Business Bankruptcy Law Update

Mark Desgrosseilliers, Moderator
Womble Carlyle Sandridge & Rice, LLP; Wilmington, Del.

James T. Markus
Markus Williams Young & Zimmermann, LLC; Denver

Michelle M. McGreal
Davis Polk & Wardwell LLP; New York

W. Timothy Miller
Taft Stettinius & Hollister LLP; Cincinnati

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James T. Markus
Markus Williams Young & Zimmermann, LLC
jmarkus@markuswilliams.com

Michelle McGreal
Davis Polk & Wardwell
michelle.mcgreal@davispolk.com

Mark Desgrosseilliers
Womble Carlyle Sandridge & Rice, LLP
mdesgrosseilliers@wcsr.com

W. Timothy Miller
Taft Stettinus & Hollister, LLP
miller@taftlaw.com

In re Berau Capital Resources Pte Ltd. (Chapter 15 eligibility)

In *In re Berau Capital Resources Pte Ltd.*, 2015 WL 6507871 (Bankr. S.D.N.Y. Oct. 28, 2015), the United States Bankruptcy Court for the Southern District of New York held that a foreign debtor who did not have a place of business in the United States had satisfied the chapter 15 eligibility provisions under section 109(a) of the Bankruptcy Code because the New York choice of law and forum selection clause in the indenture governing bonds issued by the debtor constituted intangible "property in the United States." This could lead to an expansion of access to U.S. bankruptcy courts for foreign debtors.

Chapter 15 allows foreign debtors to file for bankruptcy protection in the United States bankruptcy courts where there is a main proceeding pending in a foreign debtor's home country. The United States Court of Appeals for the Second Circuit has held that in order to be eligible to file for relief under chapter 15, a foreign debtor must satisfy section 109(a) of the Bankruptcy Code, which requires that a debtor must reside, have a domicile or place of business, or have property in the United States. *Drawbridge Special Opportunities Fund, LP v. Katherine Elizabeth Barnet (In re Barnet)*, 737 F. 3d 238, 247-251 (2d Cir. 2013). In the wake of this decision, courts and commentators argued that applying section 109(a) to chapter 15 cases would frustrate the intent of facilitating cross-border insolvencies. The debate continues today. In fact, in a recent letter to Congress, the National Bankruptcy Conference advocated for an amendment to the Bankruptcy Code that would make clear that section 109(a) does not apply in chapter 15 cases.

Since *Barnet,* bankruptcy courts in the Second Circuit have taken a liberal and expansive view of section 109(a) that has allowed foreign debtors to obtain chapter 15 relief. For example, courts have found that a bank account opened in New York one day before the filing of a chapter 15 petition, a retainer held by U.S. counsel and claims and causes of action that had already been asserted by the foreign representative in the United States constitute "property in the United States" for purposes of section 109(a). The latest in this line of cases that broadly interpret section 109(a) is *Berau*.

Berau Capital Resources Pte Ltd, a Singaporean miner and exporter of thermal coal, filed an insolvency proceeding in Singapore on July 4, 2015 after defaulting on over $450 million under a U.S. debt issuance. The issued notes were U.S. dollar denominated, the indenture was governed by New York law, and included a New York choice of forum clause, and, under the indenture, Berau appointed an authorized agent for, among other things, service of process in New York. Berau, through a foreign representative, subsequently filed a chapter 15 petition for recognition of its Singapore insolvency in the United States Bankruptcy Court for the Southern District of New York on July 10, 2015. Berau sought recognition of the pending Singapore proceeding as a foreign main proceeding and other related relief.

Although no party objected to Berau's request for recognition and Berau had a retainer held by its U.S. counsel in New York, the bankruptcy court went on to analyze Berau's eligibility to be a debtor under chapter 15 based on the U.S.-issued debt. Judge Glenn first noted that a debtor's contract rights are property of the estate. Judge Glenn went on to find that the various provisions in the indenture invoking New York law were sufficient to establish situs of the property rights

in New York, pointing to New York General Obligations Law, which allows parties to a contract to establish the situs of the contract by choosing the governing law and forum.

It remains to be seen whether *Berau* will essentially open U.S. bankruptcy court doors for all foreign debtors given that most bond indentures are governed by United States law. Additionally, Judge Glenn noted that other types of contracts governed by U.S. law may be the basis for satisfying section 109(a) of the Bankruptcy Code. Finally, another question raised by *Berau* and the other cases that have followed from *Barnett* is whether a foreign debtor possessing similar types of "property in the United States" could seek to file for chapter 11 relief on the basis that they have satisfied section 109(a).

Momentive Update *(Cram down interest rates/make-whole provisions)*

On May 4, 2015, the United States District Court for the Southern District of New York issued a decision affirming the Bankruptcy Court's confirmation of Momentive Performance Material's chapter 11 plan that provided for a "cram up" of senior secured noteholders and no payment of "make-whole" premiums. *U.S. Bank Nat'l Ass'n v. Wilmington Savings Fund Society, FSB (In re MPM Silicones, LLC)*, 531 B.R. 321(S.D.N.Y. 2015).

In its September 2014 confirmation rulings, the Bankruptcy Court held that the Momentive debtors could satisfy the cramdown standard of section 1129(b) of the Bankruptcy Code as to its oversecured creditors by distributing to them replacement notes paying a below-market interest rate. Rejecting arguments made by the objecting creditors that the Supreme Court's decision in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) required reference to market rates in chapter 11 cases, Judge Drain approved the use of a rate computed by reference to the prime rate, with an additional margin to compensate the creditors for the risk of non-payment, reasoning that the Bankruptcy Code does not require an interest rate that covers creditors' costs or provides them with a profit. The Bankruptcy Court also found that the senior noteholders were not entitled to the payment of a make-whole premium upon the repayment of the debt because the bankruptcy filing was not an intentional default intended to evade payment of the premium, and the governing indenture lacked a "clear and unambiguous clause" that required such payment in the event of an acceleration of the debt. Lastly, Judge Drain ruled that senior creditors could not make up their losses by obtaining a recovery from Momentive's second lien noteholders under an intercreditor agreement that prohibited the second lien noteholders from receiving any recovery from the "common collateral" until the senior lien creditors are "paid in full in cash" and from taking certain actions in opposition to the senior lien creditors. In interpreting the intercreditor agreement among the secured noteholders, Judge Drain found that (1) the equity distributed to second lien noteholders did not constitute "proceeds" of common collateral and (2) intervening in the make-whole dispute and supporting the debtors' cramdown plan did not violate the intercreditor agreement because the second lien noteholders were acting as unsecured creditors and disputing the amount of the senior lien creditor' claims and the adequacy of their proposed distribution, not their entitlement to collateral.

The senior noteholders appealed to the District Court, which found that Congress intended that the same formula approach that was used in *Till* with respect to chapter 13 debtors should be used in chapter 11 cases and that "the Bankruptcy Code does not intend to put creditors in the

same position they would have been in had they arranged a new loan." The District Court also agreed with the Bankruptcy Court that Momentive was not obligated to pay the make-whole premium because the bankruptcy filing triggered an automatic acceleration of the debt, and "a lender forfeits the right to a prepayment consideration by accelerating the balance of the loan. The rationale most commonly cited for this rule is that acceleration of the debt advances the maturity date of the loan, and any subsequent payment by definition cannot be a prepayment." Finally, on the intercreditor dispute, Judge Bricetti relied on a "plain meaning" approach, finding that the intercreditor agreement provided for only lien subordination (i.e., junior creditor cannot recover from collateral until senior creditor is paid in full), and not payment subordination (i.e., a junior creditor cannot receive any payments until a senior creditor is paid in full).

On May 26, 2015, the noteholders appealed to the Second Circuit. The appeal is likely to be heard in 2016; however, the lower courts' decisions have already had effects in New York and Delaware. For example, in the Energy Future Holdings bankruptcy case, Judge Sontchi, citing to *Momentive*, found that noteholders were not entitled to make-whole payments where the underlying indenture did not expressly provide for such payment following a bankruptcy default and appeal. This decision is also currently on appeal. It is likely that we will see more examples of these effects throughout 2016. For example, the rulings may invite solvent or close to solvent debtors to abuse the bankruptcy process by using the filing to reduce the interest rate on its secured (or unsecured) debt. At the very least, the affirmation of the *Momentive* Bankruptcy Court's ruling and the recent *EFH* decision have continued the trend in which courts are questioning the rights of secured creditors and, in some instances, paring them back. If affirmed on appeal and if adopted by other courts, these rulings could shift significant additional leverage to debtors and unsecured creditors, enabling them to satisfy secured lenders with long-term replacement notes at below-market rates, potentially, in certain circumstances, avoiding the need to secure additional exit financing and providing increased value to unsecured creditors.

Interestingly, the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, which was released in 2015, recommends rejection of the *Till* formula-based interest rate approach adopted by the *Momentive* Bankruptcy Court. The Commission recommends that, where possible, bankruptcy courts should use a market rate, and if a market rate cannot be determined for a particular debtor, courts should use "an appropriate risk-adjusted rate that reflects the actual risk posed in the case of the reorganized debtor, considering factors such as the debtor's industry, projections, leverage, revised capital structure, and obligations under the plan." Of course, the extent to which Congress will adopt and codify any of these recommendations remains to be seen.

TIA Update

In *Marblegate Asset Management, LLC v. Education Management Corp*. 2015 WL 3867643 (S.D.N.Y. June 23, 2015), the Southern District of New York found that a proposed out-of-court debt restructuring to the detriment of non-consenting creditors violated provisions of the Trust Indenture Act of 1939 ("TIA"), a Depression-era federal statute intended to protect rights to payment under a TIA-qualified indenture, which is a feature of any U.S. public offering of debt securities. Section 316(b) of the TIA protects a bondholder's rights to receive payment and institute suit for nonpayment. Neither of those rights can be "impaired or affected" without the

consent of the individual affected bondholder. The majority view prior to *Marblegate* read section 316(b) to protect the legal right to payment, as opposed to the substantive ability to receive payment, and thus permitted amendments that harmed noteholders' likely recovery, even severely, through majority vote.

Unlike earlier TIA cases, a critical element of the proposed restructuring in *Marblegate*, the release of a parent guarantee, was explicitly permitted by the governing indenture, and no consent was required under the indenture. Nonetheless, the District Court read section 316(b) as giving individual creditors a substantive right to protection against out-of-court restructurings they did not consent to on an individual basis. Education Management has appealed the decision to the Second Circuit.

This principle was also adopted by Judge Scheindlin of the Southern District of New York in a separate decision in one of the ongoing litigations relating to the restructuring of Caesars Entertainment and its affiliates, which held that a majority amendment to strip parent guarantees similarly deprived noteholders of their practical ability to recover payment, and thus required unanimity to avoid a violation of the TIA. *MeehanCombs Global Opportunities Fund LP v. Caesars Entertainment Corp.*, 80 F. Supp. 3d 507 (S.D.N.Y. 2015).

If affirmed on appeal or followed by other courts, these decisions are likely to have important implications for restructurings. Companies have long relied upon out-of-court restructurings to keep them afloat during financial difficulties. Thus, cases holding that a minority creditor can call into question this ability could have serious consequences. This is especially true for issuers that are ineligible for bankruptcy, such as Argentina or Foxwoods Resort Casino. Moreover, although *Marblegate* and *Caesars* both concerned actions effected at least in part by creditor vote, they could in theory be expanded to read the TIA to protect noteholders even against the issuer's unilateral actions explicitly permitted by the indenture

Congress recently proposed amendments to the TIA that would have made it more difficult for bondholders to challenge out-of-court restructurings and would have applied retroactively, thus, potentially directly affecting the *Marblegate* and *Caesars* cases. The amendments would have defined impairment of the right to payment narrowly, as a reduction in principal or interest rate or extension of maturity, and impairment of the right to institute suit would have been defined as being only an action that "prevents" suits against the "primary obligor (other than a guarantor) on such indenture security." In response, a group of law professors from around the country sent a letter to members of Congress requesting that the proposal be postponed until it can be considered in hearings and through public comment. Ultimately, the proposed amendments were not put before Congress.

Trump Entertainment *(Rejection of collective bargaining agreements)*

In a recent case, *In re Trump Entertainment Resorts Inc.*, 2016 WL 191926 (3d Cir. Jan. 15, 2016), the Third Circuit affirmed a Delaware Bankruptcy Court decision that permitted the debtors to reject an expired collective bargaining agreement. This was an issue of first impression among the Circuit Courts, and could have meaningful effects on negotiations between employers and their unions.

In *Trump*, the CBA at issue expired postpetition. Under the National Labor Relations Act ("NLRA"), an employer is prohibited from unilaterally changing the terms and conditions of a CBA even after its expiration. The employer must continue to perform under the CBA until a new CBA is negotiated or the parties reach a bargaining impasse. Section 1113 of the Bankruptcy Code establishes the standards for the rejection or modification of CBAs in chapter 11 cases. The statute is intended to balance the Bankruptcy Code's goal of successful reorganization against labor relations policies under such laws as the NLRA and the Railway Labor Act, which seek to protect employees through mandatory collective bargaining. While ordinarily a debtor in bankruptcy may reject executory contracts pursuant to section 365, section 1113 removes CBAs from the scope of section 365 and establishes a series of requirements that must be met before a CBA can be rejected. At issue in *Trump* was whether the debtors could reject the expired CBA under section 1113.

The Bankruptcy Court granted the debtors' motion, concluding that section 1113, by its terms, is not limited to "unexpired" or "executory" CBAs. Judge Gross reasoned that, from a policy perspective, there was no reason to distinguish between an unexpired CBA and an executory CBA. By contrast, granting the union the power to delay the bankruptcy would subvert the "policy and bargaining power balances Congress struck in Section 1113." The Bankrupty Court went on to find that the debtors satisfied the requirements of section 1113, and authorized the debtors to implement the terms of their last proposal to the union.

On appeal, the union did not challenge the Bankruptcy Court's findings with respect to the debtors' ability to satisfy the elements of section 1113. The union asserted that the Bankruptcy Court lacked subject matter jurisdiction to approve the motion with respect to an expired CBA. The union asserted that, because the CBA had expired, there was no collective bargaining agreement to be rejected under the express terms of section 1113. The union also attempted to distinguish the contractual obligations imposed by an unexpired CBA from the statutory "continuing obligations" that the NLRA imposes after expiration, asserting that the latter could not be rejected.

The Third Circuit's decision is based on the context in which section 1113 was enacted and the policies underlying the Bankruptcy Code generally. Section 1113 prescribes a process for rejecting a CBA, but does not mention how to treat continuing obligations imposed by the NLRA after expiration of the agreement. Nevertheless, the statute also does not expressly limit its application to only executory or unexpired CBAs. The fact that bankruptcy courts are divided on this issue does not alone render the statutory language ambiguous, and courts should not rush to the conclusion that a statute is ambiguous. The Third Circuit rejected the parties' "hyper-technical parsing of the words and phrases" used in section 1113 in favor of looking to the context in which the statute was enacted. Congress enacted section 1113 in response to the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), which was perceived as too debtor-friendly to the extent it permitted debtors to unilaterally change the terms of their CBAs without bankruptcy court approval. The statute was intended to balance the concerns of economically-stressed debtors with the unions' goals of preserving labor agreements and maintaining influence in the reorganization process. Section 1113 has strict requirements to

ensure that debtors are permitted to unilaterally implement only those modifications that are necessary and essential to a successful reorganization.

The Third Circuit contrasted section 365 of the Bankruptcy Code, which does not permit rejection of an unexpired contract, finding that CBAs are distinguishable from other executory contracts because of the unique continuing obligations imposed by the NLRA after expiration. For executory contracts generally, rejection of their terms after expiration would be a moot point because there are no continuing obligations after expiration.

The Third Circuit also distinguished cases cited by the union involving withdrawal of an employer from a multiemployer pension plan and the employer's subsequent failure to make payments to the fund after the CBA expired. In particular, *Laborers Health & Welfare Trust Fund for Northern California v. Advanced Lightweight Concrete Company*, 484 U.S. 539 (1988), involved a suit brought by a plan trustee in federal court to enforce the terms of an expired CBA with respect to the employer's continuing contribution obligations. The Supreme Court distinguished the employer's contractual obligation to make pension plan contributions pursuant to the terms of an unexpired CBA from the employer's continuing obligation under the NLRA to make post-expiration contributions, and held that the employer's failure to make post-expiration contributions did not constitute a violation of section 515 of ERISA, which only covers violations of an unexpired CBA. Thus, the Supreme Court concluded that the plan trustee would have to obtain a remedy in a proceeding before the National Labor Relations Board, and the district court did not have jurisdiction over the claim for plan contributions.

In distinguishing *Laborers Health*, the Third Circuit found that the policy considerations relied on by the Supreme Court supported the opposite conclusion as applied to section 1113 and an expired CBA, whereas the potential gap between the ERISA and NLRA statutory schemes did not create much conflict. Rather, section 1113 was enacted precisely to address the problematic interaction of the NLRA and the Bankruptcy Code in cases where labor obligations can unduly prevent a successful reorganization.

The Third Circuit further explained that its holding is consistent with the Bankruptcy Code generally, which gives debtors latitude to structure their affairs, including their labor obligations. To find that the debtors could not reject the expired CBA would undermine this purpose. Even though expired, the CBA imposed obligations that were detrimentally affecting the debtors' ability to survive and reorganize – the fact that the CBA had technically expired was irrelevant given that the debtors' onerous "continuing obligations" continued to hamper their ability to reorganize.

It remains to be seen whether courts in other Circuits will follow *Trump*. If so, employers have gained a significant advantage in union negotiations.

American Housing Foundation *(Subordination and Section 510(b))*

In *In re American Housing Foundation*, 2015 WL 1918854 (5th Cir. Apr. 28, 2015), the Fifth Circuit held that claims arising under a guarantee of a security issued by an affiliate can be subject to mandatory subordination pursuant to section 510(b) of the Bankruptcy Code just like

claims for securities fraud. The decision also contained an analysis of the definition of "affiliate" that is inconsistent with analyses by Delaware and other bankruptcy courts.

American Housing Foundation was a developer of low-income housing projects. Robert Templeton invested as a limited partner in certain limited partnerships formed under American Housing, and American Housing guaranteed repayment of Templeton's investments. American Housing filed for bankruptcy, and Templeton filed proofs of claims against American Housing based on the guaranties, which claims were objected to by American Housing's trustee. The Bankruptcy Court entered a judgment subordinating those claims pursuant to section 510(b), which provides that:

> For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

The Bankruptcy Court's reasoning was based on a recharacterization of those guaranties as equity interests in American Housing pursuant to section 502(b), which authorizes a bankruptcy court to allow or disallow a claim. Templeton appealed to the Fifth Circuit.

The Fifth Circuit did not rely on section 502(b). Rather, the appellate court focused solely on section 510(b) and found that the claims were required to be subordinated. Thus, the Fifth Circuit analyzed whether Templeton's claims were for damages, arising from the purchase or sale of security and of an affiliate of the debtor. At the outset, the Court reminded that "[s]ection 510(b) applies whether the securities were issued by the debtor or by an affiliate of the debtor." In finding that Templeton's claims were for damages, the Court held that the claims were akin to a securities fraud claim, which is distinct from a claim against an obligor for the investment itself. Next, the court explained why the guarantee claims arose from the purchase of securities, despite having arisen directly from the guaranty obligation. On this point, the Court held that the guarantees were "intimately intertwined with" the purchase itself. Finally, as to whether the limited partnership that Templeton invested in was, in fact, an affiliate of the debtor, the Fifth Circuit found that section 101(2)(C) of the Bankruptcy Code was satisfied. Section 101(2)(C) provides that an affiliate means a "person whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor". The Court relied on two different interpretations: first, that the limited partnership's business was operated by a debtor based on the evidence in the record; and second, that the limited partnership's operating agreements were agreements of the debtor even though the debtor was not a party thereto.

While the *American Housing* court's broad reading of section 510(b) may be consistent with other Circuits, it is in inconsistent with various bankruptcy courts on the interpretation of the definition of "affiliate". For example, in *In re Semcrude, L.P.*, 436 B.R. 317 (Bankr. D. Del. 2010), the Delaware bankruptcy court held that if the debtor was not party to the operating

agreement, ownership and control of an entity cannot make such entity an "affiliate" of the debtor. The Fifth Circuit rejected this reasoning and found that there is "no reason why the existence of a shell conduit between a debtor and an entity—which in no way inhibits the debtor's ability to control and operate that entity—should preclude a finding of affiliate status." Similarly, in *In re Sporting Club at Ill. Ctr.*, 132 B.R. 792 (Bankr. N.D. Ga. 1991), the bankruptcy court held that an entity was not an affiliate of the debtors for purposes of determining venue where the debtors were not "parties to any lease or operating agreement". The Fifth Circuit opined that this interpretation was "unduly strict".

Of course, the *American Housing* holding is unique to the facts of that case; however, investors should be aware that claims arising from a purchase of securities of entities over which a debtor exercises sufficient control may be mandatorily subordinated under section 510(b) of the Bankruptcy Code.

Arenas v. U.S Trustee 535 B.R. 845 (BAP 10th Cir. 2015) (Medical marijuana and bankruptcy eligibility)

Debtors, who were licensed in Colorado to grow and dispense medical marijuana, were not entitled to obtain relief in bankruptcy court.

Debtors filed a chapter 7 case. The United States Trustee moved to dismiss the case for cause, alleging that it would be impossible for a Chapter 7 trustee to administer the bankruptcy estate, which included rental income from a legal marijuana dispensary and marijuana plants, without violating federal law. In response the Debtors moved to convert their case to Chapter 13.

Court found that even though the Debtors engaged in the marijuana business, which is legal under Colorado law but a crime under federal law, was cause to dismiss the case. The court further found that there was "plenty of evidence" to support the bankruptcy court's finding of a lack of good faith" and thus under *Marrama v. Citizens Bank of Mass*. 549 US 365 (2007) rendered the Debtors ineligible for relief under Chapter 13.

Zachary v. California Bank & Trust, 811 F.3d 1191 (9th Cir. 2016) (Individual chapter 11 case and the absolute priority rule)

Individual Debtors filed a Chapter 11 case and proposed a plan of reorganization. Plan proposed to put their largest unsecured creditor in its own class and pay $5,000 on a claim of nearly $2,000,000. Creditor objected to plan arguing it violated the absolute priority rule of 11 U.S.C. 1129(b)(2)(B)(ii). The bankruptcy court, declined to follow the BAP opinion of *In re Friedman*, 466 BR 471 (BAP 9th Cir. 2012) and sustained the creditor's objection. A direct appeal to the Ninth Circuit ensured.

The Ninth Circuit noted that existence of "significant split in authorities" among the bankruptcy courts regarding the issue before the court. The court overruled the *Friedman* decision and adopted the so called "narrow view" of the scope of the BAPCPA amendments, finding that the

absolute priority rule applies in individual chapter 11 cases and the exception to the absolute priority rule created by BAPCPA only applies to property acquired by the debtor after the commencement of its case.

In Re Village Green I, GP, 811 F.3d 816 (6th Cir. 2016) (Artificial impairment and good faith)

Debtor, which owned an apartment building, filed for relief under chapter 11. Debtor's primary creditor, Fannie Mae, was owed $8.6 million and was secured by the apartment building, which was worth $5.4 million. Other than Fannie Mae, Debtor had only two other creditors, its former lawyer and accountant whom the Debtor owed less than $2400.

Debtor's plan proposed to cram down Fannie Mae. With respect to the former lawyer and accountant's claims, Debtor proposed to pay them in full not on the effective date of its plan, but rather in two installments over 60 days after the effective date. The bankruptcy court confirmed the plan over Fannie Mae's objection. The District court reversed the bankruptcy court and the matter was appealed to the Sixth Circuit.

The court considered two matters on appeal – were the claims of the former lawyer and accountant impaired for purposes of Section 1129(a)(10) and was the plan proposed in good faith and not by means forbidden by law. (See Section 1129(a)(3)).

Interestingly, the court rejected the argument that the plan artificially impaired the claims, noting

> Here, the plan undisputedly would alter the [former lawyer's and accountant's] rights, because claimants are legally entitled to payment immediately rather than in installments over 60 days. That this impairment seems contrived to create a class to vote in favor of the plan is immaterial. Section 1124(1) by its terms asks only whether a plan would alter a claimant's interests, not whether the debtor had bad motives in seeking to alter them.

The court determined that since Section 1129 (a)(3) expressly requires an inquiry into the debtor's motives in proposing a plan, "there is no reason to graft that inquiry on the plain terms of 1124(1)."

Turning the question of whether the Debtor proposed its plan in good faith, the court found that this element could not be met, stating that the debtor's projections of net income of $71,400 per month in the first year after the plan's confirmation "…renders dubious at best [Debtor's] assertion it could not safely pay off the [former lawyer's and accountant's] claims…up front rather than over 60 days.

Moreover because these claims were closely allied with the debtor "only compounds the appearance that impairment of their claims had more to do with circumventing the purposes of 1129(a)(10) than with rationing dollars."

Caesars Entertainment Operating Company, Inc. – Section 105(a) Stay of Litigation

In *Caesars Entertainment Operating Company, Inc., et al. v. BOKF, N.A., et al.* (*In re Caesars Entertainment Operating Company, Inc.*), 808 F.3d 1186 (7th Cir. 2015), the Seventh Circuit held a debtor can enjoin third-party lawsuits against the debtor's non-debtor parent corporation arising from the parent's purported guaranty of the debtor's obligations to the third-parties where the debtor can show that "the injunction . . . is likely to enhance the prospects for a successful resolution of the disputes attending its bankruptcy."

Caesars Entertainment Operating Company, Inc. ("CEOC") and more than 170 of its subsidiaries (collectively, the "Debtors") that own, operate or manage 38 casinos as part of the Caesar's gaming enterprise sought bankruptcy protection in the Northern District of Illinois on January 15, 2015. CEOC's parent company, Caesars Entertainment Corp. ("CEC"), which directly or indirectly owns, operates or manages 12 additional casinos, did not seek bankruptcy protection. In the years leading up to CEOC's bankruptcy filing, CEOC issued $1.5 billion of senior unsecured notes that were guaranteed by CEC; CEC was acquired in a leveraged buyout on the eve of the 2008 financial crisis that was paid for in part through the issuance by CEOC of approximately $24 billion in additional debt, a substantial portion of which was secured in favor of first lien noteholders and guaranteed by CEC; and CEOC issued an additional $4.46 billion in second lien notes after the LBO that were guaranteed by CEC.

In the midst of the financial crisis, CEC and the Debtors entered into various transactions to restructure their debt which had the effect of transforming CEC from a mere holding company (whose only asset was 100% of CEOC's stock) into an entity having an enterprise value of $3 billion independent of its ownership of CEOC through the acquisition of various assets of the Debtors and the sale of a portion of CEOC's stock. CEC took the position that certain of these transactions released it from its guaranties of the senior unsecured notes and the first and second lien notes. As a result, several senior unsecured noteholders and second lien note holders filed suit against CEC, the Debtors and their officers and directors alleging various causes of action and seeking to obtain reinstatement of CEC's guaranties. Less than a month prior to the Debtors' bankruptcy filings, the Debtors, their first lien noteholders and CEC reached an agreement on the terms of a restructuring support agreement (the "RSA") pursuant to which CEC would make a financial contribution to the Debtors' restructuring valued in excess of $2.5 billion in exchange for a release from more than $12.5 billion of guaranty claims.

Shortly after their bankruptcy filing, the Debtors commenced an adversary proceeding under Section 105(a) of the Bankruptcy Code seeking to enjoin the pending lawsuits against CEC brought by the senior unsecured noteholders and the second lien noteholders. The Debtors asserted that "this is a 'textbook case' for a section 105(a) injunction" because the lawsuits assert claims against CEC's assets which if successful could diminish the funds available for CEC to contribute to the Debtors' bankruptcy estates as contemplated in the RSA thereby threatening the Debtors' ability to reorganize.

The Bankruptcy Court, observing that "the Seventh Circuit has a different textbook, declined to grant the injunction. Referring to Section 105(a) as "the bankruptcy version of the All Writs Act" which gives bankruptcy courts the power to protect their jurisdiction, the Bankruptcy Court

acknowledged that unlike a traditional injunction, issuance of a Section 105(a) injunction only requires a showing that (1) the third-party litigation would impair the bankruptcy court's jurisdiction; (2) the debtor has a likelihood of a successful reorganization; and (3) the public interest would be served by issuance of the injunction. The debtor need not show irreparable harm or an inadequate remedy at law. However, the Bankruptcy Court read Seventh Circuit precedent as requiring a debtor to show that both the estate and the third-party have claims against a non-debtor, "[t]hat . . . both sets of claims are claims to the same assets in possession of the same [non-debtor], and both sets of claims arise out of the same acts", as a precondition to considering whether the debtor meets the standards for a Section 105(a) injunction. Inasmuch as the noteholders were asserting breach of contract claims against CEC, while the estate purported to have claims against CEC arising from the pre-bankruptcy restructuring transactions, the Bankruptcy Court concluded that the two sets of claims did not arise from the same acts and that "the debtors are not entitled to have the prosecution of [the noteholders'] claims enjoined, whatever the effect on CEC's contribution to the reorganization." Following affirmance of this decision by the District Court, the Debtors appealed to the Circuit Court.

In a decision written by Judge Posner, the Circuit Court reversed, noting at the outset that "nothing in 11 U.S.C. § 105(a) authorizes the limitation on the powers of a bankruptcy judge that CEC's creditors [the noteholders] successfully urged on the judges below." According to the Court, the key determination is "whether the injunction sought by CEOC is likely to enhance the prospects for a successful resolution of the disputes attending its bankruptcy." If so, and if a failure to grant the injunction will impair the debtor's prospects for reorganizing, the bankruptcy court should grant the injunction. In reaching this conclusion, the Court expressed concern that CEC not become a "badminton birdie" in a dispute between the noteholders and the Debtors over which group's claims were satisfied first from CEC's limited assets. The Court also rejected the lower courts' interpretation of prior Seventh Circuit precedent, to engraft a "same acts" limitation on Section 105(a). Consequently, the Circuit Court remanded the case to the Bankruptcy Court to determine whether the Section 105(a) injunction should be granted in light of its decision clarifying the standard for a Section 105(a) injunction.

Seaside Engineering & Surveying, Inc. – Non-Consensual, Non-Debtor Plan Releases

In *SE Property Holdings, LLC v. Seaside Engineering & Surveying, Inc. (In re Seaside Engineering & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015), the Eleventh Circuit, acknowledging a split of authority concerning the use of non-consensual third-party releases in Chapter 11 plans, applied the Dow Corning factors to approve the use of such releases, but only in "those unusual cases in which such [releases] . . . [are] necessary for the success of the reorganization, and . . . [are] fair and equitable under all the facts and circumstances."

Seaside Engineering & Surveying, Inc. was a civil engineering and surveying firm whose principal shareholders performed services for Seaside's customers, and also happened to invest in completely separate entities engaged in real estate development. SE Property Holdings, LLC and its affiliate, Vision-Park Properties, LLC (collectively, "Vision"), made loans to the real estate development companies, which loans were guaranteed by the shareholders of the Debtor. When the real estate development companies defaulted on the Vision loans, Seaside's

shareholders filed for individual bankruptcy protection under Chapter 7 of the Bankruptcy Code. Vison subsequently acquired one the debtor-shareholder's equity interests in Seaside at a sale conducted by the Chapter 7 trustee.

Seaside subsequently filed for bankruptcy protection under Chapter 11. In its Chapter 11 plan, Seaside sought to reorganize and continue operations as a limited liability company managed by certain of Seaside's original shareholders and owned by the irrevocable family trust of each shareholder. The plan valued Seaside at $200,000 and provided Vision with payment of its stock over time with interest. Significantly, the plan also contained third-party releases specifically releasing Seaside's shareholders, officers and directors from claims in connection with, relating to, or arising out of Seaside's Chapter 11 case, or the pursuit of confirmation and consummation of Seaside's Chapter 11 plan, except for claims based on fraud, gross negligence or willful misconduct. The Bankruptcy Court confirmed Seaside's plan over Vision's objection and the District Court affirmed.

Vision raised several issues on appeal to the Eleventh Circuit, including the propriety of the third-party releases. The Circuit Court noted that it had previously approved non-consensual non-debtor releases in In re Munford, 97 F. 3d 449 (11th Cir. 1996). Munford involved a settlement of breach of fiduciary duty claims against multiple defendants in which one defendant agreed to fund the bankruptcy estate in exchange for a release and a bar order prohibiting the non-settling defendants from asserting contribution or indemnity claims against it. Munford approved the non-debtor releases because they were integral to the settlement of the adversary. Since Seaside involved a different factual scenario – non-consensual, non-debtor releases in the context of a Chapter 11 plan -- the Court reviewed the circuit split on the issue and concluded that Munford places the Eleventh Circuit with the majority view that such releases are appropriate in certain limited circumstances.

In order to determine whether to approve a non-consensual, non-debtor release in a Chapter 11 plan, the Court looked to the following seven factors identified by the Sixth Circuit in *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002):

(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

(2) The non-debtor has contributed substantial assets to the reorganization;

(3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;

(4) The impacted class, or classes, has overwhelmingly voted to accept the plan;

(5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;

(6) The plan provides an opportunity for those claimants who choose not to settle to recover in full, and

(7) The bankruptcy court made a record of specific factual findings that support its conclusions.

The Court noted that these factors are "a non-exclusive list of considerations" that should be "applied flexibly," and that the bankruptcy court must determine in the first instance which factors will be relevant in the case before it. It cautioned that, "such bar orders should be used `cautiously and infrequently' . . . and only where essential, fair and equitable."

Applying these factors to Seaside's plan, the Court held that they weighed in favor of approving the non-consensual, non-debtor release --- (1) there was an identity of interests between Seaside and its shareholders who would be running the reorganized debtor such that litigation brought by Vison against those individuals will deplete the assets of the reorganized entity; (2) the services contributed by the shareholders to the reorganized entity will provide its only source of revenue; (3) the release was essential to keep Vision's continued pursuit of litigation against the shareholders from stopping the revenue stream that they generate for the reorganized entity; (4) all creditors other than Vision and the Chapter 7 trustees of certain of the shareholders voted in favor of the plan and the rejecting equity holders were paid the full value of their interests under the plan; (5) Vision will be paid the full value of its interest under the plan; (6) the "recovery in full" factor did not apply in this case; and (7) the bankruptcy court made specific factual findings supporting its approval of the release. Finally, the Court noted the release narrowly applied only to claims arising out of the bankruptcy case and did not release claims arising from fraud, gross negligence or willful misconduct. In conclusion, the Court commented that "[t]his case has been a death struggle, and the non-debtor releases are a valid tool to halt that fight."

BUSINESS BANKRUPTCY LAW UPDATE

ADDENDUM

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ANNUAL SPRING MEETING

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James T. Markus
Markus Williams Young & Zimmermann, LLC
jmarkus@markuswilliams.com

Michelle McGreal
Davis Polk & Wardwell
michelle.mcgreal@davispolk.com

Mark Desgrosseilliers
Womble Carlyle Sandridge & Rice, LLP
mdesgrosseilliers@wcsr.com

W. Timothy Miller
Taft Stettinus & Hollister, LLP
miller@taftlaw.com

In re Millennium Lab Holdings, II – Non-Consensual, Non-Debtor Plan Releases

In an unreported decision, In re Millennium Lab Holdings, II, LLC, et al., Case Number 15-12284 (Bankr. D. Del. Dec. 15, 2015), by order entered on December 14, 2015, Judge Laurie Selber Silverstein of the United States Bankruptcy Court for the District of Delaware (the "Delaware Bankruptcy Court") confirmed a Chapter 11 plan that contained nonconsensual third party releases over the objections of the Office of the United States Trustee, the United States and certain nonconsenting, or "Opt-Out" lenders.

Millennium Lab Holdings II, LLC, and its affiliates (collectively, "Millennium") filed for bankruptcy protection under chapter 11 of the Bankruptcy Code on November 10, 2015 in the Delaware Bankruptcy Case. Prior to filing for bankruptcy, Millennium offered healthcare providers urine tests for their patients to confirm compliance with drug regimens, and detect any abuse of prescription or non-prescription drugs. Between 2007 and 2014, the company grew to an operation employing almost 1,200 people, across the United States providing drug testing to over 8,000 doctors and medical facilities, with annual revenue in 2014 of $687 million. Unfortunately for Millennium and its lenders (who as of the petition date were owed in excess of $1.8 billion), in 2012 the company came under investigation by the United States Department of Justice and others for alleged overbilling to Medicare and Medicaid, paying kickbacks to medical practitioners, and engaging in otherwise illegal practices.

On March 19, 2015, the Department of Justice, on behalf of the United States of America filed a lawsuit against Millennium. After several months of negotiation, Millennium and its equity holders, TA Millennium, Inc. ("TA") (affiliated with TA Associates, a private equity firm), and Millennium Lab Holdings, Inc. ("MLH"), controlled (directly or indirectly) by Millennium's Chief Executive Officer, Mr. James Slattery reached a settlement(the "USA Settlement") with the Department of Justice. Under the terms of the USA Settlement, Millennium paid $50 million as deposit upon execution of the settlement agreement, pending approval of the settlement, which payment was guaranteed by MLH and TA (to avoid any potential preference exposure). The remaining $206 million owed under the USA Settlement was to be paid under the terms of a plan in bankruptcy.

As Judge Silverstein noted during the hearing on approval of the disclosure statement and confirmation of Millennium's plan, the Millennium case was "a prepackaged case in the classic sense." Millennium filed for bankruptcy in order to facilitate the payments due under the USA Settlement and reduce and restructure the existing $1.8 billion in secured debt obtained by Millennium in April 2014 ($1.3 billion of which was used to finance a special dividend to MLH and TA). Under the terms of the proposed plan, Millennium would assume the USA Settlement. MLH and TA would contribute a total of $325 million to the funding of the plan. The secured notes would be exchanged for $600 million in new term loan notes (reducing the secured debt by almost $1.2 billion). Noteholders would also receive their pro rata share of 100% of the equity in the reorganized Millennium. Unsecured creditors were to be paid in full under the plan. A critical part of the agreement by TA and MLH to fund the plan was that both non-debtors would receive broad releases under the terms of the plan.

Prior to filing for bankruptcy protection, Millennium solicited the plan to holders of the secured notes. If the debtors received support from at least 97% of the holders of the secured note, Millennium intended to restructure out of court. Although 99% of the holders of the secured notes voted with respect to the plan, only about 93% in number and amount of such holders ultimately voted in favor of the proposed restructuring. Accordingly, the debtors proceeded with the planned bankruptcy filing in an effort to force the terms of the restructuring on the non-consenting secured noteholders.

As might be anticipated, the proposed plan and disclosure statement drew objections from the Office of the United States Trustee (the "US Trustee") and certain of the non-consenting secured lenders (the "Voya Lenders"). The US Trustee raised issues with the plan's proposed characterization of certain claims as "unimpaired" and the proposed release by holders of such claims on the effective date of the Plan (even though their claims might not be paid until after the effective date). The US Trustee also objected to broad releases by the Millennium debtors to third-parties. Critically, the US Trustee argued that the proposed non-consensual third party releases by creditors that had not voted in favor of the plan, were not given an option to opt out of the plan, and/or otherwise objected affirmatively to the proposed third-party releases in the plan were not appropriate under applicable law in the Third Circuit. Citing Gillman v. Continental Airlines (In re Continental Airlines), 203 F.3d 203 (3d Cir. 2000), the US Trustee argued that Millennium failed to meet the high threshold for non-consensual third-party releases in the Third Circuit under Continental, namely "fairness, necessity to the reorganization, and special factual findings to support these conclusions." Id. at 214.

With respect to necessity to the reorganization, the US Trustee argued that if the 97% threshold had been met, the proposed restructuring would have occurred outside the auspices of a bankruptcy court no third-parties (other than the lenders) would have been providing releases at all. In addition, the US Trustee argued that certain third-parties released under the plan had not provided any value, let alone sufficient value to support the proposed releases, including certain non-debtor affiliates and professionals otherwise protected by the exculpation clause in the plan. Finally, the US Trustee objected to the proposed Debtor releases of non-debtor third parties, under the standards set forth in In re Zenith Elecs. Corp., 241 B.R. 92, 110 (Bankr. D. Del. 1999) and In re Master Mortgage Inv. Fund, Inc., 168 B.R. 930, 937-38 (Bankr. W.D. Mo. 1994). Specifically, the US Trustee argued that the Millennium debtors had failed to demonstrate:

1. An identity of interest between the debtors and non-debtors being released, such that any proceeding against the non-debtor release would diminish the debtors' estates;
2. Substantial contribution to the plan by the non-debtor release;
3. The necessity of the release by the Debtor to the plan;
4. Overwhelming acceptance of plan and the release in such plan by creditors; and
5. Payment of all or substantially all of claims and interests under the plan.

The Voya Lenders raised additional objections, including that the Delaware Bankruptcy Court did not have jurisdiction to enjoin non-debtor third parties from taking actions against non-debtors or to release potential claims that such non-debtor third parties against such non-debtors.

On December 11, 2015, the Delaware Bankruptcy Court approved the Millennium disclosure statement and confirmed the plan with some minor changes from the bench. Notwithstanding Judge Silverstein's warning that the decision was not to be cited back to her, was limited to the facts presented and "may not even be persuasive in other cases," (Transcript of hearing held December 11, 2015, *In re Millennium Lab Holdings, II, LLC, et al.*, Case Number 15-12284 (LSS) (Bankr. D. Del.) (the "December 11 Transcript"), Judge Silverstein's ruling demonstrates that non-consensual releases are alive and well in the Third Circuit and may be approved over objection even where parties are not afforded an opportunity to opt out of the proposed release. Initially, Judge Silverstein determined that she had related-to jurisdiction to approve the third-party releases proposed in the plan under the standard set forth in *Pacor, Inc. v. Higgins*, 743 F.2d 984 (3d Cir. 1984). Specifically, each third party receiving a release under the plan had indemnification claims and advancement rights against the Millennium debtors and "[t]hese obligations provide the basis for related-to jurisdiction." December 11 Transcript at 14-15. This jurisdiction foundation was further cemented under *In re Lower Bucks Hosp.*, 471 B.R. 419 (Bankr. E.D. Pa. 2012), which was affirmed by the United States Court of Appeals for the Third Circuit, 571 F. App'x 139 (3d Cir. 2014), because the third-party releases relate to the proposed plan and the Millennium debtors' rights under the Bankruptcy Code, and the Delaware Bankruptcy Court has sufficient jurisdiction to enter a final order under such circumstances. Because the proposed non-consensual releases met the requirements set forth in *Continental*, *Zenith*, and *Master Mortgage*, the Delaware Bankruptcy Court approved such releases (and the accompanying injunctions) in the plan. *See* December 11 Transcript at 16-24. With respect to the argument that creditors must be given an opportunity to opt out of the releases, Judge Silverstein did not require an opt out for unsecured creditors because such creditors were receiving payment in full and because, notwithstanding their receipt of notice of such releases, no unsecured creditors raised any objection to such releases. *See id.* at 27-28.

In re Tribune Media Co., et al.; In re Semcrude, L.P., et al. – Equitable Mootness in the Third Circuit

In *In re SemCrude, L.P.*, 728 F.3d 314 (3d Cir. 2013), the United States Court of Appeals for the Third Circuit, ruled that the United States District Court for the District of Delaware erred by dismissing an appeal of a plan that was substantially consummated, under the equitable mootness doctrine, suggesting that equitable mootness would present a more limited means for debtors in the Third Circuit to defeat otherwise potentially valid appeals. However, recently, in *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015), the Third Circuit upheld the dismissal of an appeal, where the appeal would have undone a crucial part of Tribune's heavily contested and substantially consummated plan of reorganization. Not only does the ruling of the Third Circuit breathe life back into the equitable mootness doctrine, it also provides additional guidance on when courts in the Third Circuit will dismiss appeals under the equitable mootness doctrines and what appellants can do in the Third Circuit to increase the chance that their appeals of even substantially consummated plans will be permitted to proceed.

SemCrude filed for bankruptcy in July 2008 due in large part to speculation by its owner in oil that in retrospect proved to be unwise. Because of the nature of SemCrude's business, buying and transporting oil purchased from producers, at the time that SemCrude and its affiliates filed their bankruptcy petitions, a significant amount of oil was in its possession for which SemCrude had not yet made payment to the producers of such oil. Very early in the bankruptcy cases, a number of such producers filed adversary proceedings to determine the extent and amount of alleged liens under various state laws. At the same time the SemCrude and its affiliates filed a motion to establish some uniform procedures to determine certain legal issues regarding the alleged liens under each state law applicable to the oil held by SemCrude. The SemCrude debtors' procedures permitted one representative proceeding to be filed for each state. The affected producers could participate in the action by briefing the matter and presenting oral argument on their respective claims. Irrespective of whether or not a producer participated in the representative action, however, it would be by bound by the bankruptcy court's holdings and findings in such matter. Over the objection of the producers, the Delaware bankruptcy court approved the SemCrude debtors' proposed procedures and stayed each of the adversary proceedings already filed by the producers, including those producers that ultimately appealed the confirmation of the SemCrude debtors' plan.

The Delaware bankruptcy court ruled against the producers in each of the representative actions filed. The Delaware bankruptcy court, however, certified the appeals of these decisions for direct appeal to the Third Circuit. While these issues remained on appeal, the SemCrude debtors and their lenders entered into a settlement with the official committee appointed in the bankruptcy cases to represent the producers' interests that on its face would resolve all of the issues with all of the producers. The SemCrude debtors incorporated this settlement into a plan. Unfortunately, certain of the producers still opposed the proposed settlement. Notwithstanding the confirmation of the SemCrude debtors' plan over the objection of such producers (who, among other things, indicated that they would seek class certification so that their action would be on behalf of all non-settling producers), these producers appealed the confirmation of the plan to the Delaware district court on the grounds that their asserted lien rights and other claims could not be discharged other than through an adversary proceeding, which proceeding had not

occurred (because it had been stayed by the Delaware bankruptcy court). The non-settling producers did not obtain a stay pending their appeal and the plan went effective on November 30, 2009. As part of the process in going effective, the SemCrude debtors made significant distributions to thousands of creditors, undertook a number of corporate transactions, and issued certain new securities. For these reasons, the Delaware district court ruled that the appeal of the non-settling producers was equitably moot in May, 2012.

In light of the "'virtually unflagging obligation' of federal courts to exercise the jurisdiction conferred on them" when an appeal is filed, the Third Circuit noted that, even for appeals of substantially consummated plans, an appellate court must find that granting the relief requested in the appeal "must be almost certain to produce a 'perverse outcome – chaos in the bankruptcy court' from a plan in tatters and/or significant 'injury to third parties.'" *Id*. at 320. Quoting *In re Continental Airlines*, 91 F.3d 553, 568 (3d Cir. 1996), the Third Circuit held that in order to dismiss an appeal of a confirmed plan as equitably moot, the appellate court must assess (1) whether the plan was substantially consummated, (2) whether the appellant obtained a stay, (3) whether the relief requested in the appeal would affect the rights of third parties, (4) whether such relief would affect the success of the plan, and (5) public policy favoring finality of bankruptcy court orders. *Id*. Moreover, in the end, the party seeking to dismiss the appeal bears the burden of proving each of these points with evidence, not just speculation.

In this instance, the parties did not dispute that the plan had been substantially consummated. Nor was there any dispute that the appellants had not obtained (or even sought) a stay pending appeal (which, of course, is what permitted the SemCrude debtors to effect the confirmed plan). *Id*. at 323. However, the Third Circuit noted that, although advisable to avoid dismissal on equitable mootness grounds, obtaining such a stay was not a prerequisite to the appellants' statutory right of appeal. *Id*. The Third Circuit did determine that the SemCrude debtors had failed to provide adequate evidence that the relief requested in the appeal would undermine the plan or that such relief would harm third parties. Among other things, the appellants' claims totaled less than 0.13% of the total funds designated for distribution to the producers and less than 0.01% of the total $2 billion distributed under the plan itself. Moreover, although the appellants had sought class certification, no class had yet been certified.

Although the SemCrude debtors alleged that granting the relief in the appeal would negatively impact the lenders, the equity holders of the new SemCrude, customers and suppliers, and other creditors. Because the SemCrude debtors produced no evidence that the lenders could terminate their post-petition loans if the appellants were successful in their appeal and because of the healthy financial condition of the SemCrude debtors post-effective date (and again the relatively small amount of the appellants' claims if allowed in full), the Third Circuit held that the Delaware district court lacked sufficient evidence to support its finding of harm to such parties. *Id*. at 323-26. Finally, the Third Circuit held that in this instance dismissing the appeal on equitable mootness grounds would not serve to "prevent a perverse outcome" and, therefore, the public policy in favor of hearing appeals on the merits outweighed the public policy favoring finality of bankruptcy court judgments. *Id*. at 326.

In contrast, in a decision in August, 2015, the Third Circuit affirmed in part and reversed in part the dismissal of an appeal on equitable mootness grounds in *In re Tribune Media Co.*, 799 F.3d

272 (3d Cir. 2015). In this case, Aurelius Capital Management, L.P. ("Aurelius") and Law Debenture Trust Company of New York and Deutsche Bank Trust Companies America (collectively, the "Trustees") appealed the confirmation of the plan of Tribune and its affiliates. Such plan incorporated a settlement of causes of action against certain insiders of the Tribune debtors, including directors and officers of Tribune, and certain lenders who provided funding for such insiders to undertake a leveraged buyout of Tribune that ultimately saddled Tribune with a tremendous debt that it could not support. The plan was confirmed over the objection of Aurelius, which had proposed an alternative plan that rather than settle the causes of action in connection with the leveraged buyout pursued such causes of action, and after an extended and highly contested confirmation hearing. Aurelius moved for a stay pending appeal, which motion was granted provided that Aurelius posted a $1.5 billion bond. Aurelius failed to post such bond (although it moved unsuccessfully to vacate such requirement) and the plan became effective.

Quoting the decision in *SemCrude*, the Third Circuit noted that the doctrine of equitable mootness had been refined in the Third Circuit such that "equitable mootness . . . proceed[s] in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation." *Id*. at 278. The Third Circuit emphasized that "'[e]quitable mootness' is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization." *Id.*at 277. Moreover, "'when a court applies the doctrine of equitable mootness, it does so with a scalpel rather than an axe. To that end, a court may fashion whatever relief is practicable instead of declining review simply because relief is not available.'" *Id*. at 278.

Critically, the Third Circuit expressly declined the invitation in a concurrence in an earlier opinion (*In re One2One Communc'ns, LLC*, 2015 WL 4430302, at *7 (3d Cir. July 21, 2015), to reconsider its relatively longstanding recognition of equitable mootness (almost twenty years since *Continental*), a doctrine that every other Court of Appeals that addresses bankruptcy appeals at all has recognized. *Id*. at 284-85. Finding that declining to exercise jurisdiction over an appeal from an Article I court did not violate Article III of the United States Constitution, that the Bankruptcy Code did not prohibit the use of the doctrine of equitable mootness, and that equitable mootness presents many practical benefits (for third parties relying on the finality of orders and for bankrupt entities looking to decrease the time (and corresponding expense) in bankruptcy), the Third Circuit took solace in the fact that the ability to obtain a stay pending appeal (and thereby prevent an appeal from becoming equitably moot) counterbalanced some of the inequity of not permitting an otherwise valid appeal to go forward. Moreover, the Third Circuit actually reversed the decision of the Delaware District Court to dismiss the appeal by the trustee for some of the Tribune debtors' notes on equitable mootness grounds, where the amount of money at stake in the appeal was relatively small and where relief requested in the appeal could be effected without unraveling the Tribune plan. *Id*. at 283-84. Thus, the Third Circuit effectively reaffirmed the viability of the equitable mootness doctrine but also provided some additional guidance regarding when such doctrine should and should be applied to strip appellants of their rights to an appeal.

RBC Capital Markets, LLC v. Jervis - Aiding and Abetting Liability Imposed on Financial Advisors

In an opinion authored by Justice Valihura, RBC Capital Markets, LLC v. Jervis, 129 A.3d 816 (Del. 2015), the Supreme Court for the State of Delaware upheld a judgment by the Court of Chancery for the State of Delaware (the "Chancery Court") that RBC Capital Markets, LLC ("RBC") aided and abetted certain breaches of fiduciary duty by the board of directors of Rural/Metro Corporation ("Rural") and was liable to a class of former shareholders of Rural in an amount in excess of $75 million.

Rural was formed in 1948 and was headquartered in Scottsdale, Arizona. Until its merger with an affiliate of Warburg Pincus, LLC ("Warburg") on June 30, 2011, Rural operated ambulance and fire protection services in over 400 communities in 22 states. From 1993 until the closing of the merger with Warburg, Rural traded publicly on the NASDAQ exchange.
In August 2010, a special committee of the board of Rural (the "Special Committee") was formed to explore and supervise the potential acquisition of American Medical Response, Inc. ("AMR"), a subsidiary of Rural's competitor, Emergency Medical Services Corporation ("EMS") and a significant presence in the ambulance business. RBC, which had advised Rural in connection with certain debt refinancings and other matters in the past, raised the idea pf acquiring AMR with the board of Rural. The Special Committee was re-formed in October 2010 in response to an offer by Irving Place Capital and Macquerie Capital to acquire Rural. Thereafter, in December 2010, the Special Committee engaged RBC to act as the financial advisor for Rural in connection with Rural's efforts to explore certain strategic alternatives, including a potential sale of Rural.

In the midst of the various potential acquisitions by and of Rural, the Chancery Court had determined that RBC and certain of the Rural directors (who were also members of the Special committee) and the chief executive officer had a strategy of their own, one that did not align with the interests of Rural's shareholders. Specifically, one of Rural's directors was "over-boarded," i.e., he was on too many boards to satisfy the rules imposed by Institutional Shareholder Services, Inc. ("ISS"), a professional firm advising institutional investors about best corporate governance practices. Accordingly, the board member was keenly interested in exiting promptly from one of his boards and, indeed, agreed with ISS that he would exit one board by April, 2011. In addition, another Rural board member served on behalf of a private equity firm that he co-founded. The private equity firm was invested so heavily in Rural equity that a favorable and prompt exit, through a sale of Rural, was decidedly in its interest. These two directors proceeded to give a negative six month review to Rural's Chief Executive Officer because the CEO was perceived to be an impediment to the sale of Rural and even actively opposed to such sale. Following the bad review, the CEO decidedly adopted the view that a prompt sale of Rural was desirable.

RBC, according to the Chancery Court and the Delaware Supreme Court had its own strategy to maximize the value of its engagement by Rural for the benefit not of Rural's shareholders but of RBC. Beginning in December, RBC and its principals involved in the Rural deal devised a plan to have an inside track on the financing of potential purchasers of AMR by acting as the sell-side advisor for Rural. RBC did not disclose this scheme to the board of Rural. Moreover, even

though the Special Committee was not authorized to initiate a sale and auction process, it did just that, with the advice of RBC. RBC specifically benefitted by pushing for a sale and auction process for Rural that coincided with the sale process being undertaken by AMR and by brining only financial buyers to the table for the potential sale of Rural because such a strategy maximized the influence that RBC would have with potential Rural purchasers and the potential that such purchasers would need financing with RBC. The Chancery Court found that the sale process pushed by RBC, while presenting certain advantages (because of a rise in the value of Rural's stock in connection with the ongoing efforts to sell AMR) had fundamental structural flaws that ultimately decreased the value realized by Rural's shareholders. Among other things, parties pursuing the AMR sale were precluded by confidentiality agreements required to be executed in connection with the overlapping sale processes by direct competitors. Ultimately, and without disclosure to Rural that was deemed adequate by the Chancery Court, RBC financed the bid submitted by Warburg, and indeed offered financing for a number of Warburg's other portfolio companies. Moreover, the Chancery Court found that RBC specifically altered its fairness opinion and analysis to make Warburg's bid look more attractive. In the end, the board of Rural, in an action that the Court of Chancery determined violated its fiduciary duty owed to shareholders, approved the proposed merger with Warburg at $17.25 per share, as offered finally by Warburg.

Because Rural's shareholders were not fully informed, and even the Rural board was not "well-informed" with respect to RBC's conflicts and the ultimate value ascribed to Rural by RBC, and because of significant flaws in the sale process engineered by the board and RBC, the Delaware Supreme Court affirmed the finding of the Chancery Court that the board breached its duties imposed by Revlon, Inc. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The Supreme Court further affirmed the findings of the Chancery Court that RBC aided and abetted these breaches of fiduciary duty, because the board had a fiduciary duty to shareholders, the board breached this duty, and RBC knowingly participated in this breach of duty (by misleading the board and failing to provide adequate information to the board with respect to RBC's conflicts and the flaws in RBC's valuation and fairness opinion), and the plaintiffs suffered damages because of the breach.

The Delaware Supreme Court ultimately affirmed the Chancery Court's judgment against RBC. However, in keeping with prior precedent, the Court limited the exposure of the financial advisor for aiding and abetting liability to instances where such financial advisor knowingly participated in the breach of duty. By expressly disclaiming the assertion by the Chancery Court that RBC had a duty to act as a gatekeeper, the Court further limited the potential exposure of financial advisors to causes of action by disgruntled shareholders. Instead, the Court expressly noted that the relationship between a financial advisor and the board it is advising is in the end a contractual relationship. If RBC had properly disclosed its conflicts and potential conflicts to the board of Rural and had not engaged in changing its valuation (and its advice regarding the proper sales process for Rural to undertake) to suit its desire to obtain fees for financing the Warburg bid, perhaps RBC would have avoided liability in the end.

In re Asarco and Its Delaware Progeny–Rejection of Contractual Fees for Fees in Delaware

On June 15, 2015, the United States Supreme Court issued its decision in *Baker Botts L.L.P., et al. v. ASARCO LLC*, 135 S. Ct. 2158 ("Asarco"). In *Asarco*, the Court determined that Baker Botts L.L.P. could not be awarded fees and expenses totaling in excess of $5 million incurred in defending its fee application. *Id*. at 2163, 2169. The Court looked at the language of section 330 of the Bankruptcy Code and found that nothing in the Bankruptcy Code indicated that Congress intended to depart from the American Rule and permit fee shifting by allowing attorneys for a trustee to receive payment from the estate for their time and expense spent defending their fee applications. *Id*. at 2164-65. Moreover, defending fee applications was not a service performed for the benefit of the estate, but was instead a service for the benefit of the professional. *Id*. at 2167. Nor was payment of fees for defending a fee application defensible on public policy grounds. The Court expressly rejected the argument that absent paying bankruptcy attorneys for work defending fee applications, such attorneys would receive less compensation than other non-bankruptcy lawyers and that such disparity would discourage the most talented attorneys from pursuing bankruptcy work. *See id*. at 2168-69.

In *Asarco*, the debtors retained Baker Botts as their primary bankruptcy counsel in what would prove to be a very contentious, and for the Asarco debtors and their creditors, a very successful Chapter 11 bankruptcy case. Among other things, at the start of the Asarco bankruptcy cases, the Asarco debtors had very few assets and liabilities for environmental and other tort claims totaling in excess of $10 billion. Moreover, the debtors had to contend with a litigious parent company, Americas Mining Corporation ("AMC"), that just two years prior to the filing of the bankruptcy cases had directed the Asarco debtors to transfer its controlling interest in Southern Copper Corporation to AMC. Thus, with massive debts and few remaining assets, the Asarco debtors had to choose between attempting to confirm a plan providing little if any recovery for its creditors or pursuing a risky and massive fraudulent transfer action against AMC.

The Asarco debtors chose the latter course. For the next few years the Asarco debtors and their counsel pursued the litigation and ultimately effectuated what the bankruptcy court described as one of the most successful restructurings ever. After first obtaining a judgment of between $7 and $10 billion against AMC, the debtors in the end cut a deal with AMC pursuant to which AMC funded a plan paying creditors in full and obtaining control over the reorganized Asarco debtors. In the course of litigating the fraudulent transfer action and ultimately confirming a successful plan of reorganization, Baker Botts accrued in excess of $113 million in fees and another $6 million in expenses. In addition, and as agreed by the Asarco debtors, Baker Botts sought approval of a success fee in excess of $4 million.

Rather than permit Baker Botts to collect the fees and expenses it had earned, the reorganized Asarco debtors, controlled by AMC, objected to an extraordinary number of time and expense entries submitted by Baker Botts. Indeed, notwithstanding that neither AMC not any other party (including the Office of the United States Trustee) had raised any objections to the fees and expenses sought in the bankruptcy cases, the reorganized Asarco debtors served a 104 page objection accompanied by 16 feet of exhibits on Baker Botts in response to its final fee application. After the review and production of hundreds of thousands of documents and a six

day trial, the bankruptcy court overruled every objection raised with respect to the fees and requested by Baker Botts.

In the course of litigation over these fees and expenses, Baker Botts accrued an additional $5 million in fees and expenses. The bankruptcy court awarded Baker Botts all of the fees and expenses it sought and that decision was affirmed by the district court. The United States Court of Appeals for the Fifth Circuit determined that in accordance with the American Rule, which Congress had not altered in enacting the Bankruptcy Code, Baker Botts was not entitled to payment for its fees and expenses incurred in defending its fee application. As noted above, the United States Supreme Court affirmed this decision. "'Our basic point of reference when considering the award of attorney's fees is the bedrock principle known as the American Rule: Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise.'" *Id*. at 2164 (*quoting Hardt v. Reliance Life Ins. Co.*, 560 U.S. 242, 252-53 (2010).

Because the Supreme Court held that the Bankruptcy Code did not "provide otherwise," intrepid bankruptcy lawyers intent on getting paid for time and expenses incurred defending their fee applications immediately began working on their "contracts," *i.e.*, their engagement letters or other retention agreements with debtors and even committees. Almost immediately and uniformly, the United States Bankruptcy Court for the District of Delaware squelched these embryonic efforts at creativity.

First, in *In re Boomerang Tube, Inc.*, 2016 Bankr. LEXIS 273 (Bankr. D. Del. Jan. 29, 2016), Judge Walrath denied an attempt by counsel for an official committee of unsecured creditors to attempt to alter the American Rule through their respective retention applications. Specifically, such counsel included a provision in their fee applications providing that the estate would indemnify such professionals for any fees and expenses incurred in defending their fee applications. The Office of the United States Trustee, in accordance with its clear statement that following *Asarco* the United States Trustee would object to any term of employment permitting payment of fees on fees (*see* Frequently Asked Questions, *available at* www.justice.gov/ust/Prof_Comp/FAQ_Prof_Comp), filed an objection. The court sustained the objection determining that neither section 328 of the Bankruptcy Code nor section 330 of the Bankruptcy Code embodied a statutory exception to the American Rule. *Id*. at *6-*7. Importantly, Judge Walrath wrote that "the ASARCO Court did acknowledge a contractual exception to the American Rule, [but] any such contract has to be consistent with the other provisions of the Bankruptcy Code." *Id*. at *9. Although retention agreements, even for Committee counsel, are contracts, they are contracts between two parties – the Committee and its proposed counsel – that a third party – the debtors' estates – will pay any costs and expenses incurred by the Committee's proposed counsel in defending its fee applications. Thus, such agreements cannot be contractual exceptions to the American Rule. *Id*. at *13. If such contracts were, however, exceptions to the American Rule, contractual provisions without a statutory basis cannot support the payment of fees on fees (even if such fees are generally allowed in the bankruptcy and non-bankruptcy marketplace). *Id*. at *20-*21.

Second, in *In re Samson Resources Corporation*, Case Number 15-11934 (Bankr. D. Del. March 1, 2016), Judge Sontchi applied Judge Walrath's opinion in *Boomerang* to the proposed retention of counsel for the Debtors. Even though the engagement letter was in this case between the

debtors and counsel and proposed to bind the debtors' estates, the court would not approve the payment of such counsel for fees on fees. In a letter that predated the entry of the ultimate orders approving the retention of debtors' counsel, Judge Sontchi stated that he would adopt the reasoning of Judge Walrath in *Boomerang* noting that Judge Walrath indicated that she would reach the same decision if the professionals were being retained because such provisions are neither statutory nor contractual exceptions to the American Rule and, even if they were, such provisions were not reasonable. *See* Letter dated February 9, 2016, *In re Samson Resources Corporation*, Case Number 15-11934 (Bankr. D. Del.) (Docket No. 641).

Third, Judge Shannon ruled in *In re New Gulf Resources, LLC*, Case Number 15-12566 (Bankr. D. Del. March 17, 2016) that a fee premium that would be paid to Baker Botts as counsel to the debtors only if an objection was filed to any of its fee applications was impermissible under the holding in *ASARCO*. In *New Gulf*, Baker Botts, after discounting its rates 10-15% prior to the bankruptcy filing, proposed a fee premium of 10% after such filing "to account for the payment uncertainty associated with representing a debtor in bankruptcy." However, Baker Botts agreed to waive such fee premium "if, and only if, Baker Botts does not incur material fees and expenses defending against any objection with respect to an interim or final fee application." Although Judge Shannon acknowledged the creativity in the Baker Botts proposal, he found no "meaningful distinction between the fee premium proposed here and the matters considered and ruled upon in *Boomerang Tube*."

Finally, both Judge Silverstein, in *In re Newberry Common Associates, LLC*, Case Number 15-12507 (Bankr. D. Del. Feb. 29, 2016) and Judge Gross, in *In re Magnum Hunter Resources Corp.*, Case Number 15-12533 (Bankr. D. Del. Feb. 26, 2016), have indicated that they also would not approve retentions that purported to permit professionals to collect fees on fees.

In re Jevic Holding Corp. – Structured Dismissals

The Bankruptcy Code permits debtors to convert their chapter 11 bankruptcy cases to cases under chapter 7 or to dismiss such cases. *See* 11 U.S.C. §1112. Moreover, Bankruptcy Code section 349 specifically addresses certain, but not all, consequences of the dismissal of a bankruptcy case, and further provides that a bankruptcy court may "order otherwise" even with respect to those consequences set forth in such section. *See id*. the Structured dismissals, in contrast to the simple dismissal of chapter 11 cases permitted explicitly by the Bankruptcy Code, generally include certain additional provisions in the order approving such dismissal including releases, settlements, distributions to professionals and creditors, and provisions permitting (or purporting to permit) retention of jurisdiction by bankruptcy courts in certain instances.

In *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015), the United States Court of Appeals for the Third Circuit, held that a "structured dismissal" of a chapter 11 bankruptcy case could be approved "in a rare case," even if such structured dismissals provided for distributions contrary to the Bankruptcy Code and the absolute priority rule embodied therein. *See* 11 U.S.C. §§ 507, 1129(a)(9)(A), (B), 1129(b)(1) (imposing "fair and equitable" requirement on chapter 11 plans as prerequisite to confirmation).

In 2006, Jevic, a trucking company, was acquired by Sun Capital Partners in a leveraged buyout. The Sun Capital deal was financed by CIT Group, which offered an $85 million revolver to the trucking company . Following the LBO, Jevic's business suffered and ultimately Jevic was compelled to enter into a forbearance agreement with CIT and Sun Capital was required, as part of this forbearance, to execute a $2 million guarantee. In May 2008, Jevic's business continued to suffer and the board of Jevic ultimately authorized Jevic and its subsidiaries to file for bankruptcy protection. One day prior to the filing of its chapter 11 bankruptcy petitions, Jevic ceased all operations and terminated its employees. At the time of the filings, Jevic owed CIT and Sun over $53 million and tax and general unsecured creditors over $20 million.

During the course of the bankruptcy cases, Jevic liquidated all of its assets to pay its secured debts. In addition, the official committee of unsecured creditors in the case filed suit against CIT and Sun for fraudulent transfer and preferential transfer in connection with the 2006 leveraged buyout. Finally, a group of truck drivers fired by Jevic filed an adversary proceeding seeking recovery of their claims for alleged WARN Act violations by the Jevic debtors. After the bankruptcy court denied in part and granted in part the motion by CIT to dismiss the action, in March 2012, representatives of the Jevic debtors, Sun, CIT, the WARN Act claimants, and the committee met in attempt to resolve their remaining disputes. At the time of the meeting, Jevic had only $1.7 million in cash and the pending causes of action for assets. The cash on hand was insufficient to satisfy the claims of the secured lenders, let alone the other potential administrative and priority claims in the bankruptcy cases, including the over $12.4 million claim asserted by the WARN Act claimants (over $8.3 million of which such claimants argued was a priority claim).

As a result of these negotiations, the parties except for the WARN Act claimants were able to resolve their claims. Pursuant to the settlement, each of the committee, CIT, Sun, and the Jevic debtors would provide mutual releases. In exchange for such releases, CIT agreed to pay $2 million to satisfy unpaid claims of professionals employed by the committee and the Jevic debtors and other unpaid administrative claims. Sun further agreed to release any of its liens on the $1.7 million in cash on hand with such funds to be used to pay any additional unpaid administrative and priority tax claims. Any amounts left after such payment would be paid to unsecured creditors on a *pro rata* basis. No amounts at all were to be paid to the WARN Act claimants. The settlement was to be accomplished through a structured dismissal pursuant to Bankruptcy Rule 9019 and Bankruptcy Code sections 349 and 1112.

The WARN Act claimants objected to the settlement because it violated the absolute priority rule, permitting the payment of unsecured claims before any payment would be made to the potentially valid priority claims of such claimants. The bankruptcy court determined that absent the settlement proposed, there would be "'no realistic prospect' of a meaningful distribution to anyone but the secured lenders . . .." 787 F.3d at 178. Nor was conversion to chapter 7 a viable alternative, because in such instance, "the chapter 7 trustee would not have had sufficient funds 'to operate, investigate or litigate' (since all the cash left in the estate was encumbered) and the secured creditors has 'stated unequivocally and credibly that they would not do this deal in a Chapter 7.'" *Id*. After dispensing with the notion that it could not approve a settlement (as opposed to a plan of reorganization) that did not comply with the priority distribution scheme in the Bankruptcy Code, the bankruptcy court determined that the outcome of the pending

fraudulent conveyance and preference litigation was uncertain at best, especially in light of the lack of funds for anyone to prosecute such cause of action. Accordingly, the interests of creditors weighed in favor of approving the settlement. On appeal, the United States District Court for the District of Delaware affirmed the opinion of the Delaware Bankruptcy Court.

The Third Circuit initially dispensed with the notion that structured dismissals can never be approved by a bankruptcy court where such dismissals provide for a distribution that is not in line with the priority scheme otherwise mandated by the Bankruptcy Code. *Id*. at 181-82. In this instance, there was and could be no showing that the structured dismissal was devised to avoid an otherwise available potential distribution under a chapter 11 plan or a chapter 7 case. Accordingly, the structured dismissal was not prohibited by the Bankruptcy Code. *Id*. at 182. Nor did the Third Circuit accept the argument that settlements pursuant to Bankruptcy Rule 9019 could not skip classes of creditors. In this regard, the Third Circuit held that "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code only if they have 'specific and credible grounds to justify [the] deviation.'" *Id*. at 184 (*quoting In re Iridium Operating LLC*, 478 F. 3d 452, 466 (2d Cir. 2007). Rejecting the argument of the Office of the United States Trustee that bankruptcy cases must have "ugly results" if such ugly results are dictated by the provisions of the Bankruptcy Code, the Third Circuit concluded:

> We doubt that our national bankruptcy policy is quite so nihilistic and distrustful of bankruptcy judges. Rather, we believe the Code permits a structured dismissal, even one that deviates from the § 507 priorities, when a bankruptcy judge makes sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estate and its creditors. Although this result is likely to be justified only rarely, in this case the Bankruptcy Court provided sufficient reasons to support its approval of the settlement under Bankruptcy Rule 9019.

Id. at 185-86.

Given the trend in bankruptcy cases, towards thinner and generally more litigious cases, with correspondingly higher costs and expenses imposed by a combination of certain changes to the Bankruptcy Code and overall increases in fees and expenses charged by all professionals, *Jevic*'s "rare case" has become all too common. Petitions for certiorari have been filed in *Jevic* and it remain to be seen whether the Supreme Court will grant *certiorari* and, if it does decide to review the decision, affirm the Third Circuit's decision.

Following *Jevic*, the United States Bankruptcy Court for the District of Utah approved a structured dismissal under section 305 of the Bankruptcy Code. *See In re Naartjie Custom Kinds, Inc.*, 544 B.R. 416 (Bankr. D. Utah 2015). Surprisingly perhaps, also following the issuance of *Jevic* opinion, the United States Bankruptcy Court for the District of Delaware denied a request for a structured dismissal temporarily in order to permit the debtors to establish an administrative bar date and determine if administrative claims could be paid. *See In re Parallel Energy LP*, Case Number 15-12263 (KG) (Bankr. D. Del. March 10, 2016). That case, as of the date of this presentation, remains pending.