houston

Holly Kelly
Grant Thornton LLP
New York

Aaron L. Kempf
University of Nevada, Las Vegas
Las Vegas

Chris Kennedy
Alvarez & Marsal
Grand Cayman, Cayman Islands

Kael Kerlick
SCJ Commercial Financial Services
Harrington, Del.

Hyeisoo Kim
University of Southern California
Los Angeles

Alison E. Kowalski
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Montclair, N.J.

William Z. Kransdorf,
Legal Services NYC
New York

Jennifer K. Krombach
Bates White
Washington, D.C.

John Kuebler
U.S. Bankruptcy Court (S.D.N.Y.)
Jersey City, N.Y.

Jeffrey S. Kwong
Levene, Neale, Bender, Yoo & Golubchik
Los Angeles

Thomas A. Labuda, Jr.
Dentons US LLP
Chicago

Christian LaChance
Davis Ward Phillips & Vineberg LLP
Montréal

Shlomo Lang
CohnReznick LLP
New York

Matthew H. Lannan
Alvarez and Marsal
Arlington, Va.

Nicholas S. Laue
Keller & Almassian, PLC
Grand Rapids, Mich.

Jaime Leggett
Bast Amron LLP
Miami

Dominic A. Litz
White & Case LLP
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could have refused to ship for any reason other than the one it communicated:

> Wilson could have simply refused, for any reason, to sell goods to debtor or offered no explanation for its refusal to do business. Instead, its sole reason for refusing to sell goods to debtor was its desire to collect its pre-petition debt. The act in this context had the effect of interfering with the reorganization effort, a result at odds with the purpose of the bankruptcy laws.[24]

As a result, the bankruptcy court entered an injunction requiring Wilson to ship goods to Sportfame on a cash-in-advance or on-delivery basis, and "on a normal basis consistent with their dealings for the past 10 years."[25] The practical lesson is clear: Be careful what is said in response to a debtor's request for supply post-petition, even if you did not have a contract with the debtor. Generically inquiring about the debtor's proposed trade terms and whether the debtor intends to treat you as a critical vendor — assuming that such an order has been entered — is the safest course.

Don't Violate the Stay by Ceasing Performance Under an Executory Contract Without Leave of Court

Stay violations are common where the vendor and debtor are parties to a contract as of the petition date. As the *Kmart* court noted, a vendor is not always entitled to cease deliveries, as it depends on the vendor's contractual relationship with the debtor. For example, there might be "long-term contracts, and the automatic stay prevents these vendors from walking away as long as the debtor pays for new deliveries."[26]

Section 365(a) of the Bankruptcy Code provides debtors with the ability to, subject to court approval, assume or reject an executory contract.[27] The Code does not define "executory contract," but many courts have adopted the Countryman definition: "[A] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[28]

Executory contracts are enforceable against the nondebtor party before assumption or rejection.[29] Section 365 provides "a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so."[30] A debtor may assume or reject an executory contract at any time before plan confirmation, although a creditor may ask the bankruptcy court to make such a determination within a particular time frame.[31]

A cautionary tale for vendors having an executory contract with a debtor can be found in *In re Feyline Presents Inc.*,[32] where Coke and the debtor entered into an agreement pre-petition under which Coke was to pay the debtor a fee for the debtor's promotional identification of Coke and its exclusive right to sell soft drinks at the debtor's concerts.[33] Coke was obligated under the executory contract to pay the debtor $150,000 post-petition as a pre-payment for the next year's concert series, but it did not make the payment. Instead, it sent the debtor a notice that Coke had suspended its performance due to the debtor's "precarious financial situation" and "inability to perform" its obligations under the contract.[34]

Vendors should assess their ongoing performance obligations under any existing contracts and be circumspect in communications with a debtor about refusals to ship — even in the absence of an executory contract.

In denying Coke's motion for summary judgment, the *Feyline* court held that Coke's refusal to make the payment was improper: "If a nondebtor party could unilaterally cease performance on an executory contract, the powers provided to a debtor under § 365(d) would have no meaning."[35] The court also provided guidance on what Coke *should have* done:

> Without question, the breathing spell afforded by 11 U.S.C. § 365(d) can impose a penalty on the other party to the contract. However, that party has a remedy and that remedy is to move, pursuant to Section 365(d)(2), for an order requiring the debtor to make an early election.[36]

Vendors who believe that they will be harmed by continuing to perform under an executory contract with a debtor should move to compel the debtor to make an early election to assume or reject their contract, or for relief from stay to terminate it. Failure to do so may violate both §§ 365 and 362.

Conclusion

The entry of a critical-vendor order, and the prospect of payment of a vendor's pre-petition indebtedness, can lead vendors to take actions that might jeopardize the very payments they desperately seek. Vendors should assess their ongoing performance obligations under any existing contracts and be circumspect in communications with a debtor about refusals to ship — even in the absence of an executory contract. **abi**

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24 *Id.*
25 *Id.* at 56.
26 359 F.3d 866, 873.
27 11 U.S.C. § 365(a).
28 Vern Countryman, "Executory Contracts in Bankruptcy: Part I," 57 *Minn. L. Rev.* 439, 460 (1973).
29 *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531 (1984); 11 U.S.C. § 365(e)(1) (prohibiting executory contract counterparty from suspending performance solely due to bankruptcy filing).
30 *Chateaugay Corp. v. LTV Steel Co. (In re Chateaugay Corp.)*, 10 F.3d 944, 954-55 (2d Cir. 1993).
31 11 U.S.C. § 365(d)(2).
32 81 B.R. 623 (Bankr. D. Colo. 1988).
33 *Id.* at 624.
34 *Id.* at 625-26.
35 *Id.* at 627.
36 *Id.* at 626.

Code to Code: Cash Is Not King Anymore

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a letter of credit in the context of bankruptcy is that it does not directly expose the tenant's cash to the risk of diminution as an unsecured claim. That said, letters of credit also serve as a strong benefit to landlords in the event of a tenant bankruptcy because the contractual rights to draw on them will likely — depending on the specific provisions — exist beyond the scope of the automatic stay.[19] Accordingly, tenants who negotiate standby letters of credit should be advised by experienced counsel on the risks and benefits that come along with executing such instruments in lieu of cash.

Another option may involve including trust language in the lease that may, to some extent, protect a tenant's security deposit by retaining a possessory interest in the deposit. However, while this use of cash may be preferable to use without trust guarantees — where commercial leases provide adequate trust language but fail to provide for the *segregation* of security deposit funds — many jurisdictions have adopted the "lowest intermediate balance rule." Depending on the circumstances, this rule may either serve as a basis to exempt the comingled funds from the bankruptcy estate or limit the tenant's right to recover the lowest intermediate balance after the account expends some or all of the funds held in trust.[20] Providing cash for use in a security deposit is almost always riskier for a tenant than providing a cash equivalent. It is imperative that tenants' attorneys carefully consider the possibility of a landlord's insolvency and the risks to a cash security deposit — a commodity whose status as "king" may well now be usurped by more predictable collateral in a bankruptcy case.

Conclusion

As most jurisdictions do not offer any statutory scheme, let alone a strict one, it falls on the parties (or, more accurately, their attorneys) to ensure that lease provisions are clearly set forth and will predictably govern the treatment of commercial security deposits or alternatives, lest sacrificing priority, amount or even approval of a creditor's claim against a debtor's estate. It is no secret that risk is a primary factor when negotiating the terms of a commercial lease. However, the risk that attaches to the possibility of a landlord's insolvency arguably outweighs the risks associated with a tenant's bankruptcy.

In the event of a tenant's insolvency, cash paid to landlords at or before the execution of a commercial lease will almost certainly become property of the debtor's estate.[21] In most jurisdictions, the lease language will generally direct the ultimate disposition of such interests, but when insolvent landlords enter bankruptcy, their cash on hand becomes a finite resource — one that multiple creditors may be competing to claim. If some or all of a landlord's liquidity includes cash security deposits, then tenants should expect to find themselves at odds with secured lenders or others who may be more likely to obtain higher-priority distributions.

Moreover, understanding the treatment of commercial security deposits in the applicable jurisdiction and proactively amending leases may ultimately aid in navigating the best course for protecting potential tenant-creditors and will likely influence whether to exercise their rights to retain possession of a leasehold — in the event of a rejection by the landlord — or treat the lease as terminated and walk away with whatever damages can be recovered from the estate.[22] It is imperative that the rights of commercial tenants be carefully considered at all stages of dealing to ensure that a landlord's insolvency does not result in the forfeiture of critical cash. abi

19 The obvious trade-off being that they also carry with them the risk of encumbering a tenant-debtor's estate if drawn on post-petition. *See, e.g., In re Senior Care Ctrs. LLC*, 607 B.R. 580, 597 (Bankr. N.D. Tex. 2019) (landlord-creditors could encumber estate post-petition by drawing on $2.7 million in letters of credit on assumed leases for 22 skilled-nursing homes). Additional concerns arise from the so-called "independence principle," which imposes an absolute duty on the issuer to pay, regardless of whether the parties perform on the underlying lease. *See Great Wall De Venezuela C.A. v. Interaudi Bank*, 117 F. Supp. 3d 474, 485 (S.D.N.Y. 2015).

20 *See, e.g., In re Columbia Gas Sys. Inc.*, 997 F.2d 1039, 1063 (3d Cir. 1993) (limiting distribution to $3.3 million of pre-petition cash); *In re Mississippi Valley Livestock Inc.*, 745 F.3d 299, 308-09 (7th Cir. 2014) (failure to trace trust funds and determine lowest intermediate balance warranted reversal and remand).

21 *But see* 11 U.S.C. § 541(b)(2) (excluding certain interests of commercial lessees).

22 The mechanics of the rights retained by tenants under a lease rejected by a landlord-debtor are governed by 11 U.S.C. § 365(h).

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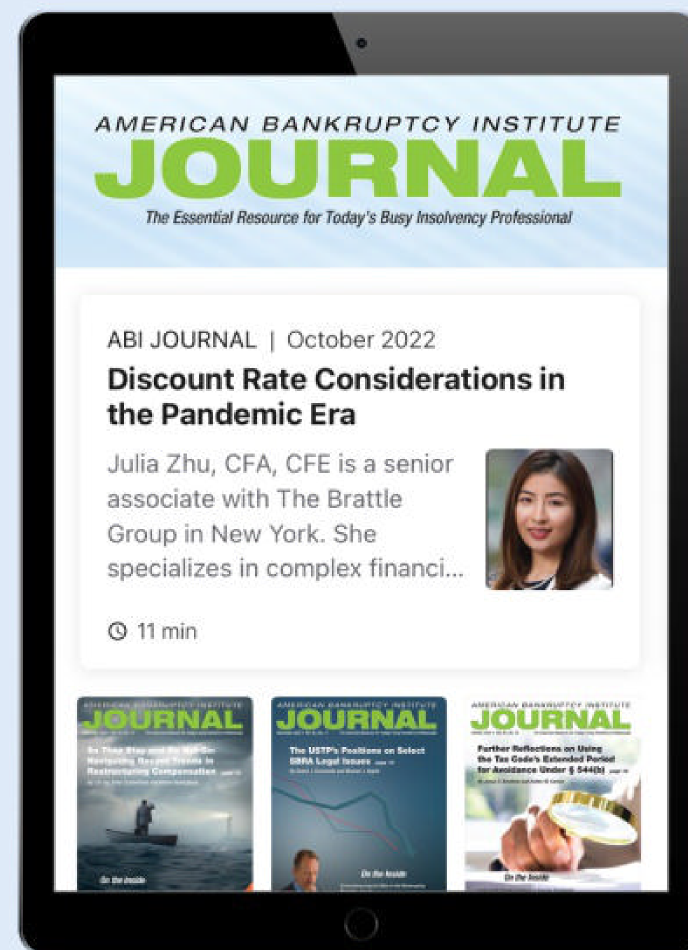

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First, the parties could extrapolate estimates based on pre-petition settlement agreements.[20] A gating issue would be to balance the confidentiality of the settlement agreements while still revealing enough to support the integrity of the estimates. The draw to this approach is its relative low cost and quickness as compared to other approaches (given that the pre-petition settlement pool is already a given at this point). However, the downfall is that the results may be skewed, as the estimate only looks to settled cases and not those awards determined by a jury.

Second, the parties could conduct a few representative sample arbitrations and/or jury trials to determine the summary.[21] The advantage is that the parties may get a more accurate gauge of the amounts, particularly if the sample adjudications are coupled with settlements. The disadvantage is that this solution takes time.

Third, the court could appoint an expert (pursuant to Rule 702 of the Federal Rules of Evidence) whose task is to develop a matrix of estimation values based on the underlying facts, claims asserted, defenses raised and other pertinent factors.[22] The interested parties are essentially moving from the court's judgment to the expert's judgment, although the expert may be more particularly specialized. Diligent attention must be given to assure a fair and neutral selection process of that expert.

Fourth, the parties could collectively work on a form questionnaire to be answered by the interested parties.[23] The advantages here are again the relative low cost and speed to the approach. The risk is that it is reliant upon parties with their own interests at stake to complete the questionnaire. The concern may be mitigated by requiring parties to submit the questionnaire under penalty of perjury and/or combine the approach with appointing an expert who can cull the data.

Fifth, the court could establish a potential step-up process whereby criteria are decided on to determine the classifications with an estimated claim assigned to that class.[24] For example, plaintiffs could demonstrate that zero to three systems have an estimated claim at $20,000, four to six symptoms are at $40,000 and so forth. The approach would still need a mechanism to collect the data, such as a questionnaire.

The second half of methods discussed are generally applicable when there may only be one (or perhaps only a handful) of PI claims in the case. This could include, for example, a singular slip-and-fall case.

Sixth, a court may hold an abbreviated evidentiary hearing or "mini trial." Of all the approaches mentioned in this article, this approach requires the most care to define the process on the front end. For example, would both bankruptcy and state court counsel be necessary to try the case? Would the parties need to call on expert witnesses, adding a level of administrative expense and delay to the proceedings? What if there was a pending state court action with outstanding *Daubert* motions or other motions *in limine*, would those need to be resolved first? If there are additional third parties (such as co-defendants or insurance companies), are they afforded an opportunity to present evidence? The authors pose that many of these questions are best left on a case-by-case basis, understanding that the goal is to pose an economic and expeditious process to estimate a claim while feeling a certain level of comfort with the estimation.

Attorneys and their clients should bear in mind the purpose, and subsequently the authority, for estimating a PI claim. Practitioners should be prepared to not only argue the legal basis for estimation, but also the actual logistics.

Seventh, the court could call for submission of competing papers akin to a competing summary-judgment proceeding. This may require the support of competing expert opinions and, therefore, could not be done overnight but would most likely present significant cost savings at a final evidentiary hearing.

Eighth, some courts have utilized an "all-or-nothing" approach. This is where the court awards the full value of the claim if the claimant proves its case by a preponderance of the evidence and zero otherwise.[25]

Ninth, and a softening of the all-or-nothing approach, is a "probabilistic method." This is where the court estimates "the probability a claim will succeed and apply the probability to the damages, reasoning that they should take into account the likelihood that each party's version might or might not be accepted by a trier of fact."[26]

Finally, if available, an appropriate guidepost may be jury verdict reporters. These reporters identify verdicts and settlements in personal-injury cases, including a summary of the background, so that the parties can ascertain any relevant PI claims and what the jury awarded in that proceeding.

Key Takeaways

Attorneys and their clients should bear in mind the purpose, and subsequently the authority, for estimating a PI claim. Practitioners should be prepared to not only argue the legal basis for estimation, but also the actual logistics. Thus, the best practice is to consider and raise these issues as soon as possible in the motion and any responses to ensure that they are properly vetted. abi

20 *In re Roman Catholic Archbishop of Portland*, 339 B.R. at 220.

21 *Id.* at 223.

22 *Id.*

23 *Id.*

24 *See, e.g., In re G-I Holdings Inc.*, 323 B.R. 583, 623-26 (Bankr. D.N.J. 2005).

25 *In re Wall*, 2020 Bankr. LEXIS 2918, at *4 (Bankr. S.D. Ala. 2020) (citing *In re A & B Assocs. LP*, 2019 WL 1470892 (Bankr. S.D. Ga. 2019)).

26 *Id.*

Cyber-U: Data-Privacy Laws May Affect a Distressed-Asset Sale

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A Business's Obligation to Obtain Opt-Ins for Sensitive Data-Processing

This item refers to a business's obligation to obtain an "opt in" from a consumer before processing sensitive PII. It exists under Colorado, Connecticut, Indiana, Tennessee and Virginia laws.

Right Against Automated Decision-Making

The "right against automated decision-making" prohibits a business from making decisions about a consumer solely based on an automated process, without any human input. This right (in some form) exists under all of the currently enacted comprehensive data-privacy laws except for Utah.

Children's PII

"Children's PII" refers to an obligation that a business obtain opt-ins from the parents or guardians of any children under a certain age (either 13 or 16 years of age) to sell those children's PII. This right exists under all of the currently enacted comprehensive data-privacy laws.

Notice/Transparency Requirement

The "notice/transparency requirement" refers to a business's obligation to provide notice to consumers about certain data practices, privacy operations or privacy programs. This right exists under all of the currently enacted comprehensive data-privacy laws.

Obligation to Perform Risk Assessments

The "obligation to perform risk assessments" refers to a business's obligation to conduct formal risk assessments of privacy or security projects or procedures. This right exists (in some form) under all of the currently enacted comprehensive data-privacy laws except for Iowa and Utah.

Prohibition Against Discrimination

The "prohibition against discrimination" refers to a prohibition against a business treating a consumer who exercises a data-privacy right differently than a consumer who does not exercise that right. This right exists (in some form) under all of the currently enacted comprehensive data-privacy laws except for Utah.

Who Enforces These Laws?

Only state governments may enforce the comprehensive state data-privacy laws that have been enacted so far. In other words, none of these laws currently contains private rights of action.[4] This is helpful to potential acquirers, as it limits the potential parties that might later pursue them for the pre-sale privacy practices of the distressed sellers. It also provides a finite list of parties who must receive notice of the proposed sale to protect the § 363 sale order.

4 This contrasts with state data-breach laws, which often permit individuals whose PII is the subject of a data breach to assert claims against parties that are responsible for the breach. The California Privacy Rights Act does provide for a private right of action, but only with respect to security breaches of personal information.

However, the issue of whether data-privacy laws *should* contain private rights of action is hotly contested, and some state legislatures (such as Florida) have considered legislation that includes a private right of action.[5] It is possible that states (or even the federal government) could enact future data-privacy laws that contain such rights. Thus, potential acquirers should not assume that there will *never* be private rights of action.

Conclusion

Unless the federal government steps in with a comprehensive privacy law that pre-empts state laws, states will be a major source of new and expanding data-privacy laws. States are likely to continue to enact new privacy laws and amend existing ones, and legal teams that conduct due diligence on behalf of potential asset-acquirers should be aware of these state laws and how they may affect their transactions. abi

5 *See, e.g.*, Florida H.B. 9, which was proposed in 2022. This bill has not been enacted.

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contained sufficient allegations.[8] The complaint specifically alleged that the trustee had examined documents, including the debtor's bank records, invoices between the parties, correspondence and the operative contract.[9] The trustee also included a chart of the relationships among the relevant entities, and had thus demonstrated due diligence, even though the complaint did not plead due diligence as an element. The court emphasized that a plain reading of the statute granted it discretion in applying the requirement, citing to the new "circumstances of the case" language in amended § 547(b).[10]

Although the factual allegations referenced by the court in *In re Trailhead* imply that the trustee sufficiently alleged due diligence regarding the alleged transfers, it remains unclear whether the trustee properly alleged due diligence regarding the defendant's affirmative defenses under § 547(c). Nevertheless, the court's analysis at least suggests that the trustee must plead factual allegations that satisfy the "reasonable due diligence" requirement before filing a complaint, but not necessarily as an independent element of the preference.

The decisions in *In re Reagor-Dykes Motors LP*[11] provide insight into what is and is not an acceptable due-diligence pleading. This case covered three complaints filed against separate defendants, and all three defendants filed motions to dismiss, contending that the trustee failed to allege sufficient facts to carry its burden of "reasonable due diligence." The court acknowledged that the SBRA was intended to deter the filing of abusive lawsuits.[12] It also recognized the lack of clarity regarding the new requirement, stating that it was unclear whether the due-diligence language created an additional pleading requirement.[13] However, the court made it clear that in bringing a preference action, a trustee must exercise due diligence and consider the party's known or reasonably knowable affirmative defenses under § 547(c).[14] As to what constitutes "sufficient due diligence," the court cautioned that it is difficult to assess a trustee's due-diligence efforts at the motion-to-dismiss stage, but the sufficiency of the due diligence depends on the case's circumstances.[15] A mere recital by a trustee that he had exercised sufficient due diligence, thus mimicking the language of the statute, is insufficient.[16]

Ultimately, the court refused to dismiss the complaint against the first defendant despite the minimal factual allegations asserted in the complaint.[17] Because the defendant had not answered the suit, its affirmative defenses were unknown, thus minimal factual allegations about the parties' relationship and the circumstances surrounding the transfers did not reflect an abusive filing.[18]

Taken as a whole, most courts are uniformly requiring trustees to allege facts reflecting their due diligence, but the extent of such due diligence remains unclear and should be determined on a case-by-case basis.

Conversely, the court dismissed the other two complaints[19] because they had failed to provide context as to the transfers and the nature of the parties' relationship.[20] In doing so, the court proffered several questions that provided insight into the type of context that should be included: "What kinds of services or goods did either defendant provide?"[21] "How were the business relationships structured?"[22] "Were the transfers on account of ordinary business practices, simultaneous value, or a cash-on-delivery agreement, or was new value provided for these transfers?"[23] None of these questions could be answered with any certainty, since there was no information in the complaints about the nature of those transfers.[24] Thus, it is important for trustees to provide context as to the transfers and the nature of the parties' relationship in the complaint.

Despite the lack of conformity in determining what constitutes "reasonable due diligence," two recent decisions seem to indicate a baseline for satisfying the requirement, whether it is an element or not. Both *In re Insys Therapeutics Inc*.[25] and *In re Ctr. City Healthcare LLC*[26] declined to rule on whether the revisions to the statute created a new element, but determined that if it was an element, it was met by the trustee and debtors, respectively.[27] In both cases, the trustee and debtors conducted an analysis of the pre-petition payments during the avoidance period for goods and services provided by the transferees, and analyzed whether those transfers were protected from avoidance by any knowable defenses.[28] They then sent letters prior to initiating suit and invited the defendants to advise them of their defenses, and to the extent any defenses were presented, they took them into account.[29] Both courts held that they conducted reasonable due diligence despite not

8 *Id.* at *7.
9 *Id.*
10 *Id.*
11 *In re Reagor-Dykes Motors LP*, No. 18-50214-RLJ-11, 2021 WL 2546664 (Bankr. N.D. Tex. June 21, 2021).
12 *Id.* at *2.
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id. See also Arete Creditors Litig. Trust v. TriCounty Fam. Med. Care Grp. LLC (In re Arete Healthcare LLC)*, No. 19-52578-CAG, 2022 WL 362924, at *11 (Bankr. W.D. Tex. Feb. 7, 2022) ("If due diligence is an element, merely paraphrasing the element will not satisfy Rule 8.").
17 *Id.* at *3.
18 *Id.*
19 The trustee was granted leave to amend the complaints.
20 *Id.* at *6.
21 *Id.* at *5.
22 *Id.*
23 *Id.*
24 *Id.*
25 *Insys*, 2021 WL 5016127 at *3.
26 *Ctr. City*, 641 B.R. at 802.
27 *Insys*, 2021 WL 5016127 at *3 (declining to conclude that amended language added new element but finding that trustee had adequately pled due diligence.); *Ctr. City*, 641 B.R. at 802 ("Even if the amended language of section 547(b) added 'reasonable due diligence' as an element ... the Debtors in this case have adequately pled factual allegations to satisfy that element.").
28 *See id.*
29 *Id.*

pleading how the affirmative defenses were not available:[30] "There is no requirement that the debtors plead how the affirmative defenses are not available, the debtors must simply plead that they considered them."[31]

Minority View: "Reasonable Due Diligence" Is an Element of § 547(b)

Although most courts have side-stepped the issue by relying on the complaint's factual allegations, the *In re ECS Ref. Inc.* court concluded that the new language inserted into § 547(b) created a condition precedent to a preference claim, requiring that the trustee's due-diligence efforts be set forth in the complaint to state a *prima facie* claim.[32] The court analyzed the condition precedent as having three prongs that a trustee must undertake before commencing a preference action: "(1) reasonable due diligence under 'the circumstances of the case'; (2) consideration as to whether a *prima facie* case for a preference action may be stated; and (3) review of the known or 'reasonably knowable' affirmative defenses that the prospective defendant may interpose."[33] In concluding that "reasonable due diligence" is an element of the trustee's preference action and not an affirmative defense, the court focused on three features of the statute.

First, § 547(b) is the sole source of the trustee's substantive rights and defines what a trustee must show for avoidable preferences.[34] Second, § 547(c) offers preference defendants an exhaustive list of nine affirmative defenses, therefore § 547(b)'s new language should not be viewed as a preference defendant's affirmative defense.[35] Third, Congress expressly allocated the burden of proof on the issue of due diligence under § 547(b) to the trustee under § 547(g).[36] Despite finding that reasonable due diligence was a new element of the preference claim, the court noted that reasonable due diligence was already required under Rule 9011 of the Federal Rules of Bankruptcy Procedure.[37] Thus, in practice, all that has changed is that trustees now have to plead their due diligence efforts in their complaints.

Practice Tip

Taken as a whole, most courts are uniformly requiring trustees to allege facts reflecting their due diligence, but the extent of such due diligence remains unclear and should be determined on a case-by-case basis. In particular, very fact-specific defenses, such as the ordinary-course-of-business defense, can be very difficult to assess until discovery. At a minimum, trustees should send pre-suit demands with a net of new-value calculation and request information to support any other affirmative defenses. Trustees should also describe these efforts in their complaints to ensure protection from any motions-to-dismiss. abi

30 *Id.*
31 *Ctr. City*, 641 B.R. at 802.
32 *Husted v. Taggart (In re ECS Ref. Inc.)*, 625 B.R. 425, 454 (Bankr. E.D. Cal. Dec. 15, 2020).
33 *Id.*
34 *Id.* at 456.
35 *Id.*
36 *Id.*
37 *Id.* at 457.

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in the process among states. For example, in Pennsylvania, although a creditor may perfect a security interest in a liquor license by filing a UCC-1 financing statement pursuant to the Pennsylvania UCC, the Pennsylvania Liquor Control Board (PLCB) will not recognize a third party's security interest unless such third party goes through a number of procedural steps with the PLCB.[21] Similarly, in Massachusetts, UCC-1 filings afford creditors a security interest, but secured lenders also must gain approval by the local licensing authority and the Alcoholic Beverage Control Commission.[22] In addition, a pledge of a license to secure a lease is not permitted under Massachusetts law.[23] In Florida, a lender must record the lien with the Division of Alcoholic Beverages and Tobacco using that department's specific form within 90 days of the creation of the lien.[24] Other states may have similar restrictions on liquor licenses, which must be researched to ensure proper perfection.

Execution Issues

Invariably, issues are likely to arise when lenders attempt to execute on a liquor license after the debtor files for bankruptcy or defaults under a security agreement. Common issues include the following: (1) the active license converting to a "safekeeping" status or otherwise expiring under the state law and local procedure; (2) the UCC-1 financing statement lapses; or (3) the parties fail to comply with applicable state laws and procedures when executing against the liquor license.

Some quota states impose "safekeeping" status on liquor licenses under certain circumstances, which sometimes proves to be problematic for creditors. In Pennsylvania, a liquor license may change status from "active" to "safekeeping" when a licensed establishment closes for a consecutive period of time, regardless of the reason, and the PLCB deactivates the license and holds the license in safekeeping while the establishment is closed.[25] When a license is in safekeeping for an extended time period, it will either be (1) reinstated by actions of the current licensee; (2) sold to another party; or (3) extinguished if the quota in that state's county or municipality is greater than permitted by the state. Accordingly, "to have a license reissued from safekeeping, [a]n application for return of the license shall be filed by the licensee," which includes additional fees.[26] If the license is reinstated by the debtor, a creditor that maintains a perfected interest in the license may pay necessary fees and taxes to execute on the license.[27] If the license expires or is obtained by another party through a quota-vacancy auction, the creditor will lose the security interest in the liquor license completely.[28]

Secured creditors may also face issues in executing a liquor license lien when the secured lender allows the financing statement to lapse. Such time periods depend on the type of collateral and the jurisdiction,[29] and most financing statements are effective for a period of five years.[30] A UCC-1 that is not continued before lapsing will cease to be effective, costing the secured party their perfected status and perhaps their priority position to collect. Once a financing statement has lapsed, it cannot be revived; consequently, a lapse will likely result in the loss of priority of the security interest on the liquor license.[31]

Creditors should be aware of the varying state procedures and requirements necessary to properly attach and perfect a security interest in a liquor license, assuming that the state even allows for such liens.

Finally, execution on a liquor license is made much more difficult due to the strict filing requirements that must be met to attach and perfect a security interest in a liquor license. In addition to closely adhering to the state-specific procedures in order to attain an enforceable lien on a liquor license, the UCC-1 financing statement must also be carefully prepared and properly filed. If a UCC-1 financing statement contains seriously misleading errors or omissions, it may result in the following: (1) a refusal by the filing office to accept the financing statement; (2) a subordination of the secured party's interest in favor of another creditor; or (3) possible avoidance of the security interest altogether.[32]

Conclusion

Properly perfecting a lien on a liquor license may afford creditors significant collateral and security when providing financing to certain debtors. Creditors should be aware of the varying state procedures and requirements necessary to properly attach and perfect a security interest in a liquor license, assuming that the state even allows for such liens. Creditors should always contact local counsel to confirm the correct process and procedure necessary to ensure that they have a valid and enforceable lien on their liquor license collateral. Moreover, creditors must perform proper and consistent due diligence with respect to their liquor license liens to avoid potential execution issues in the event of a debtor's default or insolvency. **abi**

21 *See* PLCB Guidance on Third-Party Claims.
22 *Hillbilly Ranch Inc. v. Kahn (In re Wible)*, 42 B.R. 622 (Bankr. D. Mass. 1984)).
23 M.G.L. c. 138, § 23.
24 Fla. Stat. Ann. §§ 561.32, 561.65.
25 47 P.S. §4-474.1; 40 Pa. Code § 7.31.
26 *See* 40 Pa. Code § 7.31(e).
27 *In re Kanoff*, 408 B.R. 53, 56 (Bankr. M.D. Pa. 2009) (creditor paid fees to PLCB to attain license).
28 PLCB Guidance on Third-Party Claims, p. 2.
29 *See, e.g.*, U.C.C. § 9-515.
30 U.C.C. § 9-515(a).
31 U.C.C. § 9-515(c).
32 U.C.C. §§ 9-506(a), 9-338 (issues include error in debtor(s) name(s); post-filing changes in collateral, which required updates; or issues with taxes or filing fees associated with UCC-1 filing).

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or to help finance the business, to which the debtor agreed. The debtor and the friend developed a financing arrangement where the two would enter into a loan agreement per a business transaction involving the friend's concrete business.

For each transaction, the debtor would receive roughly 30 percent of the loaned amount. The debtor would then provide the friend a check inclusive of the agreed-upon price in the loan agreement, and the friend would deposit the check into his account. For repayment, the friend would provide the debtor a check to deposit in his account. The debtor opened an account with the bank for this purpose and other similar arrangements.[18]

One day, the friend deposited three checks totaling $550,000 into the debtor's account at the bank. Due to the debtor being out of town, the debtor's wife and the friend signed several loan agreements involving different transactions totaling $535,000. After confirming with a bank representative that the previously deposited $550,000 was available to disperse, the representative wrote a cashier's check in the amount of $535,000, and the friend subsequently deposited the amount into his account.

A few days later, the bank charged back the $550,000 to the debtor's account, causing his account to be overdrawn. The debtor informed the friend of the chargeback, to which the friend promised to resolve the issue within a few weeks. Following the friend's promise, the debtor signed a promissory note and security agreement with the bank for payment on the overdrawn amount. Despite several extensions by the bank on the note, the friend could not fulfill his promise, and the account remained in default.[19]

The debtor filed suit against the friend in state court, which was later stayed due to the friend filing for bankruptcy. The debtor then filed suit against the bank in state court claiming damages for breach of contract and negligence. The creditor counterclaimed and sought judgment on the note. The state court ruled in the bank's favor, awarding judgment on the note. The debtor filed for bankruptcy, which prompted the bank to initiate an adversary proceeding against him. The bank sought a determination that because the debt resulted from a check-kiting scheme, it was nondischargeable under § 523(a)(2)(A). The bank also argued that under *Bartenwerfer*, the debtor was liable for the debt.[20]

First, the bankruptcy court rejected the bank's argument that the debtor was part of a check-kiting scheme with the friend. The court noted the many successful transactions between the debtor and friend up until the end.[21] Second, the bankruptcy court rejected the bank's *Bartenwerfer* argument against the debtor, stating:

> In the case at bar, [the debtor's] liability to [the bank] does not arise from the fraud of another for which he is vicariously liable. Rather, his liability is a direct liability on the note that he signed to cover the overcharge to his account. Accordingly, [the bank] had to prove that this debt was incurred by actual fraud committed by [the debtor]. Nothing in *Bartenwerfer* changes this.[22]

The bankruptcy court denied the bank's request and declared the debt dischargeable as to the debtor.

Conclusion

Is there no such thing as an honest debtor after *Bartenwerfer*? No. Despite the Bankruptcy Code's overall goal of helping the honest debtor discharge its debts, there is no fundamental or constitutional right to a discharge in bankruptcy even for these debtors. As concluded in *Bartenwerfer*, there are instances that even the most honest of debtors cannot get out of, and § 523(a)(2)(A) is one. In the § 523(a)(2)(A) context, the Court empathizes with the *Bartenwerfer* debtor, along with other innocent debtors who will likely be affected by its decision. However, the Court upholds the separation of powers by affirming Congress's favoring creditors over debtors in § 523(a)(2)(A), even the honest ones. abi

18 *Id.* at *1-*2.
19 *Id.* at *2-*3.
20 *Id.* at *3.
21 *Id.* at *7.
22 *Id.* at *8.

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for and against this model, highlighting the reasons why some market participants feel that it should change.

Argument for and Against the Mixed-Measurement Model

The use of fair value measurements in financial statements became a subject of debate in the aftermath of the 2008 financial crisis. While the Financial Accounting Standards Board appeared to initially lean toward universally employing a fair-value measurement, the mixed-measurement model was ultimately retained. Proponents of the mixed-measurement model have two arguments:[6]

- *Management Intent Is Relevant:* The current classifications allow management the flexibility to accurately reflect the business reason and intent behind owning specific securities. When a security is classified as HTM, this communicates that it was purchased for the contractual cashflow stream provided by the debt instrument, and that subsequent changes in the economic environment are not expected to alter management's intent to receive that stream of cashflows. Therefore, short-term fluctuations in fair value are not relevant when the stated business purpose of holding the security is considered.
- *Fair Value Introduces Unnecessary Volatility:* If all assets were recorded at fair value, the resulting short-term changes in the interest-rate environment or other factors affecting the value of debt securities would introduce volatility in financial results. For example, the average quarterly change in the fair value of HTM securities in SVB's case exceeded $3 billion in 2022. In contrast, the company's net income averaged less than $400 million per quarter.[7] Thus, interim changes in the fair value of these securities could overshadow other financial metrics.

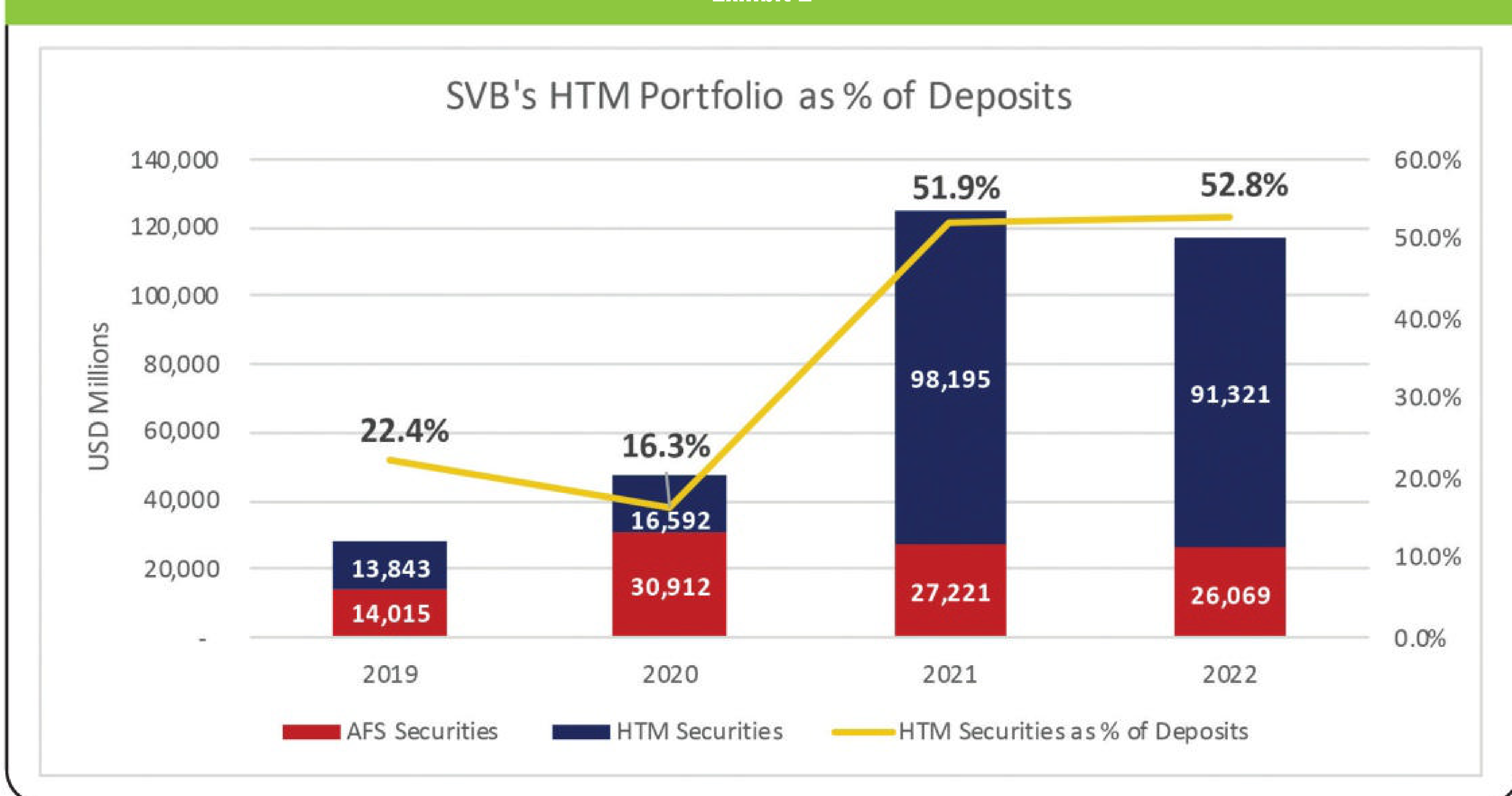
Critics of the mixed-measurement model highlight that existing standards result in the exact same debt security having materially different values on different bank balance sheets. If one bank classified the security as HTM, it would be recorded at cost, reflecting the security's value in a historical transaction that may have occurred years prior. On a second bank balance sheet, if the same security was classified as AFS, it would be recorded at current market prices, which could be materially higher or lower. Those who were against the mixed-measurement model have made three arguments:

- *Transactions Occur at Fair Value:* If SVB changed its intent and sold the HTM securities, it would receive fair value in the transaction. Furthermore, if SVB sought to use the HTM securities as collateral for a loan, lenders would likely not provide financing based on historical costs; they would lend against fair value. Investors or clients of SVB would find fair value information equally relevant when deciding to invest or keep deposits with the bank.
- *Historical Cost Is Not Relevant:* While a balance sheet reflects the actual cost and value of HTM securities at a

6 CFA Institute, Letter to the Financial Accounting Standards Board Regarding Proposed Accounting Standards Update (Sept. 30, 2010).

7 SVB Financial Group, Annual Report (Form 10-K) (2022); S&P Capital IQ (2023), SVB Financial Information.

Exhibit 2



point in time, this does not adequately reflect the current value. As SVB's case demonstrates, the economic environment can change rapidly, significantly affecting the value of bank assets. The historical cost of HTM securities purchased in a low interest-rate environment is no longer relevant when rates rise 5 percent.

• *Investors Adjust Book Values:* Throughout 2008, many bank stocks traded below their stated book values. Market prices indicated that investors were potentially discounting reported asset values to reflect current market conditions. If market participants base investment decisions and price stocks based on an estimate of fair value, then financial statements should be presented on this basis to reflect the information that investors want to see. Rather than being buried in a footnote to the financial statements, this information should be more visible. In SVB's case, analysts were discussing the company's HTM losses as early as November 2022, and reports published in early 2023 noted that if the HTM losses were recognized in financial statements (*i.e.*, adjusted to fair value), the bank's equity balance would be eliminated.

It remains to be seen whether recent events will prompt any significant change in the way debt securities are recorded in financial statements. While there are arguments both for and against the mixed-measurement model, further discussion and evaluation may be needed to determine the most appropriate course of action should any potential changes be pursued.

The Federal Reserve's Assessment of SVB's Failure

If the losses on SVB's securities portfolio were disclosed, and if analysts had been discussing the fair value of these securities as early as November 2022, some might also question how the HTM classification could have contributed to SVB's failure at all. In the wake of SVB's collapse, the Federal Reserve prepared a report to examine whether its supervisory and regulatory action (or inaction) contributed to the bank's demise. The report ultimately admitted that the Federal Reserve "failed to take forceful enough action" but highlighted numerous relevant factors, including:[8]

• *Mismanagement:* The Federal Reserve concluded that SVB's board failed to properly manage risks, including interest-rate risk. For example, although SVB had hedges in place to protect against rising interest rates, these hedges were removed relatively early in the rate cycle.

• *Uninsured Deposits:* SVB had a large concentration of uninsured deposits, which accounted for 94 percent of SVB's total deposits (more than twice as high as industry peers). The Federal Reserve concluded that SVB's announcement of asset sales on March 8, 2023, led uninsured depositors to perceive financial distress, and move quickly to withdraw deposits.

• *Customer Concentration:* SVB primarily catered to the technology and venture-capital industries, which are highly cyclical. While SVB benefited from record growth in deposits from these customers in 2020 and 2021, when the sector slowed and clients began burning cash, SVB's deposit base eroded.

The report also commented on SVB's HTM securities and acknowledged that accounting classifications may have constrained management's ability to react as the economic environment changed. The Federal Reserve stated that the HTM classification "limited" SVB's ability to adjust its securities portfolio as interest rates increased. If any portion of an HTM portfolio was sold, the entire portfolio would have become tainted, and all unrealized gains/losses would have to have been recognized immediately. This constraint, introduced by the accounting classifications SVB's management selected, may also have contributed to SVB's failure.

Conclusion

In light of the recent series of bank failures, some investors and other market participants are calling for a revisit of the financial-reporting standards and the accounting classification of debt securities. SVB's losses on HTM securities had been disclosed to investors, yet the Federal Reserve concluded that this classification may have limited management's ability to act. Whether the mixed-measurement model is the most suitable approach to present financial results and effectively communicate relevant risks to market participants remains the subject of ongoing debate. Determining the optimal framework for financial reporting and accounting is a complex task, but any lessons learned from recent events can hopefully contribute to an even more effective and robust framework for financial reporting. abi

8 Board of Governors of the Federal Reserve System, Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 28, 2023).

Exhibit 3

SVB's HTM Securities ($ Millions)	As of December 31, 2022		
	Amortized Cost	Unrealized Gains / (Losses)	Fair Value
U.S. Agency Debentures	486	(52)	434
Agency-issued MBS	57,705	(9,349)	48,356
Agency-issued CMO - Fixed Rate	10,461	(1,885)	8,576
Agency-issued CMO - Variable Rate	79	(2)	77
Agency-issued CMBS	14,471	(2,494)	11,977
Municipal bonds and notes	7,417	(1,267)	6,150
Corporate Bonds	708	(109)	599
Total HTM Securities	**91,327**	**(15,158)**	**76,169**

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In return for this commitment, the Treasury would receive nonvoting senior preferred shares, warrants to purchase 79.9 percent of the GSEs' outstanding common stock, and the right to a periodic commitment fee. Dividends on any amounts the GSEs drew from the Treasury would be 10 percent (12 percent if not paid in cash). The GSEs were further directed to wind down their mortgage portfolios according to a prescribed schedule.

Early Conservatorship (2009-12)

By the end of the second quarter of 2009, Fannie Mae had received $15.2 billion in funding from the Treasury, while Freddie Mac had received $44.6 billion. Alarmed, President Barack Obama's administration made the decision in May 2009 to increase the Treasury's commitment to $200 billion for each GSE.

By the end of the third quarter of 2009, Fannie Mae had received $44.9 billion in funding, while Freddie Mac had received $50.7 billion, forcing the Obama administration to again amend the PSPAs, providing for a funding commitment of $200 billion for each GSE plus any additional deficit amounts incurred between 2010 and 2012, less any positive GAAP-based shareholders' equity as of Dec. 31, 2012.

By the end of the first quarter of 2012, Fannie Mae had drawn $116.1 billion, while Freddie Mac had drawn $71.3 billion, translating to annual dividend requirements of $11.6 billion and $7.1 billion, respectively — amounts far exceeding the GSEs' annual earnings in the five years preceding conservatorship. The Treasury feared that the GSEs would be forced to make draws on the PSPAs in order to pay back dividends to the Treasury.

Return to Profitability (2012 Forward)

As the housing market stabilized, the GSEs began to show signs of returning to profitability. In August 2012, the FHFA directed the GSEs to increase their single-family guarantee fees by 10 basis points as a step toward encouraging greater private-sector participation in the mortgage markets. At the same time, the Treasury announced another modification to the PSPA. Among other things, this "third amendment" replaced the 10 percent dividend with a variable dividend to address fears that the GSEs would draw cash from the Treasury for the purpose of paying dividends back to the Treasury.

The third amendment required the GSEs to sweep all of their earnings to the Treasury, except for a specified amount that they were allowed to retain as a capital buffer, which would decline over the succeeding five years. Beginning in 2018, the dividend would consist of the entire net worth amount.

This action was not without controversy. The third amendment was criticized as an inappropriate expropriation of the GSEs' earnings, and a number of shareholder lawsuits followed. As earnings began to improve, the GSEs reduced their provisions for loan and guarantee losses and released the valuation allowances against their net deferred tax assets to reflect improved market conditions. These accounting entries had the effect of temporarily magnifying earnings for the next few years, distorting the perception of the GSEs' profitability. In 2019, the PSPAs were again modified to allow the GSEs to retain earnings to build capital reserves of $25 billion for Fannie Mae and $20 billion for Freddie Mac.

Successes — and Failures — of Conservatorship

There is very little doubt that the PSPAs served their primary purpose, which was to stabilize the housing markets and calm investors who feared the GSEs would default on their obligations. Writing five years after completing his tenure as Treasury Secretary, Paulson expressed satisfaction with the PSPAs' stabilizing effect but dismay that conservatorship had survived into 2013. He was further concerned that the GSEs dominated the housing market more completely than ever.[4] To this day, very little private capital has re-entered the residential mortgage market.

Winding down the GSEs and returning housing finance to the private sector was a shared goal of the Bush, Obama and Trump administrations, but only Congress holds the power to modify the GSEs' charters, and most GSE-watchers believe that congressional action is unlikely to come for many years. Recent changes to the GSEs have come through regulations originating from the Treasury and FHFA.

The Treasury's remaining funding commitment is $113.9 billion for Fannie Mae and $140.2 billion for Freddie Mac. Since 2012, the GSEs have only drawn on the PSPA once, in 2018, because of accounting changes to the rules governing loan-loss reserves. The GSEs' financial positions appear to be stronger than ever, and the GSEs proved to be a stabilizing force during the COVID-19 pandemic.

The View Ahead

The solutions developed during the 2008 crisis have become institutionalized, forming the basis of a new status quo. However, it is worth recalling that before 2008, the status quo was similarly built on a set of creative solutions that had become normalized following the savings-and-loan crisis, the War on Poverty and the Great Depression. Each of those solutions contained within them the seeds of the next crisis.

The collapse of Enron in 2001 and the passage of the Sarbanes-Oxley Act of 2002 led to a flurry of financial accounting investigations and restatements. The GSEs were the subjects of accounting restatements between 2002 and mid-2007, and during that time, every major accounting firm in the nation parked thousands of accounting consultants at the GSEs' headquarters. These consultants pored, for years, over the GSEs' books and records.

By the time the last consultants had packed up their laptops, the first rumblings of the Great Financial Crisis were

4 *Id.* at p. xxxii.

ripping through the daily headlines. Those thousands of consultants at the GSEs, buried in the contracts and books and records of these two behemoths, did not see it coming. In their defense, neither did Secretary Paulson and the GSEs' regulators,[5] which should instill a little humility in anyone who would predict the future.

In mid-March 2023, when the news broke of the collapse of Silicon Valley Bank, with its balance sheet full of Fannie Mae and Freddie Mac mortgage-backed securities, it might have been natural to feel a case of the jitters. When First Republic Bank was brought down in part by its portfolio of jumbo mortgages, those jitters might have solidified into feelings of mild panic.

Because of their now fairly explicit federal guarantee, GSE securities remain a desirable investment, and financial institutions actively seek to bolster their balance sheets with them. They are no longer full of toxic mortgages poisoning the bloodstream of the global financial circulatory system.

Silicon Valley Bank, and to a lesser extent First Republic Bank, failed because of an inflation-caused duration mismatch: Short-term obligations were financed by long-term loan assets. In an inflationary environment, with assets composed of 30-year fixed-rate mortgages, those securities lost value, causing bank runs by panicked depositors.

5 *Id.* at pp. xviii-xix.

Conclusion

Conditions in 2023 are different from 2008. The good news is that the U.S. dollar remains the world's reserve currency, and there is no credible alternative to it. The demand for U.S.-backed securities of all kinds remains high across the global economy.

The bad news is that geopolitical tensions between the U.S. and China are greater now than ever, while tensions with Russia are near the boiling point. Alternatives to currencies backed by a nation state are rising as an economic force. Growing impatience with U.S. leadership and the ability to manage its financial affairs feeds a narrative of crisis and panic, and calls for decoupling the globalized financial system from the U.S. dollar are being heard not only from Russia and China, but increasingly from relatively friendly places, such as Saudi Arabia, Brazil and India. The U.S. national debt is nearly treble its 2008 level, while inflation and higher interest rates are back after a generation of dormancy. In short, what we have to fear most, in the words of another Bush-era cabinet member, are the unknown unknowns.[6] abi

6 This is based on something said by former Defense Secretary Donald Rumsfeld. *See* Dan Zak, "'Nothing Ever Ends': Sorting Through Rumsfeld's Knowns and Unknowns," *Washington Post* (July 1, 2021), *available at* washingtonpost.com/lifestyle/style/rumsfeld-dead-words-known-unknowns/2021/07/01/831175c2-d9df-11eb-bb9e-70fda8c37057_story.html (subscription required to view article).

Legislative Update: Consumer Bankruptcy Reform Act: Uncoupling of Debts

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pay the full amount of the loan in order to keep their vehicle. Under the bill, individuals are required to pay only the liquidation value of secured claims like car loans (with an exception of cars purchased 90 days before bankruptcy)." In the text of the CBRA, there is no explanation on this other than information on establishing the average prime-offer rate for motor-vehicle financing, and the allowance per § 101 for the adjustment of car loans ("allowing the modification of car loans based on the market value of a car").

- Separation of secured and unsecured debts would potentially lessen the stress that most debtors feel when addressing sometimes dozens of creditors at once during a bankruptcy. Under § 1052(6) regarding the effect of a limited proceeding, "[T]he stay under ... section 362(a) shall apply only to entities with an interest in the property that the debtor has indicated in the schedule of affected property as intended for treatment under a plan."
- Separate treatment of repayment, residence and property plans for confirmation, discharge and revocation purposes would give debtors a greater chance of success at a quick plan confirmation. Specifically, certain debts can become contentious, resulting in adversary proceedings or objections to confirmation from creditors. Separating debts, especially larger ones such as a mortgage or car loan, into their own plans would give creditors and debtors a better chance at successfully confirming at least one plan, perhaps while other disputes are resolved.
- Confirmation hearings would remain similar to how they already are held under chapter 13, as a single confirmation hearing would be held even if multiple plans have been filed.[27]

The Cons

- Separating secured and unsecured debts into different plans could result in incurring more attorneys' fees for debtors. Under the CBRA, if a consumer debtor needs to bring all of his/her debts into bankruptcy, an attorney would need to draw up three plans.
- Multiple plans with a single confirmation hearing would result in essentially what the system already does under chapter 13, but it also could result in different outcomes for each plan at the confirmation hearing. What if a property plan can be confirmed, but a repayment plan cannot be confirmed at the end of a confirmation hearing? Section 1024(g) of the CBRA considers this possibility and would allow, upon request, for the confirmation of any plan type to be stayed until the date on which the court either confirms or denies confirmation for any other plan.[28] What promises to streamline the future hypothetical bankruptcy process could instead result in the current time frame most debtors face when trying to get their plans confirmed.

27 S. 4980, § 1023(c).
28 S. 4980, § 1024(g).

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- Limited proceedings could result in simplifying bankruptcy filings for *pro se* debtors. The CBRA appears to make the consumer bankruptcy system easier for *pro se* debtors to navigate, especially if he/she only needs to file one plan. However, this could result in debtors falling behind on payments for secured debts, such as for a car loan, and filing for a limited proceeding to resolve one debt without considering their financial obligations as a whole. While the purpose of decoupling debts under the CBRA is for this exact reason, it could result in a detriment to *pro se* debtors who are unfamiliar with bankruptcy and looking at their financial obligations as a whole. The average *pro se* debtor may feel more inclined to file for bankruptcy simply because they fall behind on one debt (*e.g.*, a car loan) under this new process. For example, a *pro se* debtor files, gets a plan confirmation and retains their car. Months later, the debtor has fallen behind on a boat payment or on a child's car bought as a graduation gift. Can the debtor file again? What about amending the plan? The decoupling of debts risks the potential for a layperson to "jump the gun," so to speak, and file a limited proceeding when a full proceeding might be a better option. Currently, when filing under chapter 7 or 13, the bankruptcy system takes into consideration a debtor's entire financial situation.
- With the CBRA proposing many debtor-friendly provisions, creditors could face uncertain results upon the confirmation of plans. With repayment from a debtor under a plan, uncertainty always exists for creditors hoping to collect what they are owed. However, the CBRA proposes even more debtor protections, such as easy plan modifications, consideration of certain circumstances during repayment delinquency and much more.[29] This could lead to even more tensions among parties negotiating plan terms, particularly if the plan is not consented to prior to a confirmation hearing.[30]

29 *See generally* S. 4980.

Weighing Both Sides

As with any proposed legislation, there is no ideal resolution. Although the pros and cons lists focus on the separation of debts and streamlined proceedings under the CBRA, there are many other changes that would affect both debtors and creditors if this legislation were enacted. The CBRA has lofty goals, but the main question that Congress should be asking itself when reviewing the CBRA is this: Will this legislation achieve its desired result?

The Likelihood of Adoption

The CBRA's stated purpose is to "simplify and modernize the consumer bankruptcy system and make it easier for individuals and families forced into bankruptcy to get back on their feet."[31] Proponents of the CBRA have further described the current bankruptcy system as unfair, expensive and complex.[32] The CBRA attempts to streamline the bankruptcy process while protecting debtors from experiencing more hardship. At this time, it remains unclear whether the CBRA will be adopted anytime soon.

As with any bill that proposes considerable changes, the CBRA will face many hurdles, particularly in its current form. Whether the addition of limited proceedings and expansion of different plan types will simplify the bankruptcy process and create more affordable proceedings for debtors is debatable. The last significant bankruptcy reform to occur was the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[33] It remains unclear whether or how much of the CBRA will ever become law, but the legislation certainly proves to be a creative alternative to the current bankruptcy system. abi

30 *See* § 1023(b) of the proposed CBRA ("Confirmation without hearing. — If no objection is raised, the court shall, upon notice, promptly confirm a plan that complies with section 1024(a) *without a hearing.*" (emphasis added)). The CBRA is proposing confirmation of uncontested plans without hearings, but this may be another attempt at the CBRA's idea of streamlining the bankruptcy process.

31 "Senator Warren and Representative Nadler Reintroduce the Consumer Bankruptcy Reform Act," *supra* n.2.

32 *Id.*

33 *See* Julia Kagan, "Bankruptcy Abuse Prevention and Consumer Protection Overview," *Investopedia* (April 26, 2023), *available at* investopedia.com/terms/b/bapcpa.asp.

LTL*: Third Circuit Dismisses J&J Subsidiary Bankruptcy*

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of [it]." 11 U.S.C. § 548(a). So, if the question becomes ripe, the next one might be: Did LTL receive reasonably equivalent value in exchange for forgoing its rights under the Funding Agreement?[19]

On remand, the bankruptcy court quickly dismissed LTL's bankruptcy (hereinafter "LTL 1.0"). Over the next four days, LTL, J&J and New JJCI cancelled the funding agreement (hereinafter "Funding Agreement 1.0") and entered into a new agreement, Funding Agreement 2.0, which provided up to $8.9 billion over a 25-year period to fund a trust that "would fully and finally resolve all current and future talc claims."[20] On April 4, 2023 (four days after dismissal), LTL refiled for bankruptcy (hereinafter "LTL 2.0"), claiming that it did so with the support of more than 60,000 talc claimants.[21]

Between April 24 and May 10, 2023, 11 parties (including the U.S. Trustee) filed motions to dismiss for a lack of good faith, largely raising the same arguments as before, plus arguments that LTL failed to remedy the issues underpinning the dismissal of LTL 1.0.[22] The question before Judge Kaplan is now whether the reduction from $61 billion to $8.9 bil-

19 *Id.* at 109, n.8 (alterations in original).

20 *In re LTL Mgmt. LLC*, No. 23-12825 (Bankr. D.N.J.) (Docket No. 3, p. 2).

21 *Id.*

22 *Id.* (Docket Nos. 286, 335, 345, 346, 350, 352, 358, 379, 384, 473, 480).

lion in funding changes the financial-distress calculation. The Third Circuit arguably acknowledged (or implied) that cancelling Funding Agreement 1.0 was one way to read their ruling, and never explicitly disavowed that reading.[23]

To the extent that Judge Kaplan decides that LTL is properly in bankruptcy, the next issue will almost certainly become whether there was a fraudulent transfer. Judge Kaplan has already acknowledged this issue in an April 27, 2023, order in LTL 2.0 granting a preliminary injunction to certain nondebtors: "[I]t remains unclear whether the transactions give rise to fraudulent-transfer liability for the benefit of the Debtor's creditors."[24] This issue, he held, was premature and undeveloped on the record.[25]

To the extent that there was a fraudulent transfer, Judge Kaplan would then have to wade into relatively uncharted territory to determine the interplay of the Texas divisional-merger statutes, Texas statutes pertaining to the liability of a terminated entity, and the extent to which they have been previously addressed in the context of a fraudulent transfer.[26] A primary author of the Texas divisional-merger statute has opined that a fraudulent transfer under these circumstances should lead to a reallocation of liabilities to one or more of the surviving entities in the merger.[27]

Conclusion

LTL's ongoing saga is far from its conclusion. Judge Kaplan took an arguably more pragmatic approach in finding good faith by reasoning that the talc claimants were better off with LTL in bankruptcy because the MDL against Old JJCI would pick winners and losers as between present and future claimants, respectively. Judge Ambro, for the panel, refused to consider Old JJCI's financial distress because LTL had Funding Agreement 1.0: "Even were we unable to distinguish the financial burdens facing the two entities, we can distinguish their vastly different sets of available assets to address those burdens."[28]

This raises an interesting question: Seemingly, the Third Circuit found that LTL was in *better* financial condition than Old JJCI, but did it need to be? Was there another way? What if J&J structured Funding Agreement 1.0 to fund LTL based on New JJCI's revenues (what were essentially Old JJCI's pre-MDL revenues)? What if it had a "liquidation event" — a type of contingency that ultimately gave LTL the enterprise value, but only under certain circumstances? This would have seemingly forced the Third Circuit to consider a more substantive question: Could Old JJCI's balance sheet have sustained a litigation burn of more than $1 billion per year? Being worth $61 billion does not mean a company can afford to lose $1 billion per year; arguably, giving LTL $61 billion in immediately available funds was more than enough, because all that was required to avoid a fraudulent transfer was "reasonably *equivalent* value" and not being rendered insolvent.

Perhaps $8.9 billion is the magic number between financial distress and insolvency. Perhaps Funding Agreement 1.0 could be structured differently to preserve Old JJCI's financial condition in LTL while avoiding a fraudulent transfer. With respect to Funding Agreement 2.0, at least, time will tell. While the Third Circuit's opinion raises (and acknowledges) questions for another day, it is both instructive as to financial distress and a veritable reminder that the Bankruptcy Code is at least as much form as it is substance. abi

23 *In re LTL Mgmt. LLC*, 64 F.4th at 109, n.18.
24 *In re LTL Mgmt. LLC*, No. 23-12825 (MBK), 2023 WL 3136666, at *8 (Bankr. D.N.J. April 27, 2023).
25 *Id.*
26 *Compare* Tex. Bus. Orgs. Code § 10.008(4) *with* Tex. Bus. Orgs. Code § 11.356(a)(1); *see also* Tex. Bus. Orgs. Code § 11.001 (definitions).
27 *See* Curtis W. Huff, "The New Texas Business Corporation Act Merger Provisions," 21 *St. Mary's L.J.* 109, 158 n.73 (1989); *see also In re Aldrich Pump LLC*, No. 20-30608 (JCW), 2021 WL 3729335, at *29 (Bankr. W.D.N.C. Aug. 23, 2021) (citing *id.*).
28 *In re LTL Mgmt. LLC*, 64 F.4th at 105.

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nations necessary to approve the assumption of an executory contract, it was first required to establish a basis for asserting *in personam* jurisdiction over the counterparty to the contract.[7] Even if the contract counterparty possesses such sufficient ties to the U.S. as to be subject to the jurisdiction of U.S. courts, establishing these ties can be expensive and time-consuming, which could compromise the efficiency of an in-court balance-sheet restructuring.

Even where a contract assumption has been approved by a court, it can be difficult to enforce an order of a U.S. bankruptcy court against a firm with few or no ties to the U.S., particularly if the party is located in a country that has not adopted the 1997 UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL MLCBI) or its successor-model law, the 2018 UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (UNCITRAL MLIJ).[8]

Thus, the debtor could find itself in a situation wherein it cannot enforce or obtain U.S. court orders without first conducting burdensome jurisdictional discovery and briefing, or where a contract is validly assumed or rejected by the debtor, but the assumption or rejection order (or the confirmed plan that effectuates the assumption or rejection) is not enforceable in the debtor's, or the counterparty's, home jurisdiction. While firms that do business in the U.S. may choose to respect U.S. court orders for commercial reasons, a firm that operates exclusively in a single country that has not adopted the UNCITRAL MLIJ might have no commercial incentive to do so.

7 *See* Hearing Transcript, *In re Alto Maipo Delaware LLC, et al.*, No. 21-11507 (KBO) at 58:16-19 (Bankr. D. Del. April 26, 2022) ("I ... will not adjudicate the assumption motion without an adversary proceeding, proper service and an establishment of personal jurisdiction over [the contract counterparty]."). This decision appears to be in tension with the holding of *In re Sae Young Westmont-Chicago LLC*, 276 B.R. 888, 896 (Bankr. N.D. Ill. 2002), in which the court approved the assumption of a lease over a personal-jurisdiction objection from the lessee, noting that "the bankruptcy judge has such [exclusive] authority over a debtor's property, no matter where the property is located."
8 Brazil, Colombia, Chile and Mexico are the only major Latin American countries, among 58 states globally, to have enacted legislation substantially adopting the UNCITRAL MLCBI. To date, no states have enacted legislation adopting the more recent UNCITRAL MLIJ.

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The "Ride-Through" Doctrine

In either of the aforementioned scenarios — where the contract in question is, or could be, subject to the § 556 safe harbor or is with a foreign firm that is not, or claims not to be, subject to personal jurisdiction in the U.S. — the Bankruptcy Code permits one particularly useful workaround: While the Code *permits* a debtor to assume or reject any executory contract, it does not require that all contracts be assumed or rejected.[9] Under the so-called "ride-through doctrine," a debtor may permit an executory contract to "ride through" the bankruptcy unaffected, meaning that the contract is not addressed in the chapter 11 plan at all.[10] Where a contract rides through, the counterparty retains any rights or causes of action that it may have had prior to the petition date, and may bring claims — or seek to terminate the contract — after the automatic stay is lifted subsequent to confirmation of a plan.

The ride-through approach, self-evidently, does nothing to address any dispute that might exist between the debtor and the contract counterparty. In particular, if the contract includes an *ipso facto* clause that would permit the counterparty to terminate the contract as a result of the bankruptcy filing or the debtor's insolvency, such clause remains in effect after plan confirmation where the contract is given ride-through treatment. Any dispute between the parties over such a clause would be properly heard in local courts in the jurisdiction where the parties are at home, or in accordance with the contract's forum-selection clause. In addition, where the debtor is on notice of a claim that might be brought by the counterparty after the plan is consummated and the automatic stay is lifted, the bankruptcy court must consider the debtor's likelihood of success in such a dispute as part of its assessment of the feasibility of the plan as a whole. Where the contract in question is a significant asset (or liability) of the debtor, the significance of this consideration is particularly acute.

Conclusion

Despite these pitfalls, bankruptcy courts have consistently approved plans that permit contracts to ride through, and multiple circuit courts of appeals have adopted the ride-through doctrine or similar formulations.[11] The ride-through doctrine remains an attractive means for a foreign debtor to effectuate a balance-sheet restructuring without the need for litigation in the U.S. over any particular contract. abi

9 The sections of the Bankruptcy Code that bear on the treatment of executory contracts are § 365, which provides that a debtor "*may* assume or reject" executory contracts (11 U.S.C. § 365(a)) (emphasis added), and § 1123, which provides that a plan "*may* provide for the assumption, rejection, or assignment" of executory contracts (11 U.S.C. § 1123(b)(2)) (emphasis added). Section 1129, which governs plan confirmation, does not include any reference to the assumption or rejection of contracts. While *dicta* in certain cases might suggest otherwise, no Code section requires assumption or rejection of executory contracts.

10 *See* Mark R. Campbell & Robert C. Hastie, "Executory Contracts: Retention Without Assumption in Chapter 11: 'Ride-Through' Revisited," *ABI Journal* (March 2000); *see also* Mette H. Kurth & Joel Ohlgren, "Ride-Through Revisited (Again): The Strategic Use of the Ride-Through Doctrine in the Post-*Catapult* Era," *ABI Journal* (June 2005). Both articles are posted at abi.org/abi-journal. Commentators have also referred to the doctrine as the "carry-through" doctrine. *See* Campbell & Hastie, *supra*.

11 *See In re Public Serv. Co. of New Hampshire*, 884 F.2d 11 (1st Cir. 1989); *In re Matter of Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991); *In re Boston Rd. Ltd. P'ship*, 21 F.3d 477 (2d Cir. 1994).

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run out of cash and breach the liquidity covenant in the near future, but intended to continue operating and increase enrollment, and viewed its financial distress as temporary. The court determined that the gift would be impossible or impractical to fulfill and relief could be obtained under *cy pres*:

> [T]here is a public policy in favor of upholding gifts for charitable purposes [and] [t]o this end, "although the testator intended that the property should be applied to a particular purpose named by him, yet he had a more general intention to devote the property to charitable purposes. The testator would presumably have desired that the property should be applied to purposes as nearly as may be like the purposes stated by him rather than the trust should fail altogether."[20]

The *Polytechnic* court addressed the last requirement, "that the proposed modification most closely approximates the intent of the testatrix."[21] It found that re-characterizing $5 million of the restricted gift to "unrestricted" and $8.4 million to temporarily restricted most closely approximated the donor's intent.[22] The court noted that the modification did not entail the expenditure of cash and would revert to its restricted status when no longer needed, projected to be by 2030 at the latest.[23] However, the university's problems continued, and it returned to court in 2009 to ask that another $38 million of the endowment gift be modified to be unrestricted.[24] The court granted the request, noting that when the funds were no longer needed to meet federal and loan mandates, the university expected to reclassify the funds as restricted.[25]

At least one commentator has concluded that institutions "making a strong showing of unsustainable financial circumstances" should have relief under *cy pres* to modify restrictions to prevent institutions from closing.[26] The UPMIFA essentially codifies *cy pres* and provides better guidance to institutions, so the result would be the same under the UPMIFA.[27] Modifying restrictions requires a court proceeding and a notice to the state attorneys' general.[28]

20 *Id.* at 418-19.
21 *Id.* at 422.
22 *Id.* at 418.

23 *Id.* at 422.
24 *In re Polytechnic Inst. of New York Univ.*, 24 Misc. 3d 1249(A), 901 N.Y.S.2d 902, 2009 *N.Y. Slip Op.* 51935(U) *4 (Sur. Ct., Kings Co. 2009).
25 *Id.* at *6.
26 *See* Tait, *supra* n.13, at 1802.
27 *See Matter of Coe Coll.*, 935 N.W.2d 581, 593 (Iowa 2019).
28 U.P.M.I.F.A. §§ 6(b)-(c) (Unif. L. Comm'n 2006); *Dodge*, 276 Va. at 14-15 (citing Virginia statute that confers state's attorney general with authority to act on behalf of public with respects to charitable entities; many other states have similar statutes).

Seeking relief under the *cy pres* doctrine or UPMIFA may alleviate the need for bankruptcy protection to reorganize and provide liquidity. However, guidance under case law is sparse, and the level of unsustainable financial circumstances needed to obtain relief appears to be high. In addition, seeking relief in a public forum adds to the institution's financial problems, but it may have no alternative if it seeks to continue operating.

Involvement of State Attorneys' General

In court proceedings under both *cy pres* and the UPMIFA, the state's attorney general is usually an interested party.[29] The attorney general often has the primary responsibility for regulating, enforcing and supervising organizations that administer and solicit charitable funds, and protecting donors.[30] It is advisable to reach out to the attorney general early in the process to ensure that state requirements are being met for modifying restrictions on restricted funds or winding down an institution.

Chapter 11 Reorganization

Educational institutions may be debtors under chapter 11.[31] Obtaining use of restricted funds under *cy pres* or the UPMIFA would likely require a motion for use of property other than in the ordinary course of business, with the only interested party being the state's attorney general.[32] Because cash is involved, it would likely be equated to a motion to use cash collateral.

Chapter 11 poses significant issues to an educational institution. Most institutions rely on federal student loans and aid under title IV of the Higher Education Act. If an institution "has filed for bankruptcy," its eligibility to participate in the programs terminates automatically upon the filing because the institution no longer meets the definition of "eligible financial institution."[33] Consequently, for an institution to avail itself of a chapter 11 reorganization proceeding, it cannot rely on federal student loans or aid — a highly unusual circumstance. However, filing chapter 11 may be appropriate if an institution seeks an orderly wind-down and its self-liquidation is likely to produce more value.[34]

Chapter 7 Liquidation

An abrupt closing followed by a chapter 7 liquidation would seem to be the worst way to close a university. In 1982, Milton College in Beloit, Wis., closed, stranding its baseball team in St. Joseph, Mo., where the team was playing in the national tournament.[35] Its rich history was lost, and media accounts focused on the abrupt closing and stranded ballplayers. Although nothing prevents a chapter 7 filing, it seems overly disruptive.

The closing of an institution involves more than just appropriate financial liquidation. There are the usual wind-down requirements such as Worker Adjustment and Retraining Notification Act notice requirements (if an exception does not apply) and other issues affecting the closure of any organization. Students, faculty and alumni will all be affected.

To address these issues, institutions need to properly preserve and have accessible student financial aid records and academic transcripts. "Teach-outs" for students to complete their coursework at other institutions should be considered. Accrediting agencies must be notified, and the preservation of historical information needs to be addressed. Finally, after the wind-down is complete, restricted funds will need to be transferred to other charitable institutions after court approval and notice to the state's attorney general as provided in the UPMIFA.[36]

Conclusion

As more universities become financially distressed, they will reach out to insolvency professionals for guidance. Professionals will need to be equipped to address the unique issues involved regarding higher-educational institutions. abi

29 *See* U.P.M.I.F.A. §§ 6(b)-(c) (Unif. L. Comm'n 2006); *Dodge*, 276 Va. at 14-15.
30 *See, e.g.*, Calif. Corps. Code §§ 5350 and 9230; Calif. Gov't Code §§ 12588 and 12598.1.
31 11 U.S.C. § 109(a); *In re Betty Owen Schs. Inc.*, 195 B.R. 23 (Bankr. S.D.N.Y. 1996) (no issue raised by U.S. Department of Education as to educational institution's ability to see relief under Bankruptcy Code).
32 11 U.S.C. § 363(b)(1).
33 20 U.S.C. §§ 1002(a)(6), 1088(a)(4); *In re Betty Owen Schs. Inc.*, 195 B.R. 23 (Bankr. S.D.N.Y. 1996).
34 *In re Integrated Telecom Express Inc.*, 384 F.3d 108, 120 (3d Cir. 2004).
35 Paul Batesel, "Milton College," America's Lost Colleges, *available at* lostcolleges.com/milton-college.
36 U.P.M.I.F.A. §§ 6(c) (Unif. L. Comm'n 2006).

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solicitors.[4] Thus, subject to some legacy issues, the second limb has fallen away.

However, the nuances and controversies around the first and third limbs of support for modified universalism (*i.e.*, at common law and in respect of the model law) both predate Brexit and continue to this day. Nevertheless, any such discussion about the British commitment to modified universalism is now, as a practical matter, informed by the consequences of Brexit, along with the insecurities of the legal profession and related policymakers. Let's now consider the relevant issues.

Rubin and *Gibbs*

Two decisions loom large when considering where the U.K. courts are now placed with respect to modified universalism. The first is the late Victorian decision of the English Court of Appeal in *Antony Gibbs & Sons v. La Société Industrielle et Commerciale des Metaux* (1890),[5] which established the rule, and the second is the more recent decision of the English Supreme Court in *Rubin and another v. Eurofinance SA and others* (2012).[6]

4 *The Lawyer*, Jan. 17, 2018. As a matter of fact, 82 percent of U.K.-based lawyers voted to remain in the EU in the referendum.

5 (1890) 25 Q.B.D. 399 CA.
6 [2012] UKSC 46.

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The rule in *Gibbs* established that a debt may only be discharged (or varied) by the governing law of that debt. Thus, if a foreign proceeding purports to discharge a debt, and the governing law of that debt does not recognize such a discharge, then as far as the English courts are concerned, such a discharge is ineffective. The exception is where the creditor is present in or submits to the jurisdiction of the foreign proceeding. In practice, from an English perspective, this is most relevant to foreign composition proceedings and English law-governed debt.

Arguments have been developed that recognition of foreign proceedings under the UNCITRAL Model Law on insolvency and, in particular, Article 21 of the CBIR, which confers discretion on the courts to provide assistance with respect to foreign proceedings, effectively overreached the rule in *Gibbs*. This means that the English courts should be able to recognize, by way of a permanent injunction, the effects of a foreign law composition as can be done in the equivalent situation in the U.S. under chapter 15. However, it was established by the Court of Appeal in *Re OJSC International Bank of Azerbijan; Bakhshiyeva v. Sberbank of Russia & Ors*. (2018)[7] that proceedings under the CBIR can only be used to provide procedural assistance to foreign law proceedings — not to give effect to such proceedings in a way that varies substantive English law rights. In summary, the CBIR cannot be used in a way that circumvents the rule in *Gibbs*.

In *Rubin*, the Supreme Court used the opportunity to roll back on the jurisprudence of *Cambridge Gas*. The notion that insolvency or bankruptcy law, when it comes to recognition of insolvency-related judgments, is *sui generis* due to the principles of modified universalism, and not subject to the usual rules of private international law governing recognition and enforcement of foreign judgments, was disavowed. Likewise, Article 21 of the CBIR could not be used to recognize foreign insolvency-related judgments. The case was heard together as *Re New Cap Reinsurance Corp. (in liquidation)*, which confirmed that where a party submits to the foreign jurisdiction (*e.g.*, by filing a proof in the foreign insolvency proceedings), the English courts can then give effect to those proceedings.

To these cases can be added the Privy Council decision in *Singularis Holdings Ltd. v. PricewaterhouseCoopers* (2014),[8] on appeal from the Court of Appeal of Bermuda, as to whether Cayman Island-appointed liquidators could seek relief under Bermudan common law to compel an auditor to disclose material belonging to it pertaining to the company in liquidation. In refusing the appeal of the liquidators, the Privy Council disavowed any notion in *Cambridge Gas* that the court had jurisdiction over parties simply by virtue of its power to assist.

The rule in *Gibbs* has had a mixed reception internationally. In *In re Agrokorr d.d., et al*. (2018),[9] Hon. **Martin Glenn** of the U.S. Bankruptcy Court for the Southern District of New York stated that it "remains the governing law in England despite its seeming incongruence with the principle of modified universalism espoused by the model law and a broad consensus of international insolvency practitioners and jurists." The courts in Singapore have abandoned the rule in *Gibbs*.

In July 2022, the U.K. government commenced a consultation on two new UNCITRAL Model Laws adopted by the commission: one on Recognition and Enforcement of Insolvency-Related Judgments, and another on Enterprise Group Insolvency.[10] These are expressed to be complimentary to the existing Model Law on Cross-Border Insolvency Proceedings. The U.K. government considers itself to be among the first states to consider the new model laws, but the consultation is now closed.

In relation to the Model Law on Recognition and Enforcement, two approaches are the adoption of an extensive draft model law, or the adoption of a new article (called "Article x"), which clarifies that Article 21 of the existing Model Law provides the courts with the discretion to recognize and enforce a judgment. Because it remains subject to the court's discretion, the consultation paper argues that the provisions cannot be used to cut across the rule in *Gibbs* but will rather deal with the jurisdictional issues raised by *Rubin*. However, not everyone accepts that this will be the outcome.

It is sometimes said that the genius behind humanity's success is the ability to hold two contradictory notions at the same time. What seems reasonably clear is that in this post-Brexit world, in terms of the U.K.'s own self-image, it still sees itself at the cutting edge of progressive development with respect to comity and modified universality, hence the desire to push ahead with the new model laws. At the same time, there is great hesitancy to compromise on the notion that other jurisdictions should be able to vary or discharge English law-governed rights.

Conclusion

In some respects, these two positions can be harmonized. Unmodified universalism is a fantasy, but it is the modified part that is the most interesting. Every state will bring its own priorities to the party. For EU member states, it is the emergent single market that is all important. For the U.S., its more liberal approach to the recognition of the insolvency proceedings of other jurisdictions may reflect its wider commitment to a rules-based international order, which has helped underpin its own international standing. For the U.K., in a period of insecurity regarding its place in the world, and of relative decline, it is the instinct to protect the wide and enduring acceptance of English law throughout much of the world as the basis for international trade and its legacy in any number of common law jurisdictions. The rule in *Gibbs* is not just a parochial concern of English insolvency lawyers; it speaks to something much deeper. abi

7 [2018] EWCA Civ 2802.
8 [2014] UKPC 36.
9 591 B.R. 163 (Bankr. S.D.N.Y. 2018).

10 This will not be addressed in this article, although significant elements of it provide for comity and universalism.

Bad Faith *and* Then Some? The Fourth Circuit's Debtor-Friendly Approach

LTL was never supposed to be in the Third Circuit, and for good reason (for the debtor). The case was originally filed in the Western District of North Carolina under the Fourth Circuit, which has a substantially different test for dismissing a chapter 11 case for bad faith. The Fourth Circuit's *Carolin* decision states that for a chapter 11 petition to be dismissed in bad faith, the moving party must show that the debtor's filing was made with subjective bad faith *and* was objectively futile, meaning that there is no going concern to preserve and no hope of rehabilitation. The most important word here is "and," meaning that the test is conjunctive, as you must have *both* parts. At least hypothetically, you could still file a case in bad faith in the Fourth Circuit but not be dismissed for a bad-faith filing if there is a nonfutile purpose that the Code will help you accomplish.

Carolin set an extremely high dismissal bar for multiple reasons. First, it is much easier said than proven that a case was filed in "subjective bad faith." The *Carolin* case held that subjective bad faith is found where a debtor "abuse[s] the reorganization process" to "cause hardship or delay creditors."[7] These claims would likely require a prolonged and complex evidentiary proceeding, thus adding significant expense to the estate and creditors. The evidence to show intent to abuse the bankruptcy system would be extraordinary and certainly not the type of evidence that sophisticated debtors would have just lying around waiting to be discovered.

Further, the second half of the test regarding the "objective futility" of the petition is arguably even harder to prove. The *Carolin* court stated that the objective-futility test was designed to ensure that chapter 11 filings have a relationship to chapter 11's purpose: reorganizing a troubled debtor or protecting a going-concern value.[8] Stated differently, upon filing there would never be a chance that the debtor could be fixed, or that value could preserved for creditors. Very few cases likely fit into the "objectively futile" pile in the modern era of distressed investing (at least, outside of single-asset real estate cases). There is always going to be a market for assets, especially when they are "on sale" as distressed assets in a bankruptcy proceeding. If there is a market to sell the assets into, then there is certainly a going concern to protect, therefore avoiding both objective futility and a dismissal for a bad-faith filing.

Faithless Filings, or Faithful to Code Provisions?

Under both Third and Fourth Circuit precedents, good faith, as it is commonly understood, is not required. Although these same circuits have created an additional good-faith requirement to file a chapter 11 case, the way they have interpreted "good faith" in the chapter 11 context has nothing to do with the debtor's honest intentions. Rather, the question revolves around an evaluation of the debts owed by the debtor instead of the debtor's intentions for treatment of those debts and what the Bankruptcy Code can accomplish for the debtor.

> **Good faith is long dead, but perhaps it never existed in chapter 11 to begin with.**

Under the Third Circuit's approach, the question is one of "financial distress," a (likely deliberately) not-well-defined phrase. Financial distress is not a fixed target. Even similar situations, such as facing mass tort litigation, can both be and not be the grounds to set a company into financial distress. An interesting thought is the threshold for these mass tort bankruptcies. When do they cross into "financial distress" sufficient to defeat dismissal on good-faith grounds in the Third Circuit? The likely answer, at least in view of *LTL*, is that they need to have substantial losses in adjudicated lawsuits on the merits of the mass tort claims, enough to wipe out backstop financing or threaten the going concern of the "GoodCo," which was not present in *LTL*. This test is much easier to meet for traditional chapter 11 cases, such as in the oil industry. A significant drop in oil prices makes a company unable to pay its debt obligations, which would appear to be financial distress threatening the enterprise, as the creditors can begin to use their contractual recourse against the debtor.

Compare this to the situation in *LTL*, where the threat to the enterprise is merely hypothetical, since the judgments owed were payable on paper, even though they were substantial. The Third Circuit appears to be saying that you need an existential threat to the company, such as judgments already on the books that the company cannot handle. According to the Third Circuit, you cannot skip a step; you need to lose first, then come to bankruptcy court for help. However, if your plan is to file, wouldn't litigation to rack up judgments be actions in bad faith? It certainly would not appear to be an action in good faith, but it could establish good faith nonetheless.

Under the Fourth Circuit's approach, good faith is clearly not required. Ignoring the issue of "subjective bad faith" and the high bar of evidence that would be needed to prove it, the second part of the Fourth Circuit's two-part test has even less to do with good faith. The objective-futility test requires that the chapter 11 process cannot do anything for the debtor. But again, that situation is extremely rare outside of single-asset cases. A house-flipping limited liability company that owns one house and is far behind on the mortgage with a half-finished remodel is likely the kind of case that is objectively futile, as there is only one lender, and it does not want to work with the debtor. That is absolutely not the case in mass tort bankruptcies, where bad faith often is alleged.

In fact, there are myriad reorganizational tools available to mass tort debtors to take on new debt, sell assets, pay

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7 *Carolin Corp. v. Miller*, 886 F.2d 693, 702 (4th Cir. 1989).
8 *Id.* at 701.

Good Faith Is Dead; Long Live the Bankruptcy Purpose

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liabilities and refinance the organization's future through a complex deal-making process overseen by the bankruptcy court. Use of such a process, at least in the Fourth Circuit, would preclude a determination that the case was filed in bad faith. You could go so far as to even consider "objective futility" to mean that as long as a case has a *bankruptcy purpose*, the case cannot be dismissed for bad faith.

Conclusion

Good faith is long dead, but perhaps it never existed in chapter 11 to begin with. We live in the era of "bankruptcy purpose" and are left to wrestle with whether a company is truly in "financial distress" or has any reasonable hope of reorganization.

Nonetheless, in this time of clever venue-engineering, the underlying intent of any bankruptcy case is going to receive scrutiny by creditors. The standard applied by courts to that scrutiny should not be so divergent as to allow easy prediction of the outcome of the case, such as when *LTL* was transferred from the Fourth Circuit to the Third. If the good-faith requirement is going to be enforced, then the good-faith requirement must be uniform in at least the questions asked, even if the standards applied might end up slightly different. abi

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or.[16] Because § 1326(b) requires payment of a standing trustee's fees "*[b]efore* or at the time of each payment to creditors under the plan," it suggests that plan confirmation is not a prerequisite to payment of the trustee's fees.[17] Judge Tucker declined to add his own gloss to this line of cases, noting instead that they already "contain exhaustive discussions of the issue" and adopting their reasoning.[18]

Miscellaneous

• *SR Construction Inc. v. Hall Palm Springs LLC, et al. (Matter of RE Palm Springs II LLC)*, --- F.4th ----, 2023 WL 2966520 (5th Cir. April 17, 2023) (Fifth Circuit affirmed lower courts' determination that lender was good-faith purchaser under § 363(m), thereby rendering construction company's appeal "moot"; since Code does not explicitly define "good faith," Fifth Circuit looked to how it had previously defined the term in *In re TMT Procurement Corp.*, 764 F.3d 512 (5th Cir. 2014), to assess construction company's claims; in evaluating lender under notice-based definition of "good faith," Fifth Circuit rejected construction company's argument that lender was not good-faith purchaser because there were "adverse claims" of which lender was aware; Fifth Circuit explained that under notice-definition of "good-faith purchaser," threshold for "adverse claim" is dispute in ownership interest; accordingly, neither construction company's mechanic's lien, nor its adversary proceeding to find that transfer may be voidable, gave rise to level of "adverse claims" necessary to impair lender's status as good-faith purchaser; Fifth Circuit also rejected construction company's argument that lender was not "good-faith purchaser" under conduct-based definition, explaining that actions identified by construction company that allegedly constituted misconduct by lender were disclosed to bankruptcy court and disclosure strongly favors finding of good faith; further, Fifth Circuit explained that fact that lender obtained ownership interest in property in order to control bankruptcy sale process was not nefarious *per se*);

• *In re Hall*, --- B.R. ----, 2023 WL 2927164 (Bankr. M.D. Fla. April 13, 2023) (as matter of first impression, bankruptcy court held that exceptions to discharge set forth in chapter 5 of Bankruptcy Code do not apply to corporate subchapter V debtors receiving a discharge under § 1192; in so holding, bankruptcy court rejected Fourth Circuit's reasoning and conclusion in *Cantwell-Cleary Co. v. Cleary Packaging LLC (In re Cleary Packaging LLC)*, 36 F.4th 509 (4th Cir. 2022), and instead agreed with five bankruptcy courts to address issue thus far; bankruptcy court's holding turned on amendments in Small Business Reorganization Act (SBRA) to language of § 523(a) to add reference to § 1192, as well as canon of statutory construction directing courts to advance interpretation of statute that would render every word operative; bankruptcy court reasoned that if Congress intended for § 523(a) discharge exceptions to apply to corporations receiving discharge under § 1192, then SBRA addition was unnecessary);

• *In re Free Speech Sys. LLC*, --- B.R. ----, 2023 WL 2732943 (Bankr. S.D. Tex. March 31, 2023) (bankruptcy court held that debtor's subchapter V eligibility is not impacted by affiliate of debtor subsequently filing bankruptcy case with debts exceeding the $7.5 million cap under § 1182(1)(A); rather, bankruptcy court held that debtor's eligibility for subchapter V is determined as of petition date; court reasoned that under Bankruptcy Rule 1020(a), debtor is required to indicate in its voluntary petition whether it is electing to proceed under subchapter V and attest that it satisfies both prongs of definition of "debtor" under § 1182(1); pursuant to Bankruptcy Rule 1020, subchapter V case then proceeds in accordance with statement of election made by debtor in petition *unless* debtor's subchapter V election has been challenged within applicable challenge period and court finds that election statement is incorrect; bankruptcy court further explained that subchapter V is streamlined chapter 11 process and it would contradict subchapter V's text and purpose to allow debtors to float in and out of subchapter V at any time due to post-petition affiliate filings);

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16 *In re Nardello*, 514 B.R. at 113.
17 *Id.* at 113-14.
18 *In re Baum*, 2023 WL 3294625, at *6.

• *Wright v. Trystone Capital Assets LLC (In re Wright)*, --- B.R. ----, 2023 WL 2697847 (Bankr. D.N.J. March 29, 2023) (bankruptcy court held that chapter 13 debtor may only recover value of debtor's exempted property from avoidance of fraudulent transfer; bankruptcy court explained that chapter 13 debtor only has standing to avoid fraudulent transfers under § 522(h) because unlike chapter 11 and 12 debtors-in-possession who are granted virtually all powers of trustee, including avoidance powers under § 548, Bankruptcy Code only grants to chapter 13 debtors powers of trustee under certain subsections of § 363; pursuant to § 522(i), chapter 13 debtor's recovery on transfer avoided under § 522(h) is subject to § 550, which limits recovery to transfer that was avoided or value thereof; because § 522(h) limits debtor's ability to avoid transfer of property to extent that it would have been entitled to exempt such property, bankruptcy court reasoned that debtor may only recover value of his exemption in property from transferee; in so holding, bankruptcy court broke with other courts that have held that chapter 13 debtor may also recover "for the benefit of the estate" because § 522(i)(2) only preserves for debtor a transfer to extent that debtor may exempt such property and exempted property is not property of estate; rather, bankruptcy court concluded that in order to recover either entire value of transferred property or transferred property itself, chapter 13 trustee would have had to avoid the transfer);

• *In re Spencer*, 2023 WL 2563751 (Bankr. S.D. Ill. March 17, 2023) (as matter of first impression, bankruptcy court held that Fair Debt Collection Practices Act (FDCPA) constitutes "applicable law" for purposes of § 544(b)(1); chapter 7 trustee sought to avoid debtor's disclaimer of his share of inheritance as fraudulent transfer by "stepping into the shoes" of the Internal Revenue Service (IRS) and avoiding debtor's disclaimer under § 3304 of FDCPA; court pointed to broad language of § 544(b) and noted that only limiting factor imposed by § 544(b)(1) is that "triggering creditor" into whose shoes trustee steps must have ability to avoid transfer under law in question; FDCPA contains provisions for avoidance of fraudulent transfers (28 U.S.C. §§ 3301-3308) that U.S. agencies, such as IRS, may use to recover on debt owed to U.S., including amounts owed on account of taxes; because IRS was unsecured creditor in this case, bankruptcy court agreed that trustee could step into IRS's shoes and employ § 3304(a) of FDCPA as applicable law under § 544(b) to avoid debtor's disclaimer of his inheritance as fraudulent transfer);

• *In E. Coast Foods Inc.*, ___ F.4th ___, 2023 WL 3296746 (9th Cir. May 8, 2023) (unsecured creditor lacked standing to appeal from order approving enhanced fee award to chapter 11 trustee in case when confirmed plan provided for full payment to creditors, secured by collateral with value exceeding creditors' claims; "person aggrieved" standard is not proper inquiry to determine standing to appeal in bankruptcy context; standing requires that appellant suffered "injury in fact" that is "fairly traceable" to defendant's conduct, and that can be "redressed by a favorable decision"; creditor's argument that payment of enhanced fee to trustee made it less likely that it would actually receive payment in full was "too conjectural and hypothetical" to confer standing given that value of plan's assets greatly exceeded amount of claims to be paid under plan);

• *In re 2 Monkey Trading LLC*, 650 B.R. 521 (Bankr. M.D. Fla. 2023) (rejecting Fourth Circuit's decision in *In re Cleary Packaging LLC*, 36 F.4th 509, 511 (4th Cir. 2022), and joining other bankruptcy courts in holding that in chapter 11 subchapter V case, exceptions to discharge enumerated in 11 U.S.C. § 523(a) apply *only* to individual debtors);

• *In re Hall*, ___ B.R. ___, 2023 WL 3330347 (Bankr. M.D. Fla. May 5, 2023) (noncontingent liquidated claim must be included in determining whether debtor exceeds debt limit for subchapter V eligibility under 11 U.S.C. § 1182, notwithstanding *bona fide* dispute as to liability; because eligibility must be determined "as of the date of the filing of the petition," post-petition pendency of proceedings challenging amount or validity of claim does not affect inclusion of claim in eligibility determination); and

• *In re Palmieri*, 650 B.R. 595 (Bankr. N.D. Ill. May 15, 2023) (siding with majority of courts in holding that when trustee seeks to avoid fraudulent transfer under 11 U.S.C. § 544(b), trustee may step into Internal Revenue Services's shoes, the so-called "golden creditor," to take advantage of 10-year statute of limitations). abi

Legislative Highlights

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payments, the funds are not usually swept automatically to the recipient's linked bank or credit union account. Instead, companies hold and invest the funds. These activities are not typically subjected to the same oversight that an insured bank or credit union faces. Apps also earn money through fees on merchants and other ancillary services, like selling crypto-assets and offering affiliated financial products.

• Funds sitting in payment app accounts often lack deposit insurance. When users receive payments through these apps, these funds are not automatically swept into their linked bank or credit union accounts. In addition, payment app companies do not necessarily store customer funds in an insured account through a business arrangement with a bank or credit union. The company's investments carry risk, and if the company were to fail, customers could lose their funds.

• User agreements for digital payment apps often lack specific information on where funds are being held or invested, whether and under what conditions they may be insured, and what would happen if the company or the entity holding the funds were to fail.

The CFPB said that many states are enacting policies to ensure that these digital payment apps are able to meet their obligations, including a new law recently enacted in Texas. State laws, however, generally do not require that customer funds be stored in or automatically swept into insured accounts. The CFPB will continue coordinating with other state and federal regulators to monitor the evolution of this segment of the payments ecosystem and take appropriate steps. abi

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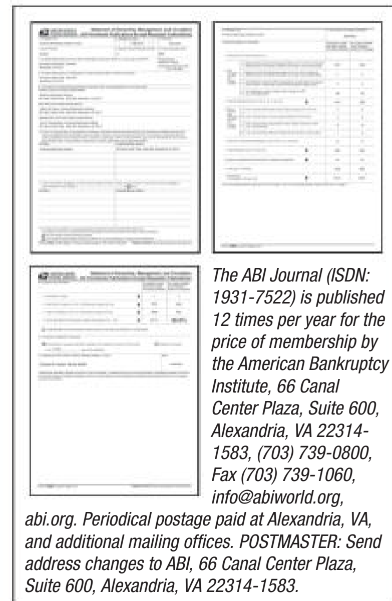

The ABI Journal (ISDN: 1931-7522) is published 12 times per year for the price of membership by the American Bankruptcy Institute, 66 Canal Center Plaza, Suite 600, Alexandria, VA 22314-1583, (703) 739-0800, Fax (703) 739-1060, info@abiworld.org, abi.org. Periodical postage paid at Alexandria, VA, and additional mailing offices. POSTMASTER: Send address changes to ABI, 66 Canal Center Plaza, Suite 600, Alexandria, VA 22314-1583.

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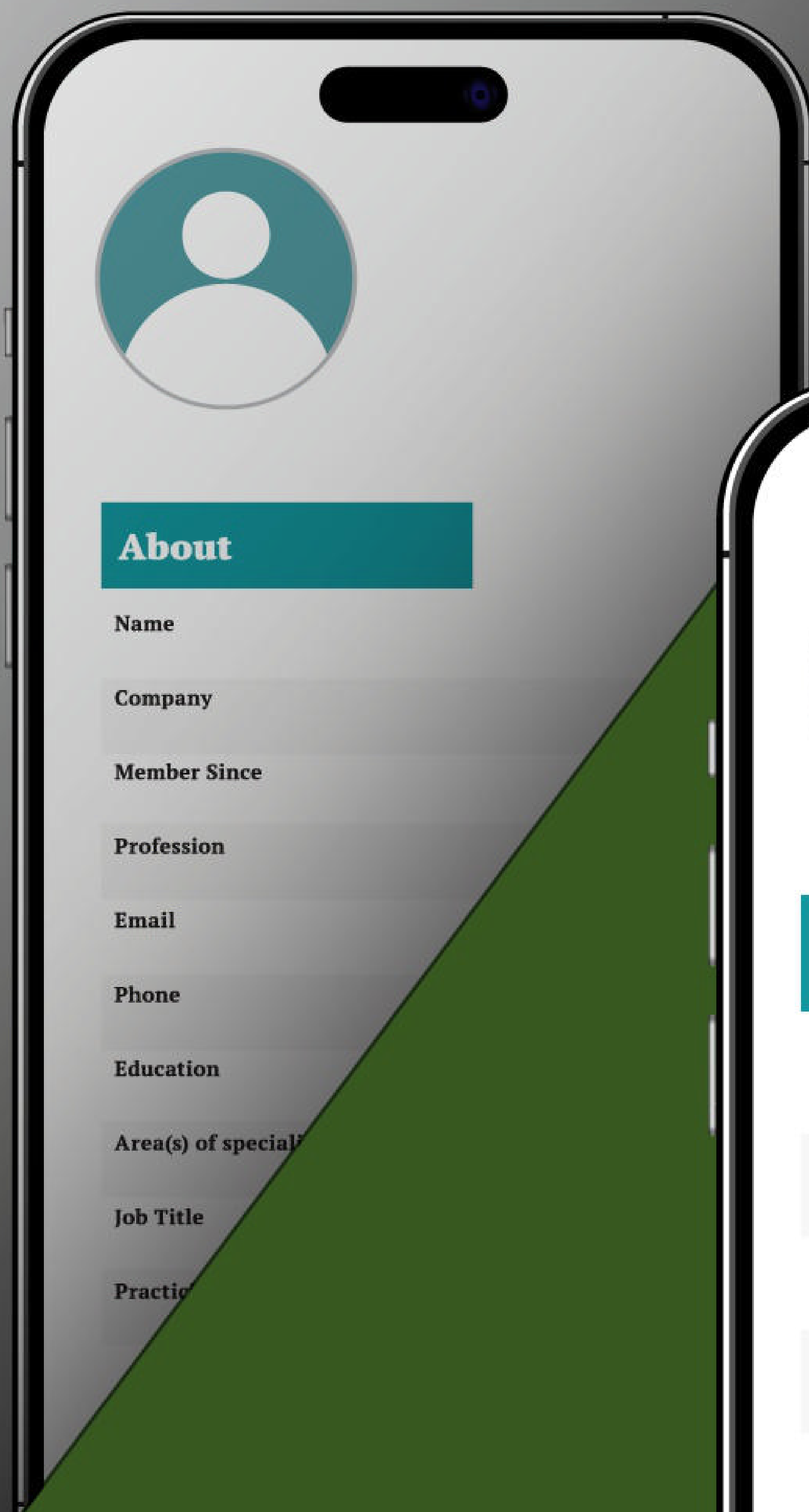

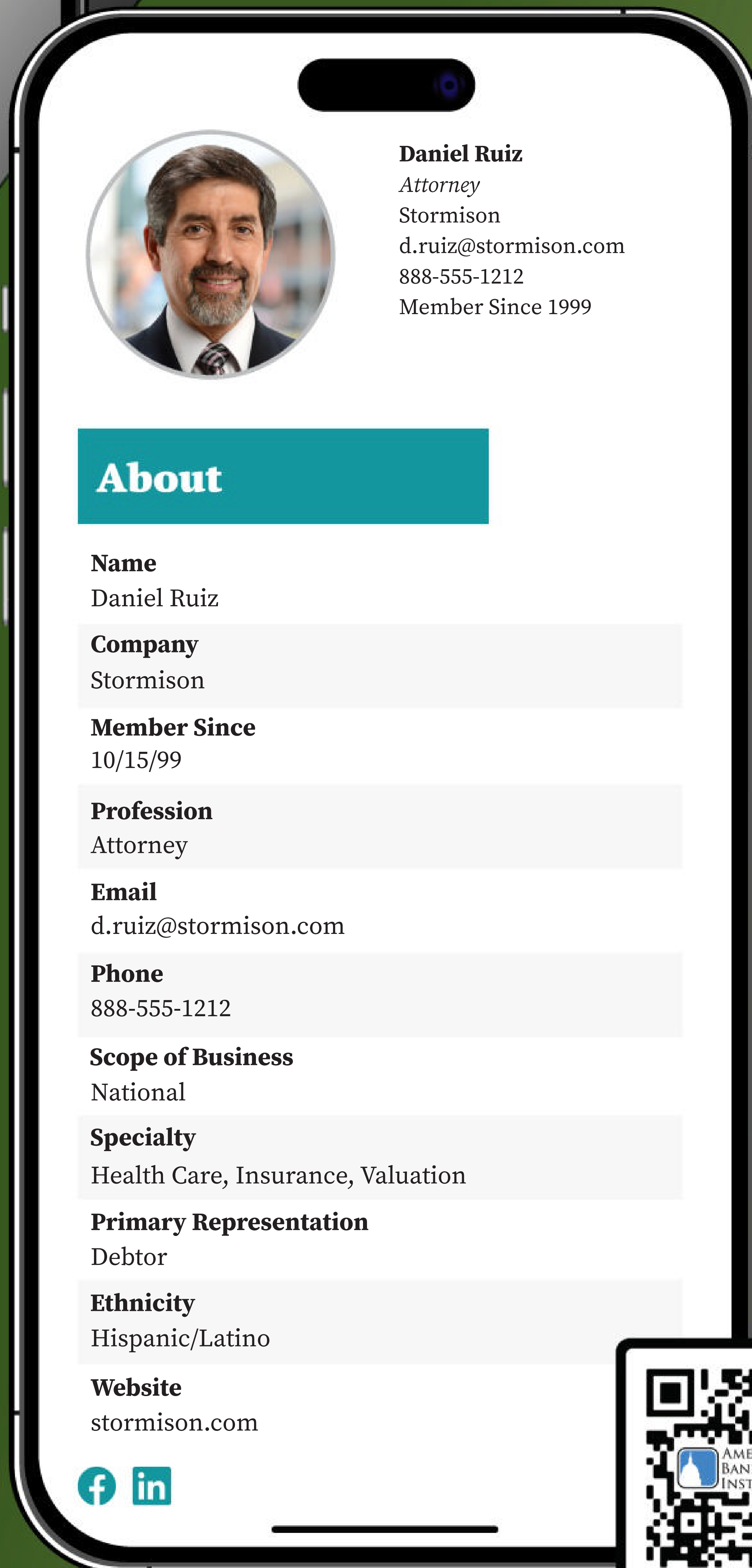

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