ABI WINTER LEADERSHIP CONFERENCE 2009
Public Companies and Claims Trading Committee

Circuit Splits: Will Recent Decisions on Several Key Issues Result in Forum-shopping?

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1. Standards for Rejection of a Collective Bargaining Agreement

   a. 2d Circuit

Truck Drivers Local 807 v. Carey Transp. Inc., 816 F.2d 82 (2d Cir. 1987)
The Second Circuit rejected the Third Circuit's holding in *Wheeling-Pittsburgh Steel* that "necessary" is synonymous with "essential." Rather, the necessity requirement places on the debtor the burden of proving that its proposal is made in good faith and contains necessary, but not absolutely minimal, changes that will increase the likelihood of a successful reorganization. The court noted that the debtor does not need to prove that it will ultimately achieve rehabilitation, just that there is an increase in likelihood as a result of the modifications. The court looked to legislative history, which suggests that "necessary" should not be equated with "essential" or "bare minimum." The court also adopted the reasoning of the bankruptcy court below, which noted that, because the statute requires the debtor to negotiate in good faith over the proposed modifications, it would not make sense for an employer to first propose the bare minimum changes necessary because it would leave no room for good faith negotiation. With respect to the fairness requirement of section 1113, the Second Circuit held that the debtor is not required to prove that management and non-union employees will have their salaries and benefits cut to the same degree that union workers' salaries and benefits will be reduced. It is sufficient to show that managers and non-union employees are assuming increased responsibilities as a result of the decrease in labor force without receiving salary increases to reflect the additional work load. The Second Circuit found a lack of good cause for rejection of proposed modifications to a CBA where the union stonewalled participation in negotiations and did not offer any reason for rejecting the proposal other than its view that the modifications were excessive, even in the absence of a snap-back provision. Finally, the Second Circuit, relying on *Bildisco*, noted that the bankruptcy courts must focus on the ultimate goal of chapter 11 when balancing the equities. The court set forth six equitable considerations: (1) the likelihood and consequences of liquidation if rejection is not permitted; (2) the likely reduction in the value of creditors' claims if the bargaining agreement remains in force; (3) the likelihood and consequence of a strike if the bargaining agreement is voided; (4) the possibility and likely effect of any employee claims for breach of contract if rejection is approved; (5) the cost-spreading abilities of the various parties, taking into account the number of employees covered by the bargaining agreement and how various employees' wages and benefits compare to those of others in the industry; and (6) the good or bad faith of the parties in dealing with the debtor's financial dilemma. Applying the foregoing analysis, the Second Circuit affirmed the lower courts' approval of the rejection of the CBAs.

In re Delta Air Lines, 342 B.R. 685 (Bankr. S.D.N.Y. 2006)
The bankruptcy court for the southern district of New York relied upon the holding in *Carey* that "necessity" requires a showing that the proposal to the unions was made in good faith and contained necessary but not absolutely minimal changes that would enable a successful reorganization. Moreover, the proposal must be viewed as a whole, and not by its specific elements. The union argued that the changes were not "necessary" because they reflected a minimal portion of the company's overall costs and would not make or break the reorganization. The court rejected this "last man standing" argument, noting that the statute requires that all affected parties be treated "fairly and equitably" and all constituencies must therefore bear their fair share of the cost of reorganization. Nevertheless, the court denied the debtor's request to reject the CBA because it found that the debtor did not satisfy its obligation to "confer in good faith" based on the fact that the debtor had stated to the union from the outset that the proposal was "non-negotiable." The court did note that in certain circumstances a "non-negotiable" proposal may be appropriate, such as where reorganization is impossible absent the proposed modification. The court also held that while modifications need not be "identical" among constituencies, they must be fair and equitable and be supported by some justification. A wide disparity in treatment is not acceptable. Disparate treatment constitutes "good cause" for refusal to accept a proposed modification. Finally, the court found that, while a balancing of the equities favored the debtor's request to modify because the pay scale was substantially higher than that within the industry, the union was not required to accept modification to the lowest common denominator or even the median or average of competitors. Nevertheless, because the statute requires a finding that balancing of the equities "clearly favors rejection," based on the court's findings with respect to the other requirements of the statute, the court declined to authorize rejection of the CBAs.

In re Northwest Airlines Corp., 346 B.R. 307 (Bankr. S.D.N.Y. 2006)
The bankruptcy court, applying the standard from *Carey*, stated that modifications to a CBA are "necessary" if they have a significant impact on the debtor's operations and are required for the debtor to successfully reorganize

and compete in the marketplace upon emergence from chapter 11. The court must focus on the total impact of all proposed changes on the debtor's ability to reorganize, not on whether any single proposed change will achieve that result. Modifications are "fair and equitable" if they spread the burden of saving among every constituency while ensuring that all sacrifice to a similar degree, but they need not be identical. It is also appropriate to look at prepetition cost reductions. Good cause does not exist when the proposal is one of "take it or leave it." However, if a union demands provisions that are not economically feasible and does not offer an alternative that would enable the debtor to successfully reorganize, the court will find that the union acted without good cause. The court applied the six-factor test from *Carey* to determine whether the balance of the equities favored rejection. Applying the foregoing analysis, the bankruptcy court authorized the debtor's rejection of the CBAs.

b. 3d Circuit

Wheeling-Pittsburgh Steel Corp. v. United Steelworkers of America, AFL-CIO-CFC, 791 F.2d 1074 (3d Cir. 1986): The Third Circuit adopted a nine step process for analyzing whether the requirements of section 1113 have been satisfied. The Debtor has the burden of establishing the following nine elements: (1) The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement. (2) The proposal must be based on the most complete and reliable information available at the time of the proposal. (3) The proposed modifications must be necessary to permit the reorganization of the debtor. The Third Circuit construed necessity "strictly to signify only modifications that the trustee is constrained to accept because they are directly related to the Company's financial condition and its reorganization." The emphasis is on determining whether and what modifications should be made with "the somewhat shorter term goal of preventing the debtor's liquidation." The absence of a snapback provision, providing that a portion of any excess of profits over projections will be distributed to union employees, is a strong indicator the necessity test is failed. (4) The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably. The "focus of inquiry as to 'fair and equitable' treatment should be whether the Company's proposal would impose a disproportionate burden on the employees." (5) The debtor must provide to the Union such relevant information as is necessary to valuate the proposal. (6) Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union. (7) At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement. The amount of time for negotiation must depend on the circumstances of the particular case. However, the need for haste in itself cannot support an abbreviated negotiation period. (8) The Union must have refused to accept the proposal without good cause. (9) The balance of the equities must clearly favor rejection of the collective bargaining agreement. Applying these nine factors, the Third Circuit reversed the lowers courts' approval of the rejection of the collective bargaining agreement at issue, pointing primarily to the lack of a snapback and undue weight on the need for haste. *See also In re Kaiser Aluminum Corp.*, 456 F3d 328 (3d Cir. 2006).

c. 5th Circuit

United Food and Commercial Workers Local Union Nos. 455, 408, 540 and 1000 v. Appletree Markets, Inc., 155 B.R. 431 (S.D. Tex. 1993): This court adopted the nine factor test set forth above. At issues were factors 3, 4, and 5. With respect to the necessity test, the court expressly rejected the Third Circuit's focus on the short term goal of avoiding liquidation, instead adopting the Second Circuit test that the debtor must prove "that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully." The court reasoned that "creditors are not likely to extend additional funds to a reorganized debtor unless there is a reasonable basis to conclude that the reorganization will be successful and not merely a prelude to another reorganization or a liquidation." "To determine whether a debtor's proposed modifications to a CBA are necessary, a court must focus on the total impact of the changes in the debtor's ability to reorganize, not on whether any single proposed change will achieve that result." With respect to whether the proposed modification of the CBA at issue was "fair and equitable", the fact that employee wages were being reduced while management salaries were not was not determinative because management salaries and benefits were already below market rate while employee wages and benefits were better than market standard in several respects. This fact outweighed the absence of a snapback provision, which the court characterized as merely one factor to be considered. *See also In re Texas Sheet Metals, Inc.*, 90 B.R. 260 (Bankr. S.D. Tex. 1988) (applying the same approach).

d. 7th Circuit

International Union et al. v. Gatke Corp., 151 B.R. 211, 213 (N.D. Ind. 1991): The Court adopted the Second Circuit's position in *Carey* (over the Third Circuit's holding in *Wheeling-Pittsburgh Steel*) as the more persuasive and better-reasoned approach, noting that collective bargaining "is not a practicable goal if one negotiating party is barred from advancing anything other than the absolute minimum that can be accepted if it is to survive," and that "the Second Circuit's longer term focus, which encompasses the ultimate success of reorganization rather than merely the avoidance of immediate liquidation, is more consistent with the statute."

In re Garofalo's Finer Foods, Inc., 117 B.R. 363, 556 (Bankr. N.D.Ill. 1990): The Court used same nine factor test used by *Wheeling-Pittsburgh Steel*.

e. 9th Circuit

In re Big Sky Transportation Co., a Montana corporation, d/b/a/ Big Sky Airlines, Northwest Airlink and Big Sky Transco, Debtor, 104 B.R. 333 (9th Cir. 1989):

The Ninth Circuit adopted nine factors for analyzing whether the requirements of section 1113 have been satisfied. The Debtor has the burden of establishing the following nine elements: (1) The debtor in possession must make a proposal to the union to modify the collective bargaining agreement. (2) The proposal must be based on the most complete and reliable information available at the time of the proposal. (3) The proposed modifications must be necessary to permit the reorganization of the debtor. The court adopted the same definition of necessary as the Second Circuit did in *Truck Drivers Local 807 v. Carey Transp. Co.*, 816 F.2d; the debtor must prove "that its proposal is made in good faith, and that it contains necessary, but not absolutely minimal, changes that will enable the debtor to complete the reorganization process successfully." The court expanded on this and stated that a reorganization plan can only be confirmed "if the court determines that neither liquidation nor a need for further reorganization is likely to follow." (4) The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably. The court expanded on this factor and, relying on *Carey, supra*, stated "[f]air and equitable treatment does not, of necessity mean identical or equal treatment." (5) The debtor must provide to the union such relevant information as is necessary to valuate the proposal. (6) Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the union. (7) At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement. (8) The union must have refused to accept the proposal without good cause. (9) The balance of the equities must clearly favor rejection of the collective bargaining agreement. Applying these nine factors, the Ninth Circuit granted the debtor's motion to reject the collective bargaining agreement at issue.

2. Lease Proration/Stub Rent

a. 2d Circuit

i. District Court Cases

Urban Retail Props. v. Loews Cineplex Entm't Corp., 01 Civ. 8946, 2002 U.S. Dist. LEXIS 6186 (S.D.N.Y. Apr. 9, 2002)
Lease required the debtor to make a $1 million construction reimbursement payment to landlord upon the debtor's opening of the newly constructed facility. Although most of the construction was completed prepetition, the payment came due postpetition. Landlord sought to compel payment of entire reimbursement amount under § 365(d)(3). The debtor argued that § 365(d)(3) mandated proration of the payment such that the debtor was only responsible for costs related to postpetition construction. On appeal of bankruptcy court's decision which ordered proration, court noted that the issue of lease proration has yet to be addressed by the Second Circuit. According to the court, the obligation at issue here -- a one-time capital expense reimbursement -- was different from obligations which accrue over time such as rent, common area maintenance, and taxes. The rationale for prorating those types of obligations, the court reasoned, was inapposite here. Moreover, the court observed, the payment would not have been triggered absent the debtors' continued postpetition operation and use of the facility. As such, the court declined to prorate the reimbursement obligation and instead required payment in full to landlord.

The Equitable Life Assurance Soc'y of the United States v. Petrie Retail, Inc. (In re Petrie Retail, Inc., 233 B.R. 256 (S.D.N.Y. 1999)
In addition to fixed rent, lease at issue required payment of "percentage rent" on all sales that exceeded a minimum threshold or "breakpoint" amount. When debtor reached the breakpoint amount postpetition, landlord sought full amount of percentage rent due under the lease. The debtor argued that even though the obligation to pay percentage rent was triggered postpetition, the amount payable should be prorated over the entire year. In addressing the issue of whether proration was warranted, the court first rejected the "billing date" approach on the basis that it "clearly conflicts with the statutory purpose [of § 365(d)(3)] by allowing a landlord to impose upon a debtor obligations arising from the debtor's pre-petition occupancy and use of leased premises, rather than the debtor's post-petition efforts to continue operating its business." The court noted further, however, that unlike an obligation to pay fixed rent and taxes, which can be said to accrue incrementally each day, "[t]here is . . . no such logical basis for proration of contingent obligations such as percentage rent, which can be said to arise only when the tenant exceeds the breakpoint and its obligation to pay percentage rent becomes certain." Accordingly, the court adopted the "sales breakpoint approach." Under this approach, the percentage rent based on sales made after the petition date are treated as postpetition obligations and the percentage rent attributable to prepetition sales are treated as prepetition obligations. Thus, to the extent the breakpoint is reached postpetition -- as was the case here -- all percentage rent is treated as a postpetition obligation.

Newman v. McCrory Corp. (In re McCrory Corp.), 210 B.R. 934 (S.D.N.Y. 1997)
Lease required debtor to pay real estate taxes in advance for the prospective year on an annual basis. After the petition date and immediately before the debtor's rejection of the lease, the payment of annual taxes came due. The issue for the court was whether § 365(d)(3) required the debtor to pay the full amount due under the lease or a prorated portion covering the period from the petition date to the rejection date. According to the court, the statutory language of § 365(d)(3) was not entirely clear on this issue. In examining the legislative history, the court pointed out that there was nothing to indicate that Congress indented to deviate from the pre-existing practice of prorating lease obligations under § 503(b)(1). Indeed, the court observed, the legislative purpose of § 365(d)(3) was to ensure that landlords receive "current payments" for "current services" and not to provide landlords with a windfall at the expense of other creditors. The court concluded that because the debtor's tax liability accrued on a daily basis, § 365(d)(3) only obligated the debtor to pay the amounts that accrued postpetition. As the court noted, a contrary result would be equally disadvantageous to landlords if a debtor's obligation to pay taxes came due immediately before the petition date.

Bullock's Inc. v. Lakewood Mall Shopping Ctr. (In re R.H. Macy & Co., Inc.), 93 Civ. 4414, 1994 U.S. Dist. LEXIS 21364 (S.D.N.Y. Feb. 23, 1994)
Lease at issue obligated the debtor to pay landlord for real estate taxes assessed on the leased premises. After the petition date, the tax obligation that came due covered prepetition and postpetition periods. Landlord argued that because payment obligation did not arise until after the petition date, the entire amount was required to be paid under § 365(d)(3). The debtor argued that to the extent the taxes accrued prepetition, they were not an "obligation" that "arose" postpetition. In rejecting the debtor's argument, the court observed that the unambiguous language of § 365(b)(3) supported the "billing date" approach. According to the court, the debtor improperly conflated the existence of a "claim" with the existence of an "obligation." In other words, the court reasoned, although a "claim" comes into existence notwithstanding its contingency, an obligation does not arise until performance is due. As such, the court concluded that the debtor was required to pay the full amount of the claimed taxes -- thereby affirming the bankruptcy court's ruling in _In re R.H. Macy & Co., Inc._, 152 B.R. 869 (Bankr. S.D.N.Y. 1993).

Child World, Inc. v. The Campbell/Massachusetts Trust (In re Child World, Inc.), 161 B.R. 571 (S.D.N.Y. 1993)
Lease required debtor to reimburse landlord for payment of taxes within 15 days of landlord's submission of documentation. Five weeks after the petition date, the landlord provided the debtor with the documentation triggering debtor's payment obligation under the lease. The debtor reimbursed landlord only for the portion of the taxes that accrued postpetition. Landlord argued that full amount was due under § 365(d)(3). According to the court, the legislative history of § 365(d)(3) did not support the billing date approach. Instead, the court held, proration was more consistent with the purpose of § 365(d)(3) and the debtor was not required to reimburse the landlord for taxes which accrued prepetition -- thereby reversing the bankruptcy court's ruling in _In re Child World, Inc._, 150 B.R. 328 (Bankr. S.D.N.Y. 1993).

ii. Bankruptcy Court Cases

In re Stone Barn Manhattan LLC, 398 B.R. 359 (Bankr. S.D.N.Y. 2008)
Lease required debtor to pay rent in advance on a monthly basis on the first day of the month. The debtor filed for bankruptcy after the first of the month. Landlord subsequently sought stub rent for the period from the petition date until the beginning of the following month. After reviewing the prior case law on the subject, the court concluded that proration of the lease was proper under § 365(d)(3). According to the court, § 365(d)(3) was intended to ensure that landlords receive "current payment" for "current services." Irrespective of whether payment was due prepetition, landlord was providing the debtor with occupancy after the petition date. The debtor was therefore required to pay the landlord all rent accruing after the petition date.

In re Sandra Rothman, SLP, P.C., Case No. 07-71129-478, 2007 Bankr. LEXIS 2651 (Bankr. S.D.N.Y. Aug. 2, 2007)
Rent payments were due on the first of every month under lease at issue. Debtor filed its bankruptcy petition on the second day of the month. Landlord argued that § 365(d)(3) required payment of first month's rent irrespective of the fact that payment came due prepetition. After reviewing the divergent case law on stub rent and lease proration, the court concluded that lease proration was required under § 365(d)(3). This conclusion was necessary to avoid inequitable results to both debtors and landlords.

In re Ames Dept. Stores, Inc., 306 B.R. 43 (Bankr. S.D.N.Y. 2004)
When debtor rejected lease mid-month, landlord argued that full month's rent was nonetheless due under § 365(d)(3) because obligation "arose" postpetition and prior to rejection. The debtor argued that its liability under § 365(d)(3) should be limited to the post-petition, pre-rejection period. Agreeing with the debtor's position, the court concluded that lease proration was required for several reasons. First, nothing in the legislative history of § 365(d)(3) indicated an intent to depart from the prior practice of lease proration under § 503(b)(1). Second, requiring full payment for post-rejection rent was inconsistent with Bankruptcy Code sections 365(g) and 502(g) which required that lease rejection claims be treated as prepetition unsecured claims. Third, requiring full payment for post-rejection rent is inconsistent with the Congressional purpose of requiring "current payment" for "current services" because the landlord provides no post-rejection services. Fourth, prohibiting post-rejection lease proration could be just as inequitable to landlords on different set of facts. Fifth, rent obligations accrue on a daily basis regardless of when payment is due. Based on the forgoing, the court rejected the billing date approach as inconsistent with the Bankruptcy Code. *See also In re Victory Mkts., Inc.*, 196 B.R. 6 (Bankr. N.D.N.Y. 1995) (adopting proration approach with respect to tax obligations); *In re Ames Dept. Stores, Inc.*, 150 B.R. 107 (Bankr. S.D.N.Y. 1993) (endorsing lease proration approach); *In re Swanton Corp.*, 58 B.R. 474 (Bankr. S.D.N.Y. 1986) (same).

b. 3d Circuit

Centerpoint Properties v. Montgomery Ward Holding Corp. (*In re Montgomery Ward Holding Corp.*), 268 F.3d 205 (3d Cir. 2001): The lease at issue provided for the debtor to reimburse the landlord for all real estate taxes assessed on the premises. After the petition date, the landlord sent the debtor three invoices: two for solely pre-petition taxes and one covering pre- and post-petition taxes; all amounts became payable post-petition. "[H]olding that an obligation arises under a lease when the legally enforceable duty to perform arises under the lease," the Third Circuit concluded that § 365(d)(3) required payment in full of all three invoices. The Third Circuit rejected proration as inconsistent with the plain language of the statute. *See also T&N Ltd. v. Computer Sales Int'l, Inc.* (*In re Federal-Global Mogul Inc.*), 222 Fed. Appx. 196, 2007 U.S. App. Lexis 6120, at *9 (3d Cir. 2007) (reaffirming *Montgomery Ward*).

c. 5th Circuit

In re Appletree Markets, Inc., 139 B.R. 417 (Bankr. S.D. Tex. 1992): Rent for the post-petition period came due and payable the day before the debtor its bankruptcy petition. Reasoning that the rent obligation did not "arise" after the petition, the court did not require the debtor to make any payment of the post-petition rent pursuant to § 365(d)(3). *See also In re FPP Operating Partners, L.P.*, 2004 Bankr. Lexis 896 (Bankr. N.D. Tex. 2004) (similarly rejecting the proration approach).

d. 7th Circuit

In re Bachrach Clothing, Inc., 2008 WL 4449870 (N.D.Ill. 2008): A Chapter 11 debtor-tenant's obligation for real estate taxes, under a commercial lease that required it to pay such taxes as additional rent, accrued each day over the period of time to which the taxes related, even though the taxing authority did not bill for these taxes until after the debtor's purported assumption of the lease. The Court held that, accordingly, accrued taxes were part of the "cure" amount that the debtor had to pay as a prerequisite to assuming the lease.

HA-LO Indus. v. CenterPoint Props. Trust, 342 F. 3d 794 (7th Cir. 2003): The Court adopted the “payment date” rule, at least with respect to the debtor's real property lease obligations under section 365(d)(3), which requires the debtor-lessee to pay in full any real property lease obligation for which the debtor's payment is due postpetition, even if the obligation accrued prepetition and the landlord delayed submitting the invoice until after bankruptcy. The rationale is that section 365(d)(3) requires the debtor to “timely” perform all obligations arising after the petition date under any real property lease, and that the time in which an obligation arises should be measured by the lease itself. For example, unless the lease expressly provides for daily prorated rent, the rent due on the first day of the month for the entire month must be paid in full, even if the debtor rejects the lease and vacates on the second day of the month. *HA-LO Indus*., 342 F. 3d at 800; see also *UAL Corp.*, 291 B.R. 121 (Bankr. N.D. Ill. 203).

In re Handy Andy Home Improvement Centers, Inc., 144 F.3d 1125 (7th Cir. 1998): The Court held that the debtor's obligation to pay its landlord for property taxes arose when taxes accrued prepetition, even though the landlord did not seek reimbursement for taxes until after entry of order for relief. This is commonly referred to as the “proration approach.”

e. 9th Circuit

The Ninth Circuit’s ruling in In TreeSource Indus. v. Midway Engineered Wood Prods. (In re TreeSource Indus.), 363 F.3d 994 (9th Cir. Wash. 2004), appears to adopt the accrual method for determining whether an obligation under a lease is an administrative expense under § 365(d)(3). In *TreeSource*, the question before the Ninth Circuit was whether an obligation to remove a concrete block upon termination of the lease was an administrative expense. In its analysis of this issue, the Ninth Circuit commented (in dicta) that, although an obligation of the lessee to remove a concrete slab accrued at lease termination and not over time, and thus was an administrative expense, that obligation would be characterized in a manner “different from tax or rent obligations, for which the relevant time to determine whether the obligation is pre- or post-petition is when the obligations accrue and not necessarily when performance must take place.” The Ninth Circuit further elaborated (again in dicta) that the character of the taxes, as pre- or post-petition debt, is determined by the date the taxes accrue. The billing date, however, governs the date the taxes are payable by the Debtor under the terms of the leases. *Id*. at 998 (quoting *In re Ernst Home Ctr., Inc.*, 209 B.R. 955, 964 (Bankr. W.D. Wash. 1997)).

Relying upon the Ninth Circuit’s ruling in *TreeSource*, the Bankruptcy Court for the District of Oregon concluded in In re Troutman Investment Co., No. 602-69650, 2004 LEXIS 1040 (Bankr. D. Or. April 13, 2004), that the Ninth Circuit had adopted the so called “accrual” or “proration” approach to “stub rent” characterization, and therefore held that only that portion of the charges accruing post-petition, pre-rejection are entitled to administrative expense priority.

In In re National Refractories & Minerals, Corp., 297 B.R. 614 (Bankr. N.D. Cal. 2003), the bankruptcy court noted the split in the circuits and two schools of thought (the proration/accrual theory and the performance/billing date theory) in connection with the proper construction of § 365(d)(3). The bankruptcy court reviewed the authorities, and adopted what it referred to as the “majority” proration/accrual theory, following the Seventh Circuit *In Re Handy Andy Home Improvement Center, Inc.*, 144 F.3d 1125 (7th Cir. 1998).

Without citing to the Ninth Circuit’s ruling in *TreeSource*, the Bankruptcy Court for the District of Arizona also adopted the proration approach, following *National Refractories*. See In re Pictureesque, LLC, No. 2-06-02461, 2006 Bankr. LEXIS 3689 (Bankr. D. Ariz. Dec. 22, 2006) (stating that there was no Ninth Circuit authority on point).

Another bankruptcy judge in the District of Arizona has, however, adopted a contrary approach. In *In re Designer Doors, Inc.*, 389 B.R. 832 (Bankr. D. Ariz. 2008), Judge Haines commented that, despite the language in *TreeSource Industries*, "the preference of the accrual approach over the performance date approach (or vice-versa) is still an open question in the Ninth Circuit." Judge Haines went on to rule that "[t]he language and the purpose of § 365(d)(3) favor the billing date approach."

Despite Judge Haines' ruling, the clearly favored (if not the required) approach to determination of the characterization of "stub rent" under § 365(d)(3) in the Ninth Circuit would appear to be the proration method.

3. Stay Pending Appeal/Mootness

a. 2d Circuit

i. Stay Pending Appeal

In re General Motors Corp., Case No. 09-50026, 2009 Bankr. LEXIS 1800 (Bankr. S.D.N.Y. July 7, 2009)
The decision as to whether to grant a stay pending appeal lies within the discretion of the court. The litigant must demonstrate that (1) it would suffer irreparable injury if a stay were denied; (2) there is a substantial possibility, although less than a likelihood, of success on the merits of movant's appeal; (3) other parties would suffer no substantial injury if the stay were granted; and (4) the public interest favors a stay. The party must show satisfactory evidence of all four prongs. If the movant seeks a stay without a requirement that it post a bond, the movant has the burden of demonstrating why it should deviate from the requirement. The Second Circuit requires a balancing of the factors as opposed to adopting a rigid rule. Noting the split within the circuit on the issue of whether mootness constitutes irreparable injury, the court held that the risk of mootness, standing alone, does not constitute irreparable injury. A bond may be a practical alternative where the injury to the estate from the delay of appeal is merely monetary and would not be irreparable.

In re DJK Residential, LLC, Case No. 08-10375, 2008 U.S. Dist. LEXIS 19801 (S.D.N.Y. March 7, 2008)
A movant seeking a stay pending appeal must demonstrate that (1) it would suffer irreparable injury if a stay were denied; (2) there is a substantial possibility, although less than a likelihood, of success on the merits of movant's appeal; (3) other parties would suffer no substantial injury if the stay were granted; and (4) the public interest favors a stay. To be successful, the movant must show satisfactory evidence on all four criteria. Failure to satisfy one factor will doom the motion. Noting the split within the circuit on the issue of whether mootness constitutes irreparable injury, the court held that the risk of mootness, standing alone, does not constitute irreparable harm. The fact that the cost of posting a bond would be prohibitive in light of the magnitude of the potential loss to the non-moving parties highlights the extent of the injury and that the would be substantial and irreparable.

ii. Equitable Mootness

In re Chateaugay Corp., 988 F.3d 322 (2d Cir. 1993) ("Chateaugay I")
An appeal should be dismissed as moot when, during the pendency of an appeal, events occur that would prevent the court from fashioning effective relief and/or when implementation of effective relief would be inequitable. Dismissal of an appeal is appropriate when the appellant has not made an effort to obtain a stay, thereby permitting such change in circumstances to occur as to render it inequitable to reach the merits of the appeal. The ability to achieve finality is essential to fashioning effective remedies, particularly in bankruptcy court. Completed acts in accordance with an unstayed order of the court must not be routinely vulnerable to nullification of a plan is to succeed. A party that proceeds without seeking a stay does so at its own risk.

In re Chateaugay Corp., 10 F.3d 944 (2d Cir. 1993) ("Chateaugay II")
In bankruptcy, determinations as to mootness involves constitutional considerations (i.e. whether there is a live case or controversy) as well as equitable considerations. Substantial consummation will not moot an appeal if all of the following circumstances exist: (1) the court can still order some effective relief; (2) such relief will not affect "the re-emergence of the debtor as a revitalized corporate entity; (3) such relief will not unravel intricate transactions so as to "knock the props out from under the authorization for every transaction that has taken place" and "create an unmanageable, uncontrollable situation for the Bankruptcy Court;" (4) the parties who would be

adversely affected by the modification on appeal have notice of the appeal and an opportunity to participate in the proceedings; and (5) the appellant pursued with diligence all available remedies to obtain a stay of execution of the order if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from. A claimant should not be denied an appeal on grounds of mootness solely because the injury is too great for the debtor to satisfy in full where at least partial relief may be available. Although the court recognized the value of finality in bankruptcy and the need to afford a "fresh start," the appeal was not dismissed because the appellant sought a stay of confirmation and because partial relief could be granted.

In re Best Products Co., Inc., 68 F.3d 26 (2d Cir. 1995)
In bankruptcy, determinations as to mootness involves constitutional considerations (i.e. whether there is a live case or controversy) as well as equitable considerations. An appeal is moot when although effective relief could conceivably be fashioned, implementation of that relief would be inequitable. Failure by the appellant to seek a stay, thereby allowing consummation of a plan, renders the appeal equitably moot.

In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005)
An appeal should be dismissed as moot when, even though effective relief may be fashioned, implementation of that relief would be inequitable. Equitable mootness is invoked to avoid disturbing a reorganization plan once implemented. When a plan of reorganization has been substantially consummated, an appeal should be dismissed unless several requirements are satisfied. A key consideration is whether the appellant sought a stay pending appeal of the confirmation order. A party must seek a stay even if it seems unlikely that the court will grant one. If a stay was sought, the appellate court will provide relief if at all feasible unless it would "knock the props out from under" the transactions that have taken place and would create an unmanageable, uncontrollable situation for the court. If the appellant failed to seek a stay, the question is not only whether the court can provide relief without unraveling the plan, but also whether it should provide the relief based on equitable considerations.

In re Adelphia Comm. Corp., 361 B.R. 337 (S.D.N.Y. Jan. 24, 2007)
Courts within the Second Circuit have followed the same standard used for stays of district court orders pending appeals. The decision as to whether to grant a stay pending appeal lies within the discretion of the court. Four factors should be considered (1) whether the movant would suffer irreparable injury absent a stay; (2) whether there is a substantial possibility, although less than a likelihood, of success on the merits of movant's appeal; (3) whether other parties would suffer no substantial injury if the stay were granted; and (4) whether the public interest favors a stay. Although lower courts have held that all four factors must be satisfied, the Second Circuit has not articulated such a rigid rule; rather, it treats the inquiry as a balancing test. Irreparable harm must be neither remote nor speculative, but actual and imminent. The court noted the circuit split as to whether mootness constitutes irreparable injury, and held that the loss of appellate rights is a "quintessential form of prejudice" and therefore the risk of mooting any appeal of significant claims of error satisfies the requirement of irreparable injury. An appeal should be dismissed as moot when events occur during the pendency of an appeal that prevent the court from fashioning effective relief, or if implementation of effective relief would be inequitable. Where a plan of reorganization has been substantially consummated, mootness is presumed and can only be rebutted by a showing that (a) the court can still order some effective relief; (b) such relief will not affect the emergence of the debtor as a revitalized corporate entity; (c) such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the bankruptcy court; (d) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (e) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order where the failure to do so creates a situation rendering it inequitable to reverse the order appealed from. A bond that is commensurate with the threatened loss to the non-moving parties must be posted absent "exceptional circumstances."

In re Adelphia Comm. Corp., 367 B.R. 84 (S.D.N.Y. April 2, 2007)
Where a plan has been substantially consummated, there is a presumption of equitable mootness unless the movant can demonstrate that each of the five factors in *Chateaugay II* supports permitting the appeal to be heard on the merits. The ability to fashion partial relief is relevant to a determination as to whether an appeal is constitutionally moot, but has no bearing on whether an appeal is equitably moot.

b. <u>3d Circuit</u>

<u>*Gillman v. Continental Airlines*, 91 F.3d 553 (3d Cir. 1996)</u>: Factors that are considered by the Third Circuit in determining whether to apply the doctrine of equitable mootness include: (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments. *See United Artists Theatre Co. v. Walton* (*In re United Artists Theatre Co.*), 315 F.3d 217 (3d Cir. 2003) (declining to apply equitable mootness to issue of enforceability of indemnification provision in the financial advisor's engagement letter and the plan on the grounds that modifying a release provision generally does not undermine a substantially consummated plan).

<u>*Schroeder v. New Century Liquidating Trust* (*In re New Century TRS Holdings, Inc.*), 407 B.R. 576 (D. Del. 2009)</u>: Nearly a year after New Century's plan of liquidation was confirmed, the district court overturned the confirmation on appeal. The district court dismissed the precedent established *Continental* as irrelevant to the liquidation context because unraveling a substantially consummated reorganization plan can be difficult in that it requires reversing multiple, often complex, future-looking transactions and inequitable in that it shifts the tables on non-adverse third parties who have acted in reliance on the debtor emerging from bankruptcy in accordance with the particulars of the reorganization plan. "However, it makes less sense to treat the unraveling of the plan with such significance in a liquidation context, since (in that context) the plan transactions tend to be discrete and relatively simple transactions aimed at disposing of the debtor's assets in the short term . . . and the non-adverse third parties transacting with the debtor are not doing so with any particular interest in debtor's future condition . . . ." The district court then went on to apply the factors articulated in *Continental*. Although the district court concluded that the plan of liquidation had been substantially consummated, it opined that "the only aspects of plan implementation that arguably need to be reversed are the relatively few distributions that have occurred, but these are not sufficient to establish 'great difficulty and inequity.'" The further fact that a stay pending appeal had not been obtained was not accorded much weight as it appeared that no creditor class had received distributions and the plan components that had gone forward were "not those on which non-adverse third parties have detrimentally relied." The affect on the plan's success was also not a heavily weighted factor given the liquidation context: nothing in the record suggested "that undoing the current liquidation plan will affect debtors' ability to liquidate in the future under a different plan." Finally, in respect of the public policy of affording finality to bankruptcy judgments, the district court opined that it is often the case in the liquidation context that non-adverse third parties do not change their position in reliance on finality to the degree that reversing the plan would discourage similarly situated parties from transacting business with a liquidating debtor. Thus, in the liquidation context, the district court may have effectively eliminated the doctrine of equitable mootness. The district court's decision was not appealed further.

c. <u>5th Circuit</u>

<u>*Technology Lending Partners, LLC v. re San Patricio County Community Action Agency* (*In re San Patricio County Community Action Agency*), 575 F.3d 553 (5th Cir. 2009)</u>: The Fifth Circuit examines three factors in determining whether to apply the doctrine of equitable mootness: (1) whether a stay has been obtained, (2) whether the plan has been substantially consummated, and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan. "The ultimate question to be decided is whether the Court can grant relief without undermining the plan and, thereby, affecting third parties." *See Manges v. Seattle-First National Bank* (*In re Manges*), 29 F.3d 1034 (5th Cir. 1994); *In re GWI PCS 1, Inc.*, 230 F.3d 788 (5th Cir. 2000). *See also Hilal v. Williams* (*In re Hilal*), 534 F.3d 498 (5th Cir. 2008) (equitable mootness need not foreclose an appeal from aspects of Chapter 11 plan confirmation that solely concern professional compensation and releases); *Wooley v. Faulkner* (*In re SI Restructuring, Inc.*), 542 F.3d 131 (5th Cir. 2008) (same).

<u>*Bank of New York Trust Co., NA v. Official Unsecured Creditors' Committee* (*In re The Pacific Lumber Co.*), Case No. 08-40746 (5th Cir. Sept. 29, 2009)</u>: In a direct appeal concerning the debtors' confirmed and substantially consummated plan, the Fifth Circuit questioned the propriety of the equitable mootness doctrine, calling it a "judicial anomaly" and stating that application of the doctrine "abdicates appellate review of very real, continuing controversies." Nevertheless, it concluded that it was bound by its prior decisions to determine whether the doctrine was applicable here. In its application of the doctrine, however, the Fifth Circuit effectively suggested that the doctrine is not applicable where the rights of secured creditors are at issue, stating that the Fifth Circuit

"has been especially solicitous of the rights of secured creditors following confirmation" and finding "no case that applied equitable mootness to decline review of the treatment of a secured creditor's claim." Combined with the fact that the appeal was of sufficient import to warrant certification for direct appeal, the Fifth Circuit declined to apply the doctrine to the review of the appellant's secured claim. On the other hand, the Fifth Circuit found the appellant's impairment and classification arguments concerning its unsecured claims to be equitably moot because the small unsecured creditors had received payment, their third-party expectations could not reasonably be undone, and no remedy could be afforded short of unwinding the plan. Finally, the issue concerning the propriety of third party releases in the plan was not equitably moot, citing *Hilal* for the proposition that "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process."

d. 7th Circuit

In re UNR Indus., 20 F.3d 766, 769 (7th Cir.), *cert. denied,* 513 U.S. 999, 115 S.Ct. 509, 130 L.Ed.2d 416 (1994): The Court stated that the use of the word "mootness" as a shortcut for a court's decision that the *fait accompli* of a plan confirmation should preclude further judicial proceedings has led to unfortunate confusion. Judge Easterbrook, writing for the court, stated: "[t]here is a big difference between *inability* to alter the outcome (real mootness) and *unwillingness* to alter the outcome ('equitable mootness'). Using one word for two different concepts breeds confusion." *Id.* (emphasis in original).

In re Envirodyne Indus., Inc., 29 F.3d 301, 304 (7th Cir.1994): The Court stated that the "now nameless doctrine" lives on and "is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties." *Envirodyne,* 29 F.3d at 304.

Specialty Equip Co., Inc., 3 F.3d 1043, 1048 (7th Cir. 1993): Following UNR, the court considered its duty to be to "ask not whether this case is moot, 'equitably' or otherwise, but whether it is prudent to upset the plan of reorganization at this late date."

e. 9th Circuit

The circumstances where an appeal may be rendered moot in a bankruptcy case under Ninth Circuit authority are set forth in several distinct legal theories. First, *In re Combined Metals Reduction Co.*, 557 F.2d 179, 189 (9th Cir. 1977), sets forth the general equitable principle that "where an act or event sought to be enjoined has been performed or has occurred, an appeal from the denial of the injunction will be dismissed as moot. The Ninth Circuit has underscored that this principle does not relate solely to the question of equitable mootness in bankruptcy. Rather, bankruptcy equitable mootness principles are merely an outgrowth from the existing precedents that construe mootness in connection with appeals on orders on injunctive relief where a stay has not been obtained. *Id*. From the general principle that was set forth in *Combined Metals Reduction*, two legal theories have developed in the Ninth Circuit for when an appeal may be rendered moot.

The first theory focuses on the court's ability (or rather inability) to fashion meaningful relief. *See Baker & Drake, Inc. v. Public Service Commission of Nevada (In re Baker & Drake, Inc.)*, 35 F.3d 1348, 1351-52 (9th Cir, 1994) (stating that "[f]ailure to obtain a stay, standing alone, is often fatal but not necessarily so; nor is the "substantial culmination" of a relatively simple reorganization plan").

In *Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.)*, 652 F.2d 793, 797 (9th Cir. 1981), the Ninth Circuit dismissed an appeal as moot because the appellant did not obtain a stay of the bankruptcy court's confirmation of a Plan of Arrangement and, as a result, a significant portion of the plan had been carried out before the appeal could be heard. The Ninth Circuit reasoned that overruling the bankruptcy court's confirmation of the plan would "create an unmanageable, uncontrollable situation for the Bankruptcy Court" to undo the portion of the plan that had been carried out and thus the appeal was equitably moot.

This same principle may also apply when a transaction is consummated in reliance on the judgment, and the third party purchaser of property is not a party to the appeal. *See Kaonohi Ohana, Ltd. v. Sutherland*, 873 F.2d 1302, 1306 (9th Cir. 1989).

The other theory applies when an order authorizes the sale of property, and implements 11 U.S.C. § 363(m). The theory is premised on the particular need for finality of such orders. *See Onouli-Kona Land Co. v. Estate of Richards (In re Onouli-Kona Land Co.)*, 846 F.2d 1170, 1172 (9th Cir. 1988). In *In re Onouli-Kona Land* the Ninth Circuit applied a strict *per se* mootness rule where the appellant had failed to obtain a stay of an order for sale of property of the estate, emphasizing the "particular need" for finality in bankruptcy, the Ninth Circuit held that the lack of a stay would serve as a jurisdictional bar to the appeal, regardless of whether circumstances would still permit the court to grant relief to the parties, except for a circumstance when real property is sold to a creditor who is a party to the appeal and the sale is subject to statutory rights of redemption. *See also Arnold & Baker Farms v. United States (In re Arnold & Baker Farms)*, 85 F.3d 1415, 1419-20 (9th Cir. 1996), *cert. denied*, 519 U.S. 1054, 117 S. Ct. 681 (1997); *Vista Del Mar Assocs., Inc. v. West Coast Land Fund (In re Vista Del Mar Assocs.)*, 181 B.R. 422, 424-25 (9th Cir. BAP 1995).

In S.S. Retail Stores Corp. v. Ekstrom (In re S.S. Retail Stores Corp.), 216 F.3d 882 (9th Cir. 2000), the Ninth Circuit appears to have either developed a new "unfairness" equitable mootness theory, or otherwise significantly broadened the circumstances under which an appeal is rendered moot under the first theory. "While the doctrine of equitable mootness focuses on whether it is, for all practical purposes, *impossible* to award effective relief, other equitable considerations center on whether it would be *unfair* to grant the requested relief. Therefore, even if an appeal is not equitably moot, a court may still hold that the equities weigh in favor of dismissing the appeal. *Id*. at 885 (citing *In re Federated Dep't Stores, Inc.*, 44 F.3d 1310, 1320 (6th Cir. 1995) for the principle that even though the appeal was not moot because effective relief was possible, it was inequitable to require that the debtor's counsel disgorge fees and costs awarded by the bankruptcy court). If nothing else, S.S. Retail Stores demonstrates the significant discretion an appellate court possesses in connection with construing the rather vague (and often disorganized) equitable mootness standards that exist in the Ninth Circuit.

f. 9th Circuit Stay Pending Appeal – What Is the Applicable Standard for Receipt of a Discretionary Stay Under Rule 8005 (A Sliding Scale or Not?)

As is the case in most other circuits (but by no means unanimous), the courts of the Ninth Circuit have adopted the familiar test for determining whether a preliminary injunction should be granted set forth in *Hilton v.Braunskill*, 481 U.S. 770, 776, 107 S. Ct. 2113, 95 L. Ed. 2d 724 (1987) in connection with determining whether a discretionary stay should be granted under Fed. R. Bankr. Proc. 8005. That test is: (i) Appellant is likely to succeed on the merits of the appeal; (ii) Appellant will suffer irreparable injury' (iii) No substantial harm will come to appellee; and (iv) The stay will do no harm to the public interest. *See e.g., In re Wymer*, 5 B.R. 802 (B.A.P. 9th Cir. Cal. 1980).

Some significant discord has resulted among the lower courts, however, on the proper application of these four factors. *Compare Rose Townsend Trust v. Johnston (In re: Johntson)*, No. 06-80040, 2007 Bankr. LEXIS 3092 (Bankr. E.D. Wash. Sept. 7, 2007) (requiring movant to show under first factor that he is "likely to succeed" on the merits, rather than merely presenting a "substantial case") *and Silicon Valley Bank v. Pon (In re: Pon)*, No. C-93-2745, 1994 U.S Dist. LEXIS 2559 at *6 (N.D. Cal. Feb. 25, 1994) (holding that the four factors are conjunctive, and movant will not win a stay unless each factor is established by a preponderance of the evidence) *with Lynch v. Ca. Pub. Util. Comm'n*, No. C-04-0580, 2004 U.S. Dist. LEXIS 6022 at *6 (N.D. Cal. April 9, 2004) (reciting traditional Ninth Circuit "sliding scale" balancing tests used for preliminary injunctions and temporary restraining orders).

In Dynamic Finance Corp. v. Kipperman (In re North Plaza, LLC), 395 B.R. 113 (S.D. Cal. 2008), the District Court for the District of Southern California held that the four factors may not be applied in "sliding scale" fashion. The court noted the split of authority, stating that "because these factors were imported from the standard for deciding preliminary injunctions or staying them pending appeal, district courts in this circuit have not agreed on how to apply the discretionary stay factors when deciding whether to stay a final bankruptcy court order pending appeal."

In *North Plaza*, the District Court reasoned that the "sliding scale" approach "ignores the procedural posture of a Rule 8005 stay where the movant is appealing a bankruptcy court's final determination on the merits. "A 'sliding scale' approach, which often results in disproportionately weighting the "irreparable harm" prong, is appropriate for preliminary injunctions because a court deals with the dispute on first impressions, relies on a less-than-

developed factual and legal record, and will ultimately revisit the issue down the road. In contrast, where--as here--a court has taken extensive evidence and briefing and issued a determination on the merits, an interest in finality arises. This finality would be rendered impotent if an enjoined party could always raise the spectre of irreparable injury to trump the trial court's order, no matter how unlikely an appellate victory on the merits." As such, the District Court held that the appellants must show that "it is more likely than not they will succeed on the merits, whatever the possibility of irreparable injury."

Hoffmeier Zamora v. Virtue (In re Continental Coin Corp.), No. CV 08-0093, 2009 U.S. Dist. LEXIS 74392 (C.D. Cal. August 21, 2009), is an example of the other view. In *Hoffmeier*, the District Court for the Central District of California suggested a heightened sliding scale formula, *i.e.*, that "the four factor test for a stay may not be appropriate in all circumstances, and need not be applied rigidly." Furthermore, the District Court suggested that because it was permitted to issue a stay *sua sponte* under Rule 8005, the failure of the moving party to meet its burden under the Irwin standard "will not preclude a bankruptcy court from issuing a stay." "Bankruptcy courts should primarily consider the administration of the bankruptcy case." *Id*. at *29 (citing *In re Gleasman*, 111 B.R. 595, 599 (Bankr. W.D. Tex. 1990).

4. Third party releases

a. 2d Circuit

In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005)
This is the leading case on third-party releases in the Second Circuit. Creditors Deutsche Bank and Bear Stearns challenged the third-party releases in the plan of reorganization that was confirmed and substantially consummated. The Second Circuit held that the bankruptcy court erred in approving non-debtor releases, stating that "[a] nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan." Citing *Drexel*, the Court explained that in prior decisions, the Second Circuit had held that "in bankruptcy cases, a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan." In other words, it is not sufficient that a material contribution may have been made to the estate in exchange for the release; the release *itself* must be important to the plan of reorganization. Those rare cases where the release itself is important to the plan of reorganization include situations where (i) the estate received substantial consideration, (ii) the enjoined claims were "channeled" to a settlement fund rather than extinguished, (iii) the enjoined claims would directly impact the debtors' reorganization by way of indemnity or contribution, or (iv) the plan otherwise provided for the full payment of the enjoined claims. In addition, "[n]ondebtor releases may also be tolerated if the affected creditors consent." The *Metromedia* court explained that it was reluctant to approve nondebtor releases because the only explicit authorization in the Bankruptcy Code for nondebtor releases is section 524(g), which authorizes releases in asbestos cases when specified conditions are satisfied. Although section 105(a) may be read expansively to allow nondebtor releases in non-asbestos situations, section 105(a) "does not allow the bankruptcy court to create substantive rights that are otherwise unavailable under applicable law." In addition, the court was concerned that a nondebtor may, in effect, use a nondebtor release as a "bankruptcy discharge arranged without a filing and without the safeguards of the Code." The Court concluded that the test for approving third-party releases was not simply a matter of factors and prongs and that nondebtor releases have not been tolerated absent unique circumstances.

Macarthur Co. v. Johns-Manville Corp., 837 F.2d 89 (2d Cir. 1988)
The Second Circuit concluded that the bankruptcy court had authority to issue injunctive orders relieving insurers of obligations related to insurance policies pursuant to the court's power to dispose of a debtor's property free and clear of third-party interests and to channel such interests to the proceeds of the disposition. The court concluded that "[s]ince the insurance settlements are a cornerstone of Manville's proposed plan of reorganization, the Bankruptcy Court's orders are a critical part of the entire reorganization."

In re Johns-Manville Corp., Case Nos. 82-11656, 82-11657, 82-11660, 82-11661, 82-11665 through 82-11673, 82-11675, 82-11676, 2004 Bankr. LEXIS 2519 (Bankr. S.D.N.Y. Aug. 17, 2004), *aff'd in part and vacated in part, In re Johns-Manville Corp.*, 340 B.R. 49 (S.D.N.Y. 2006)
As part of the 1986 plan of reorganization of Johns-Manville, the bankruptcy court approved a settlement wherein Manville's insurers (including Travelers) would contribute to a personal injury settlement trust in exchange for

releasing future claims that were channeled to the trust. This settlement – which was contingent upon the injunction – had been described as the "cornerstone" of Manville's reorganization. Over a decade later, plaintiffs began filing lawsuits in state courts against Travelers seeking to recover, not for Manville's wrongdoing, but for Travelers' own alleged wrongdoing for either violating state statutes by hiding the dangers of asbestos (the "Statutory Direct Actions") or by violating common law duties of failing to warn the public (the "Common Law Direct Actions"). The bankruptcy court enjoined the Direct Actions stating that section 1142(b) vested it "with authority to oversee implementation of the plan and retain jurisdiction for acts necessary for the consummation of the plan" and that it retained such jurisdiction throughout the implementation of the confirmed plan of reorganization. The court, therefore, was "enforcing its own Orders and thus its jurisdiction is derivative of the original jurisdiction." The bankruptcy court relied on *MacArthur's* conclusion that bankruptcy code section 105(a) is construed liberally to enjoin suits that might impede the reorganization process and here, like *MacArthur*, "to permit actions against Manville's insurers arising from Manville's policies would adversely affect property of the estate and would interfere with reorganization."

Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.), 517 F.3d 52 (2d Cir. N.Y. 2008) (*rev'd and remanded, Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195 (2009) (J. Calabresi, J. Sotomayor, and J. Wesley)

The Second Circuit vacated the district court's affirmation. The Second Circuit reiterated that nondebtor releases are permissible only in unique circumstances and that a nondebtor's financial contribution to a debtor's estate is not a sufficient basis for providing it with releases. The Second Circuit further concluded, however, that the bankruptcy court did not have jurisdiction to order the release or injunction over the present third party claims. While the Second Circuit concluded that the bankruptcy court had continuing jurisdiction to enforce its own 1986 injunction, the present claims did not fall within its jurisdiction. The Direct Actions against Travelers were not barred by the original injunction because the suits were predicated on state laws pursuant to which Travelers owed plaintiffs an independent duty. The Second Circuit further found that plaintiffs sought claims not against the *res* of the Manville estate, but instead sought damages in excess of and unrelated to Manville's insurance policy proceeds. The Second Circuit found that, unlike the claims in *Macarthur* where plaintiffs sought indemnification for the tortious wrongs of Manville to be paid out of Manville's insurance policies, the Direct Actions constituted independent tort actions. The Second Circuit distinguished *MacArthur* because in that case, the claims were derivative of Manville's liability because third parties sought proceeds of Manville's insurance policy on the basis of Manville's conduct. In contrast, the claims that were at issue on appeal were directly against Travelers and plaintiffs had not made any claims against an asset of the bankruptcy estate or that would otherwise affect the estate. Accordingly, the Second Circuit held that the bankruptcy court had no jurisdiction over the Direct Actions. The court stated that, even though in a literal sense the instant claims did "arise out of" the insurance coverage to Manville, they did not conform to the bankruptcy court's jurisdiction over the *res* of the estate.

Travelers Indem. Co. v. Bailey, 129 S. Ct. 2195 (2009)

The Supreme Court reversed the Second Circuit, finding that, under the clear language of the injunction, the Direct Actions involved claims based upon, arising out of or relating to Travelers' insurance coverage of Manville. The Supreme Court held that the bankruptcy court had jurisdiction to clarify or interpret its prior orders and the bankruptcy court did not exceed its jurisdictional authority in enjoining the suits. The linchpin of the Supreme Court's decision was its view that it was too late to challenge the jurisdiction exercised by the bankruptcy court in 1986 when it first provided broad injunctive relief. Once the 1986 orders became final (following the resolution of *Macarthur*), they were no longer subject to challenge. Thus, the 1986 orders became res judicata as to every matter that was offered and received to sustain or defeat the claim or demand, and as to any other admissible matter that might have been offered for that purpose. The Supreme Court stated that "this sort of collateral attack…[entertained by the Second Circuit]… cannot be squared with res judicata and the practical necessity served by that rule." The Supreme Court emphasized that its holding was narrow and did "not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing."

In re Drexel Burnham Lambert Group, 960 F.2d 285 (2d Cir. 1992), *cert. dismissed*, 506 U.S. 1088

Certain objecting class members appealed from the district court's order approving a settlement agreement, arguing, *inter alia*, that the district court should have stricken provisions in the agreement enjoining future actions against Drexel's directors and officers. The Second Circuit affirmed, concluding that a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan. The

Drexel court found that the settlement agreement was an essential part of the debtor's plan of reorganization and that the injunction was a key component of that settlement agreement and therefore affirmed the order approving the settlement agreement. *See also Clain v. Int'l Steel Group*, 156 Fed. Appx. 398, 399 (2d Cir. 2005) (approving a third-party release barring former shareholder of the debtor from asserting claims against the purchaser of its assets because the sale of the debtor's assets was essential to the debtor's plan of liquidation and was a prerequisite to confirmation and consummation of a chapter 11 plan).

St. Vincents Catholic Med. Ctrs. v. Goodman (In re St. Vincents Catholic Med. Ctrs.), 09 Civ. 0375, 2009 U.S. Dist. LEXIS 86499 (S.D.N.Y. Sept. 16, 2009)
In affirming the bankruptcy court's denial of St. Vincent's motion to enjoin medical malpractice suits against certain nondebtor parties, the district court noted that the bankruptcy court did not make any findings that (1) discharging the liability of third parties would be important to the plan of reorganization; (2) the third parties had given substantial consideration to the estate; (3) that enjoined claims against them would be channeled to a settlement fund and not just extinguished; or (4) the plan of reorganization provided for payment of such claims in any way. In addition, the court cited *Metromedia* for the proposition that "[n]o case has tolerated nondebtor releases absent the finding of circumstances that may be characterized as unique" and concluded that "[i]t is far from clear that such circumstances exist here."

In re Adelphia Comm. Corp., 364 B.R. 518 (Bankr. S.D.N.Y. 2007)
Certain parties objected to a settlement that, *inter alia*, included a channeling injunction that would prohibit the objecting parties and other directors and officers from proceeding directly against insurers to pursue claimed entitlements under insurance policies. The court concluded that such a channeling injunction could not be issued in light of Second Circuit authority. The court reasoned that channeling injunctions are permissible in some circumstances, such as where they play an essential role in a plan of reorganization. An example would be a mass tort case where a plan could only be confirmed if insurers contributing to a fund were assured that they would not have to later contribute. The court cited *Johns-Manville* as precedent for supporting transactions similar to the one at bar, but concluded that the policies currently at issue were not nearly as important to the debtors' chapter 11 case as those in *Johns-Manville*. In this case, Adelphia had already reorganized and distributed the overwhelming bulk of its value to its creditors. Accordingly, while the channeling injunction would benefit certain creditors, it was not a "make or break" requirement for a successful reorganization. As such, the court concluded that the channeling injunction was not an essential (or even important) element of a successful reorganization. The court noted that, while channeling injunctions and third party releases are technically distinct, they are both subject to the *Metromedia* analysis because they similarly afford protection to nondebtors against claims by other nondebtors.

In re Adelphia Comm. Corp., 368 B.R. 140 (Bankr. S.D.N.Y. 2007)
The *Adelphia* court stated that *Metromedia* "requires the bankruptcy community in the Second Circuit to be much more circumspect in providing for third-party releases than it used to be." The court further stated that release provisions should be analyzed individually because the relevant factors would apply differently to different provisions. The *Adelphia* court went on to approve three categories of third-party releases contained in the debtors' plan: (1) Indemnified Persons: where the releases were consistent with the estate's indemnification obligations (e.g., by employment contracts, corporate bylaws, or retention or loan agreements); (2) Unique Transactions: where the third party contributed substantial consideration to the plan of reorganization; and (3) Consent: where the releases are appropriately disclosed and consent was given through a vote in support of the plan.

In re Spiegel Inc., Case No. 03-11540, 2006 Bankr. LEXIS 2158 (Bankr. S.D.N.Y. Aug. 16, 2006)
A motion was brought for an order declaring that certain claims against certain nondebtors were not barred by the release and injunction provisions of the debtors' plan of reorganization and related confirmation order. In denying the motion, the court stated that the plan release and injunction were critical components of a settlement that was fair and equitable and played a vital part in the plan of reorganization. The court also relied on its belief that the movant had made a calculated decision not to file a proof or claim or participate in the cases but to wait to challenge the plan release and injunction.

b. 3d Circuit

Gillman v. Continental Airlines (*In re Continental Airlines*), 203 F.3d 203 (3d Cir. 2000): The Third Circuit here addressed the issue of third party releases as a matter of first impression. The debtor's plan provided for a release of its directors and officers, which affected a certain pending class action. In reversing the approval of the release, the Third Circuit found that none of the hallmarks of permissible non-consensual releases--fairness, necessity to the reorganization, and specific factual finding to support these conclusions--were present. Importantly, there was no evidence that the directors and officers provided a critical financial contribution to the debtor's plan that was necessary to make the plan feasible in exchange for receiving a release of liability. However, the Third Circuit refused to adopt a bright line rule against third party releases. *See In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001) (interpreting *Continental* to mean "that if a sufficient factual basis for both necessity and fairness are provided, such a limited non-consensual release may be approved").

In re Zenith, 241 B.R. 92 (Bankr. D. Del. 1999): With respect to releases of third parties by the debtor, the court adopted a five factor test: :(1) an identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) substantial contribution by the non-debtor of assets to the reorganization; (3) the essential nature of the injunction to the reorganization to the extent that, without the injunction, there is little likelihood of success; (4) an agreement by a substantial majority of creditors to support the injunction, specifically if the impacted class or classes "overwhelmingly" votes to accept the plan; and (5) provision in the plan for payment of all or substantially all of the claims of the class or classes affected by the injunction.

c. 5th Circuit

In re Zale Corp., 62 F.3d 746 (5th Cir. 1995): While the Fifth Circuit has not addressed non-debtor releases in the context of a plan, in *Zale*, the Fifth Circuit rejected a non-debtor release in the context of weighing the approval of a settlement plan. It reasoned that § 524 prohibits the discharge of non-debtor debts. Note that the court distinguished two Second Circuit cases approving of non-debtor releases on the fact that the settlements there provided an alternate means for potential claimants to recover. *See also Republic Supply v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987) (enforcing a consensual non-debtor release but on the grounds of *res judicata*).

In re Wool Growers Central Storage Co., 371 B.R. 768 (Bankr. N.D. Tex. 2007): The borrowed the five factor test for the analysis of a non-debtor release set forth in *Zenith* above, explaining: "for the first factor, most courts look to whether or not indemnity or contribution exists between the debtor and third party. Substantial contribution, the second factor, has included cash, insurance proceeds, subordination of claims, and forfeiture of claims. Factor three looks at whether or not the release is necessary because without the release the reorganization would not happen. Most courts have held that factor four is satisfied when over ninety percent of the impacted creditors approve the plan. As for the fifth factor, most courts have held that full payment is necessary. The factors do not all have to be present to approve the non-consensual nondebtor release; the courts have generally balanced the factors, looking at the specific facts in each case."

Bank of New York Trust Co., NA v. Official Unsecured Creditors' Committee (*In re The Pacific Lumber Co.*), Case No. 08-40746 (5th Cir. Sept. 29, 2009): In a direct appeal concerning the debtors' confirmed and substantially consummated plan, the Fifth Circuit struck the non-debtor releases from the plan except with respect to releases of the creditors' committee and its members. The Fifth Circuit reasoned that § 524(e) only releases the debtor. However, it noted that § 1103(c), which lists the committee's powers, implies that committee members have qualified immunity for actions within the scope of their duties.

d. 7th Circuit

In re Ingersoll, Inc., 2009 WL 996995 (7th Cir. 2009): The Court upheld a nondebtor release as permissible. The Court was persuaded by the fact that the release did not provide blanket immunity, but was narrowly tailored by the fact that the bankruptcy court found that the release was an "essential component" of the plan, the fruit of "long-term negotiations," and was achieved by the exchange of "good and valuable consideration" by the released parties that "will enable unsecured creditors to realize distribution in this case."

The Court stated that it made no difference that the release at issue was in favor of a nondebtor from claims of a noncreditor. The Court stated there is nothing in the Code that forbids this from happening when the party whose claim is extinguished had notice and opportunity to object. The Court noted that it was not issuing a blank check to bankruptcy courts to approve such releases and that in most instances releases like the one approved in this case would not pass muster.

The court reasoned that section 105 broadly 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]" and that section 1123(b)(6) allows a court to include in a plan "any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]."

In re Conseco, Inc., 301 B.R. 525 (N.D. Ill. 2003): The Court held that a release that was part of a settlement reached between the releasing creditors and the debtors could be included in the plan because it was voluntary and given in exchange for a distribution to which the releasing creditors were not otherwise entitled).

In re Keck, Mahin & Cate, 241 B.R. 583, 592 (Bankr. E.D. Ill. 1999). The Court approved a plan provision which released individual contributing partners of the debtor law firm from the claims of all creditors who accepted distributions under the plan, even though they rejected the plan.

In re Sybaris Clubs Int'l, 189 B.R. 152 (N.D. Ill. 1995): The Court denied the debtor's plan which incorporated a non-consensual permanent injunction protecting a non-debtor.

In re Specialty Equip. Co., Inc., 3 F.3d 1043, 1048-1049 (7th Cir. 1993). The Court held that substantial consummation of a chapter 11 plan mooted a party's challenge to a plan provision which released non-debtor parties where the plan was the subject of lengthy negotiation, the releases were essential to the plan and nullification of the releases would have amounted to imposing a different reorganization plan on the parties which had negotiated the plan. Although Specialty Equipment was decided on mootness grounds, the Seventh Circuit nonetheless communicated its approval of the consensual non-debtor releases at issue in the case, but did not rule on the proprietary of non-consensual third party releases.

In re Energy Coop. Inc., 886 F.2d 921 (7th Cir. 1989): The Seventh Circuit held that a bankruptcy court has both jurisdiction and authority to enjoin creditors from asserting claims which are property of the estate against non-debtors. The causes of action which were enjoined against the non-debtors included breach of contract, breach of fiduciary duty, equitable subordination, alter-ego, piercing the corporate veil and preference claims. 886 F.2d at 923. But the court did not discuss whether other actions might be deemed "property of the estate" and therefore subject to a permanent injunction.

e. 9th Circuit

The seminal case regarding the permissibility of third party releases (whether contained in a plan or otherwise) is *American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.),* 885 F.2d 621, 624 (9th Cir. 1989), which holds that 11 U.S.C. § 524, while allowing discharges of liability for debtors, expressly limits the Court's power under Section 105 of the Bankruptcy Code. 885 F.2d at 625 (stating that "section 105 does not authorize relief inconsistent with more specific law"). American Hardwoods holds that Section 524 of the Bankruptcy Code bars release of third parties from liability, requiring that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

American Hardwoods holds that the limits of the section 105 power must be defined with reference to the language of section 524. Noting that section 524 describes the effect of a discharge "as an injunction against the commencement or continuation of an action...to collect…any such debt as a personal liability of the debtor," the Ninth Circuit held that a post-confirmation injunction barring collection of a state court judgment against the debtor's officers was indistinguishable from a discharge of liability under Section 524. Id. at 526. The Ninth Circuit stated, "Section 524 constructs a legal bar to [the judgment's] recovery. A discharge is in effect a special type of permanent injunction. American seeks the same. The permanent injunction requested by American falls squarely within the definition of a discharge under section 524(a)(2). American requests "an injunction against…an action…to collect…[a] debt." Id. at 626. The Ninth Circuit reasoned that a post-confirmation

injunction restraining collection of a debt against a non-debtor is the equivalent of a discharge of liability of a non-debtor, which is expressly not permitted under section 524. Finding that section 105 does not authorize relief inconsistent with more specific law, the Court held that the "specific provisions of section 524 displace the court's equitable powers under section 105 to order the permanent relief sought by American." *Id.; see also* In re Golden Plan of California, Inc., 829 F.2d 705, 713 (9th Cir. 1986).

Solidus Networks, Inc. v. Indivos, Corp. (In re Excel), 502 F.3d 1086, 1095 (9th Cir. 2007), later explained *American Hardwood*'s holding to require that any post-confirmation injunction restraining acts against non-debtors was barred. *See also Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985); *Commercial Wholesalers, Inc. v. Investors Commercial Corp.*, 172 F.2d 800, 801 (9th Cir. 1949); *Sun Valley Newspapers, Inc. v. Sun World Corp. (In re Sun Valley Newspapers, Inc.)*, 171 B.R. 71, 77 (B.A.P. 9th Cir. 1994) (holding reorganization plans which proposed to release non-debtor guarantors violated § 524(e) and were therefore unconfirmable); *In re Rohnert Park Auto Parts, Inc.*, 113 B.R. 610, 1990 Bankr. LEXIS 989, 23 Collier Bankr. Cas. 2d (MB) 259 (B.A.P. 9th Cir. Cal. 1990); *In re Keller*, 157 B.R. 680, 686-87 (Bankr. E.D. Wash. 1993) (refusing to confirm a reorganization plan that compelled a creditor to release liens against a non-debtor's property).

In *Resorts International, Inc. v. Lowenschuss, (In re Fred Lowenschuss)* 67 F.3d 1394, 1402 (9th Cir. 1995), a plaintiff in a civil suit filed bankruptcy early in the lawsuit's proceedings. Lowenschuss' plan of reorganization included a global release provision, releasing the liability for actions against himself and his estate. Although the bankruptcy court initially confirmed the debtor's plan, the global release provision was later vacated on appeal. Agreeing with the American Hardwoods rationale, the Ninth Circuit concluded that the explicit authority to enjoin claims in asbestos cases is evidence that "524(e) denies such authority in other, non-asbestos, cases." *Id*. at 1402 n 6. The Ninth Circuit also noted that its decision in *In re American Hardwoods* should be understood as a full and complete rejection of the Fourth Circuit's holding in *A.H. Robins*. *Id*. at 1402.

Notwithstanding *American Hardwoods*, The bankruptcy court for the District of Arizona has suggested that *A.H. Robins* may still be followed by the courts of the Ninth Circuit. In *New Magma Irrigation & Drainage District v. Maricopa County (In re New Magma Irrigation & Drainage Dist.)*, 193 B.R. 528 (Bankr. D. Ariz. 1994), the bankruptcy court for the District of Arizona commented in dicta that "several of the Circuit Courts of Appeals have used the authority of § 11 U.S.C. § 105 to impose a permanent injunction against non-debtors, and the Ninth Circuit has certainly left the door open for a similar result in this circuit, if presented with appropriate facts. *Id*. at 532 (citing I*n re A.H. Robins Co., Inc.*, 880 F.2d 694 (4th Cir. 1989)). While conceding that "although the Ninth Circuit "has not been as eager to allow the injunction of actions against nondebtors" the bankruptcy court suggested that "the Ninth Circuit Court has certainly suggested that it would support such an action" under the right circumstances." *Id*. The bankruptcy court went on to suggest that the five-factor test set forth in A.H. Robins would be the appropriate standard for review of a permanent injunction to the benefit of non-debtors. *Id*. at 533; *accord In re Regatta Bay, LLC*, 406 B.R. 875, 2009 Bankr. LEXIS 1293 (Bankr. D. Ariz. 2009) (also suggesting that the test in *A.H. Robins* might still be entertained by the Ninth Circuit). *New Magma*'s dicta appears to have been implicitly overruled, however, by the Ninth Circuit's holding a year later in *Lowenschuss*.

5. Lockups

a. 2d Circuit

In re Bush Indus., Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004)
Official committee of equity holders (the "Equity Committee") objected to confirmation of debtor's plan on numerous grounds. Among their objections, the Equity Committee argued that prepetition lock-up agreement (the "Lock-Up") demonstrated that plan was not proposed in good faith as required by Bankruptcy Code § 1129(a)(3). Under the proposed plan, all but one class of creditors were to be paid in full but equity holders were to receive no distributions. Evidence demonstrated that the debtor's enterprise value did not exceed the sum of outstanding claims. Equity Committee's argument was premised on the fact that (i) the Lock-Up limited the debtor's ability to seek maximum value for shareholders and (ii) the Lock-Up provided for a "golden parachute" for debtor's principal officer and director. Before rejecting the Equity Committee's first basis for objection, the court observed that the Lock-Up provided for assurances of post-petition financing from the only class of impaired creditors and that absent the Lock-Up, the debtor might have been able to effect any distribution to unsecured creditors. According to the court, "[n]othing in the Bankruptcy Code requires a debtor to seek a distribution to shareholders

of a company that lacks equity value in excess of outstanding debt." As such, the existence of the Lock-Up itself did not evidence a lack of good faith. With respect to the Equity Committee's second basis for objection, however, the court agreed that the debtor violated the § 1129(a)(3)'s good faith requirement when it negotiated to include a golden parachute as part of the Lock-Up. According to the court, the Lock-Up demonstrated that the officer's interests were preferred over the interests of shareholders in violation of board members' fiduciary duties. As such, the court concluded, the plan had been proposed in good faith. The court reasoned further that subsequent deletion of the golden parachute provision did not cure the defect because good faith requirement governs plan process rather than substance. According to the court, "[u]nless management documents a good faith effort to obtain for all shareholders the premium that officers and directors were able to secure for themselves, the debtor fails to show that it has proposed a plan in good faith."

In re Worldcom, Inc., Case No. 02-13533 (AJG), 2003 Bankr. LEXIS 2192 (Bankr. S.D.N.Y. May 16, 2003)
Case did not involve a lock-up agreement but the court's discussion of the definition of "solicitation" may be insightful in the lock-up context. At issue before the court was a motion for the appointment of a chapter 11 trustee or examiner. The movants argued, among other things, that such relief was warranted based on the debtors' improper solicitation of acceptances for its proposed plan in violation of Bankruptcy Code § 1125(b). According to the movants, the debtors had entered into an agreement with certain bondholders "that would accord the bondholders a substantial premium over the treatment they might otherwise realize . . . if they agree to withdraw as members of the MCI Trade Committee and agree that they will not contest the Plan in their capacity as holders of MCI trade claims . . ." The debtors argued in response that no written agreements were entered into and that the discussions regarding treatment of claims occurred in the context of plan negotiations as opposed to solicitation. The court agreed with the majority of courts adopting a narrow reading of the term "solicitation" for purposes of § 1125(b). Such a narrow reading, the court reasoned, was "essential to promote a consensual reorganization process." Moreover, the court observed, a narrow reading, "avoids the chill on debtors' postpetition negotiations with their creditors which otherwise might prove devastating to the reorganization process." (citation and internal quotation marks omitted). Without deciding the issue, the court concluded that the debtors' alleged conduct would likely be deemed to be permitted plan negotiation as opposed to improper solicitation. In any event, the court concluded the movants' allegations, even if true, did not support the appointment of a chapter 11 examiner or trustee.

Trans World Airlines, Inc. v. Texaco Inc., (In re Texaco Inc.), 81 B.R. 813 (Bankr. S.D.N.Y. 1988)
Postpetition settlement agreement between the debtor and Pennzoil obligated both parties to use their best efforts to obtain confirmation of proposed plan. Agreement provided further that parties would not vote in favor of any alternative plan. Objectors to the agreement argued, *inter alia*, that the agreement constituted an unauthorized solicitation of plan acceptances in violation of Bankruptcy Code § 1125(b). The court rejected objector's argument because the agreement did not require Penzoil to actually cast a ballot in favor the plan. Moreover, the fact that Penzoil agreed not to vote for any alternative plan did not violate § 1125(b). This conclusion followed because there were no alternative plans on file and the requirements of § 1125(b) applied only to filed plans. Also relevant to the ruling was the court's recognition that absent the settlement agreement with Penzoil, the debtor would be unlikely to confirm any plan that paid Penzoil less than $10.3 billion it was owed based on prior judgment.

b. 3d Circuit

Official Committee of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co., 322 B.R. 560 (M.D. Pa. 2005): While the court here concluded that the agreement at issue was not a lock-up because the DIP lender was not bound to vote in favor of the debtor's plan, this case is helpful as it discusses *In re Stations Holding Co. Inc.*, 2004 Bankr. LEXIS 1220 (Bankr. D. Del. Aug. 18, 2004), and *In re NII Holdings, Inc.*, 288 B.R. 356 (Bankr. D. Del. 2002), which are said to have created a bright line rule against lock-ups and explains why that is not the case. In *Stations Holdings*, the plan support agreement was negotiated entirely post-petition, and in *In re NII Holdings*, the fully executed plan support agreement, although negotiated pre-petition, was obtained post petition. Thus, the holdings of the United States Bankruptcy Court for the District of Delaware rested on the fact that a creditor or interest-holder signed a lock-up agreement *after* the petition date. *See also* Kurt A. Mayr, *Unlocking the Lockup: The Revival of Plan Support Agreements Under New § 1125(g) of the Bankruptcy Code*, 15 NORTON J. BANKR. L. & PRAC. 729 (Jan. 2007) (reaching the same conclusion and discussing the new safeharbor of § 1125(g) that further undermines the holdings of *Stations* and *NII Holdings*).

In re Owens Corning, Case No. 00-3837 (Bankr. D. Del. June 23, 2006) (Docket No. 18233 (transcript of bench ruling). The debtor, the committee for asbestos claimants, bondholders and others entered into a wholly post-petition plan support agreement. The trustee challenged the agreement based upon the holdings of *Stations* and *NII Holdings*. The court rejected the trustee's challenge, ruling that the plan support agreement was not a "solicitation." A plan support agreement is not a vote on a plan; rather, it is an agreement to cast a vote in the future subject to a number of conditions. Thus, by very narrowly defining "solicitation" to be limited to a request for an official vote, free creditor negotiations remain uninhibited. *See Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94 (3d Cir. 1988) (concluding that "solicitation" must be read narrowly and holding that a creditors' inquiries to other creditors regarding the debtors' proposed plan and urging to vote against that plan did not amount to solicitation under § 1125(b)).

c. 5th Circuit

In re Heritage Organization, LLC, 376 B.R. 783 (Bankr. N.D. Tex. 2007): The trustee and a group of creditors were joint proponents of a plan. Confirmation was opposed on the grounds that the votes of the joint proponent creditors were improperly solicited post-petition. As a preliminary matter, the court concluded that § 1125(b) does not apply to soliciting co-proponents of a plan. Moreover, the court endorsed a narrow definition of "solicitation" and concluded that the term sheet outlining the terms of the joint proponents' plan did not amount to "an official request for a vote." The court distinguished *Stations* and *NII Holdings* as follows: "In each of those cases, the agreement provided that a breach of the creditor's agreement to vote for the plan could not be compensated by money damages and permitted the debtor to seek specific performance of the creditor's agreement to vote for the plan in the event of a breach. Accordingly, the locked-up creditor could not 'reconsider its preliminary decision' to vote in favor of the plan after receiving adequate information, and the locked-up creditor was stripped of the Bankruptcy Code's protection against the harm caused by solicitation without court-approved, adequate information. Finally, the Court noted that § 1125 was designed to "discourage the undesirable practice of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests." Because the co-proponent creditors could not "seriously be characterized as too ill-informed to act capably in their own interests", the "fundamental purpose of § 1125(b) would thus not be served by its application" in this case.

d. 7th Circuit

There appear to be no published decisions in the Seventh circuit on the issue of lock-up agreements.

e. 9th Circuit

The courts of the Ninth Circuit have not expressly ruled on whether a lockup agreement would constitute an improper solicitation, but several cases which construe the scope and breadth of a "solicitation" under 1125(b) indicate that the courts of the Ninth Circuit may choose to distinguish both *Stations Holding Co.* and *NI Holdings* and follow instead *In re Owens Corning*, which relied upon a narrow definition of "solicitation," that is, limited to a request for an official vote.

Generally, the courts of the Ninth Circuit draw distinction between solicitation that occurs pre-petition, solicitation that occurs post-petition but before court approval of a disclosure statement, and solicitation that occurs following court approval of a disclosure statement. In *In re California Fidelity, Inc. (Duff v. United States Trustee)*, 198 B.R. 567 (B.A.P. 9th Cir. 1996) (Russell, J.). The Bankruptcy Appellate Panel noted that "the term solicitation as used in § 1125(b) has been narrowly interpreted to mean nothing short of a 'specific request for an official vote."' The Panel also noted in dicta that *after* the disclosure statement has been approved and disseminated with a proposed plan, "a party violates § 1125 if it solicits votes for or against a plan using false or misleading information. *Id*. at 572 (citing *In re Apex Oil Co.*, 111 Bankr. 245, 250 (Bankr. E.D. Mo. 1990); *In re Gulph Woods, Corp.*, 83 Bankr. 339, 343 (Bankr. E.D. Pa. 1988); and *In re Snyder*, 51 Bankr. 432, 437 (Bankr. D. Utah 1985)).

A more recent case, *In re Trans Max Technologies, Inc.*, 349 B.R. 80 (Bankr. D. Nev. 2006), has articulated the standard for solicitations made prior to the petition date, as well as the standard that should apply following the court's approval of a disclosure statement. In *Trans Max*, the Bankruptcy Court for the District of Nevada

followed *In re Apex Oil Co.*, 111 B.R. 245 (Bankr. E.D. Mo. 1990), as to what constituted an improper solicitation *following* court approval of a disclosure statement under 1125(b).
The bankruptcy court commented that the *Apex* standard would "accommodate the need for adequate information (supplied by the court-approved disclosure statement), while allowing creditors and the debtor to engage in discussions and negotiations over the plan's fate." *Id.* (quoting 111 B.R. at 247). In *Trans Max*, the bankruptcy court found that e-mails sent from the debtor's counsel, requesting that return of the ballot with a "yes" vote, constituted a "solicitation" under the narrow construction 1125(b) prevalent in the Ninth Circuit "because it directly requested that creditors exercise their vote on a specific plan in a particular way." The court ruled, however, that the e-mails did not violate the standard under *Apex* where the e-mails were "in good faith . . . [and] did not propose or refer to any alternate plan." *Id.* at 87. The *Trans Max* court also noted the recent amendment to the Bankruptcy Code provisions, which expressly "authorize prepackaged bankruptcy plans." (citing 11 U.S.C. § 1125(g)).

6. Successor Liability

a. 2d Circuit

In re Chrysler LLC, 576 f.3D 108 (2d Cir. 2009)
Second Circuit examined the scope of the language "any interest in such property" in section 363(f) of the Bankruptcy Code to determine whether property could be sold free and clear of successor liability with respect to certain products liability personal injury claims. The court examined the Third Circuit's decision in *TWA*, "the leading case on this issue," and held that in personam claims, including any potential state successor or transfer liability claims, as well as in rem interests, are subject to section 363(f) and may be extinguished in a sale transaction. The Second Circuit recognized the trend toward an expansive reading of "interests in property" to include other obligations that may flow from ownership of the property, and that given the expanded role of section 363 in bankruptcy proceedings it makes sense to harmonize the application of sections 1141(c) and 363(f). The court agreed with *TWA* and *Leckie* that the term "any interest in property" encompasses those claims that "arise from the property being sold." Allowing successor liability claims while limiting other creditors' recovery to sale proceeds would be inconsistent with the priority scheme. Moreover, the ability to sell free and clear of successor liability was a key inducement to the sale. Accordingly, the Second Circuit held that the assets could be sold free and clear of existing successor liability claims. However, the court declined to delineate the scope of the bankruptcy court's authority to extinguish future claims that might arise after the sale.

In re General Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009)
As a general rule, a purchaser of assets does not assume the liabilities of the seller unless expressly agreed otherwise. Successor liability is an equitable exception. A textual analysis of section 363 is inconclusive as to the extent to which a sale order can bar successor liability claims. Authority under section 363(f) to sell free and clear of successor liability turns on whether such a claim is an "interest in property." The term "interest" includes more than a lien, and is something that may accompany the transfer of the underlying property. The usage of "interest" in the Bankruptcy Code means different things in different contexts. Textual analysis does not support or foreclose the possibility that "interest in property" includes rights that exist against a new party by reason of a transfer of property to that party, or that an "interest" is a right that travels with the property. The case law in this circuit, however, is clear. In *Chrysler*, the Second Circuit affirmed the bankruptcy court's express rejection of efforts to impose successor liability. Recognizing the importance of *stare decisis*, the court authorized the sale of assets free and clear of successor liability. With respect to environmental claims, however, the court held that, while the assets could be sold free and clear of successor liability for monetary obligations such as those related to cleanup costs, the purchaser would have to comply with environmental responsibilities on a going forward basis.

b. 3d Circuit

EEOC v. Knox-Schillinger (*In re Trans World Airlines, Inc.*), 322 F.3d 283 (3d Circuit 2003): The Third Circuit affirmed the order of the lower courts that extinguished the liability of American Airlines, as successor to TWA, for flight attendants' employment discrimination claims against TWA and certain travel vouchers awarded to flight attendants in a settlement. In the course of reaching this conclusion, the Third Circuit adopted a broad interpretation of the phrase "interest in property." *But see Folger Adam Sec., Inc. v. DeMatteis/MacGregor*, 209

F.3d 252 (3d Cir. 2000) (an "interest in property" does not include defenses). It stated that an "interest" refers to obligations that are connected to or arise from the property being sold; equating interests with only *in rem* interests such as liens is not consistent with the language of the statute. Here, the airline assets being sold gave rise to the claims at issue: had TWA not invested in airline assets, which required employment of the flight attendants, the claims would never have arisen. Accordingly, such claims against TWA were connected to or arose from the assets being sold and were "interests in property" of which the property could be sold free and clear under § 363(f).

c. 5th Circuit

Fairchild Aircraft Inc. v. Campbell (*In re Fairchild Aircraft Corp.*), 184 B.R. 910 (Bankr. W.D. Tex. 1995): The purchaser sought a declaration that its purchase of the debtor's business years earlier was free and clear of successor liability claims of persons injured years after the sale by an aircraft manufactured by the debtor pre-petition. The court concluded that property could not be sold free and clear of the future tort claims, stating: "Section 363(f) does not authorize sales free and clear of *any interest,* but rather of *any interest in such property.* These three additional words define the real breadth of *any interests.* The sorts of interests impacted by a sale 'free and clear' are *in rem* interests which have attached to the property. Section 363(f) is not intended to extinguish *in personam* liabilities. Were we to allow 'any interests' to sweep up *in personam* claims as well, we would render the words 'in such property' a nullity. No one can seriously argue that *in personam* claims have, of themselves, an *interest in such property.*

d. 7th Circuit

Faulkner v. Bethlehem Steel/International Steel Group, 2005 WL 1172748 (N.D. Ind.2005): The Court dismissed a discrimination claim brought against purchaser of assets out of bankruptcy estate on grounds that assets were sold "free and clear" of any "interest in property," and that "discrimination claim is an "interest in such property" for this purpose. The sale order had provided that the transfer of the debtor's assets to the buyer would vest the buyer with all right, title, and interest in those assets free and clear of any other interests, claims or liens--including any claims arising under successor liability). This case is exemplary of the more recent and expansive interpretation has been utilized to preclude assertion of a creditor's successor liability claim against the purchaser if section 363(f) is invoked and if its provisions are applicable and satisfied.

e. 7th Circuit

Christine Myers, as guardian ad litem for Lacie Myers, a minor, individually v. United States of America; OHM Remediation Services, Inc.; IT Corporation; The Shaw Group; and Shaw Environmental, Inc., 297 B.R. 774 (9th Cir. 2003):

The purchaser sought a declaration that its purchase of the debtor's business was free and clear of successor liability claims of a person injured after the sale of by the debtor's actions pre-petition. The court ruled in favor of the purchaser. In coming to this conclusion, the court construed the term "property" as used in § 363(f) broadly and held that contracts are property that can be sold. The court also, following the reasoning in *In Re Trans World Airlines,* 322 F.3d 283 (3rd Circuit 2003), rejected the claimants argument that only secured claims comprise an "interest" in property and held that an "interest" can be secured or unsecured.

7. Timing of Payment of § 503(b)(9) Claim/Definition of "Goods" Under § 503(b)(9)

a. 2d Circuit

i. Definition of "Goods"

There are no published decisions in the Second Circuit addressing the definition of "goods" under section 503(b)(9).

ii. Timing of Payment

Bankruptcy courts in the Second Circuit seem to agree with other jurisdictions in concluding that section 503(b)(9) administrative expenses need not be immediately paid and that the payment of such expenses is discretionary until the plan is confirmed. *See, e.g.*, *In re Chrysler LLC, et al.*, No. 09-50002 (AJG) (Bankr. S.D.N.Y. May 20, 2009)[1] (order authorizing payments as set forth in the applicable plan of reorganization); *In re Dana Corp., et al.*, No. 06-10354 (BRL) (Bankr. S.D.N.Y. March 29, 2006)[2] (amended final order authorizing the debtors to pay section 503(b)(9) claims in their sole discretion).

b. 3d Circuit

In re Goody's Family Clothing Inc., 401 B.R. 131 (Bankr. D. Del. 2009): AVS, one of the debtors' vendors that provided certain services, including inspecting, ticketing, and repackaging apparel purchased from other vendors, filed a timely administrative claim in respect of the invoices submitted to the debtors during the twenty days prior to the petition date. Observing that the term "goods", which is used in § 503(b)(9), is not defined in the Bankruptcy Code, the court adopted the plain meaning of the term as set forth in Article 2 of the Uniform Commercial Code: "'goods' are something that is 'moveable'". The court found this definition to be consistent with the use of the term "goods" in the Bankruptcy Code in which the term "goods" appears throughout disjunctively connected with the term "services". While AVS argued that it did ship goods to the debtors as part of its repackaging, the court pointed out that § 503(b)(9) refers to goods *sold* and not merely goods *shipped*. Accordingly, AVS had no valid administrative claim.

In re Bookbinders' Restaurant, Inc., 2006 WL 3858020 (Bankr. E.D. Pa. Dec. 28, 2006):
A debtor restaurant's supplier demanded immediate payment of its § 503(b)(9) claim, arguing (1) the debtor was paying post-petition operating expenses in the ordinary course and § 503(b)(9) requires administrative expense claims to be treated in the same manner; and (2) the debtor can afford to make the payment immediately. The court cited the Supreme Court's instruction in *Pennsylvania Department of Public Welfare v. Davenport,* 495 U.S. 552, 563 (1990), "that the Bankruptcy Code should not be read 'to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" Noting no such instruction in § 503(b)(9), the court concluded that the standard for payment of § 503(b) claims generally was applicable to claims under § 503(b)(9). Specifically, the court held that "the timing of the payment of an administrative expense allowed under § 503(b)(9) is within the discretion of the bankruptcy court and that before compelling a chapter 11 debtor to pay the allowed administrative expense I may consider potential 'prejudice to the debtor, hardship to the claimant, and . . . detriment to other creditors.'" (citing *In re HQ Global Holdings, Inc.,* 282 B.R. 169, 173 (Bankr. D. Del. 2002), and *In re Garden Ridge Corporation*, 323 B.R. 136 (Bankr. D. Del. 2005)). *See also In re Global Home Products LLC*, 2006 WL 3791955 (Bankr. D. Del. 2006) (using court's discretion to deny immediate payment of § 503(b)(9) claim after applying the three factors set forth above).

c. 5th Circuit

In re Pilgrim's Pride Corp., 2009 WL 2959717 (Bankr. N.D. Tex. Sept. 16, 2009): Debtor objected to § 503(b)(9) claims of trucking, electrical, gas, and water companies on the basis that they did not supply "goods." Striving to achieve a uniform definition of "goods", the court adopted the definition set forth in the Uniform Commercial Code: "'Goods' means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. 'Goods' also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty." However, where contracts are for the mixed supply of goods and services, the court declined to apply the UCC approach, which applies Article 2 where the contract is principally directed toward the sale of goods. The court readily concluded that trucking and garbage collection was a service. With respect to electricity, even though usage can be measured, a consumer cannot return the electricity to the provider after it has been metered; accordingly, electricity is not "movable" and does not come within the definition of "goods". On the other hand, the UCC expressly states

[1] Unpublished court order.

[2] Unpublished court order.

that a contract for the sale of a mineral (including gas and, as the definition was interpreted by the court, water) is a contract for the sale of "goods" and must be afforded the benefit of § 503(b)(9). *See In re Deer*, 2007 WL 6887241 (Bankr. S.D. Miss. June 14, 2007) (concluding that advertising was not a "good" applying the UCC Article 9 definition of the term).

In re TransAmerican Natural Gas Corp., 978 F.2d 1409 (5th Cir. 1992): While no court in the Fifth Circuit has yet opined as to the appropriate timing of payment of a § 503(b)(9) claim, courts within the Fifth Circuit apply the standard articulated in *HQ Global Holdings* and *Garden Ridge*, discussed above, with respect to other types of administrative claims. In *TransAmerican*, the bankruptcy court had concluded, in its discretion, that the claimant, who was owed over $2 million, was entitled to immediate payment because it had introduced evidence of severe financial hardship and submitted proof of insurance in an amount sufficient to cover any damages caused by defects in the products it delivered to the debtor. The Fifth Circuit affirmed the bankruptcy court's decision on appeal.

d. 7th Circuit

There appear to be no published decisions in the Seventh Circuit addressing the definition of "goods" or timing of payment under section 503(b)(9).

e. 9th Circuit

There are only three 9th circuit cases that reference §503(b)(9) (*In re South Star Oil Company,* 2008 Bankr. LEXIS 2426 (9th Cir. 2008); *In re Brown & Cole Stores, LLC,* 375 B.R. 873 (9th Cir. 2007); and *In re Incredible Auto Sale LLC* 2007 Bankr. LEXIS 1024 (9th Cir. 2007)). The cases do not provide insight into the timing of a payment made under §503(b)(9).

With respect to the definition of goods, in *In re Brown & Cole Stores, LLC,* 375 B.R. 873 (9th Cir. 2007) the Bankruptcy Appellate Panel (BAP) for the Ninth Circuit dealt with the term "goods" in a generic sense, and did not refer specifically to the definition of goods in the UCC. The court stated "[b]y the plain terms of the statute, a vendor's right to assert an administrative claim is limited in only three ways: (1) the vendor must have provided goods (not services)…" This case is also significant beyond the insight it provides into the definition of goods. The court in this case held that secured creditors that supply goods prepetition to a debtor are also entitled to assert an administrative expense under Bankruptcy Code Section 503(b)(9). Further, it was found that a priority of claim was an administrative expense and that administrative expenses are subject to the debtor's right of setoff if the debtor holds a prepetition claim against the supplier of goods. According to Collier on Bankruptcy, Section 503(b)(9) claims arise prepetition and, as prepetition claims, they are subject to the claims bar order entered by the court in accordance with Bankruptcy Rule 3003(c)(3) and creditors asserting a claim under § 503(b)(9) must file a proof of claim by the claims bar date, unless the claim is scheduled as undisputed, liquidated and noncontingent.

End.