

# **Norton Annual Survey of Bankruptcy Law**

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## **2008 Edition**

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# **YOUR BOND ISSUER HAS FILED FOR BANKRUPTCY? A SURVEY OF THE TRIPS, TRAPS, AND OPPORTUNITIES THAT AWAIT CORPORATE BONDHOLDERS IN A CHAPTER 11 CASE**

*By Richard L. Kuersteiner, James O. Johnston, Richard L. Wynne, and Lance Miller*

## **I. INTRODUCTION**

The bankruptcy of a large corporate debtor can be a messy affair. It is quite common for bondholders, banks, trade vendors, tort claimants, unionized employees, management, shareholders, and many others with conflicting interests to wage war—both in and out of bankruptcy court—in an effort to influence the proceedings. Banks may want to liquidate their collateral notwithstanding favorable prospects for a reorganization. Trade creditors may want to ensure a continuing source of future business even if it means a greater discount on their existing claims. Tort claimants may want to initiate or continue class actions outside of the bankruptcy arena. Management may want to slash payrolls or renegotiate collective bargaining agreements while adopting lucrative retention or incentive plans. Shareholders may advocate risky “bet the company” strategies with the potential for high returns that would put equity “in the money” but have low prospects of success.

Moreover, during a bankruptcy case, conflicting interests change and evolve. A secured creditor may argue that its collateral has a low value and is in need of “adequate protection” at the start of a case only to turn around and assert at the end of the case that the very same collateral is worth more than the amount of the debt (thereby enabling it to recover postbankruptcy petition interest and fees). Unsecured creditors initially may contend that the debtor’s enterprise is extremely valuable in order to stave off foreclosure and later argue for a lower value to minimize distributions to equity or junior creditors. Management may band together with labor to fend off creditors’ attempts to sell the business and then later attempt to reject collective bargaining agreements or seek wage concessions. As alliances form and break apart and deals are struck and broken, the shifting sands of a bankruptcy case can be treacherous territory for the unfamiliar or the faint of heart.<sup>1</sup>

This article explores those rocky shoals through the perspective of the corporate bondholder. In one form or another, bond debt usually comprises a substantial portion

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of a large corporation's indebtedness, and motivated bondholders typically have the opportunity to play a major role in today's public company reorganizations.<sup>2</sup>

That opportunity is likely to grow in the near future, given the reversal of fortune as the U.S. economy has been rattled by the collapse of the sub-prime mortgage market. The interdependence of various financial markets has resulted in a dramatic tightening of the credit markets for all borrowers, and it is probable that corporate defaults will increase in the near term, resulting in more out-of-court workouts and Chapter 11 bankruptcy cases.

Corporate bondholders have enjoyed an unprecedented low default rate for high-yield bonds, a mere 0.51% of dollar denominated U.S. and Canadian issues for 2007, the lowest since 1981, even though defaults increased in the fourth quarter of 2007.<sup>3</sup> In 2007, only 19 corporate bond issuers defaulted on 35 bond issues, with a dollar value of \$5.5 billion, compared to a total bond market size of \$1.075 trillion.<sup>4</sup>

In analyzing the status of the economy and the possible impact on default rates, Professor Altman of the NYU Salomon Center of the Stern Business School concludes that:

While default rates increased for two years or so before the last two recessions, it is clear they peak near the end or soon after the end of a recession. With so much talk about a possible recession in the United States in 2008 or 2009, it is easy to conclude that an increase in defaults is likely—more than would be concluded through just a fundamental analysis of individual issues.<sup>5</sup>

A direct and inevitable result of more corporate issuer defaults is that bankruptcy filings of large issues of public debt are likely to increase, perhaps substantially. In 2006, 28 public companies with liabilities in excess of \$100 million filed for Chapter 11 protection, while 38 filed in 2007. The "Billion Dollar" bankruptcy club also expanded from five in 2006 to eight in 2007.<sup>6</sup>

Given the prospects for future economic turmoil and the popularity and variety of new and innovative financing structures used in the past several years, an increase in public company bankruptcies will result in an increase in not only the number of cases but also the complexity of the legal issues that bondholders will confront.

Part II of this Article explores the benefits, and costs, of active participation in bankruptcy cases, focusing on key procedural issues. While the authors believe that the costs outweigh the benefits, there are costs that should be considered. First, active participation requires a substantial time and monetary commitment. While financial and legal advisors for an official creditors' committee are most often compensated by the bankruptcy estate, bondholders may have their own agendas to pursue at their own cost. Active participation can also expose bondholders to the risk of having to freeze their trading activities if they learn of confidential, "inside" information. At least one bankruptcy court has also required disclosures by an ad hoc bondholders' committee of their holdings and trading history, normally closely guarded information. Finally, active participation can be burdened with duties to other bondholders or even all creditors.

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Part III reveals why active participation may be important, through an examination of several “make or break” issues that may determine whether a bondholder gets a large piece of the bankruptcy pie or is left with the crumbs. Substantive issues facing bondholders include:

- Can a seller’s misconduct or receipt of avoidable payments taint bonds in the hands of a later transferee?
- Can bondholders enforce all of their contractual rights, such as “no call” or “make whole” provisions, or conversion rights?
- Can the debtor discount the bondholders’ recovery for original issue discount?
- Who gets what? (seniority, subordination, and absolute priority disputes)

In each case, the authors attempt to make sense of it all by making practical suggestions for bondholders planning for future bankruptcy cases or involved in current cases.

## II. THE BOND ISSUER FILES: NOW WHAT? MAKING A DIFFERENCE IN THE BANKRUPTCY CASE

One of the first issues that a bondholder must confront after the commencement of a bankruptcy case is whether, and how, to participate in the proceedings. An active participant can have a significant impact on the case and the ultimate success or failure of a reorganization. Through the bankruptcy process, the bondholder can maximize the return on its investment, both in absolute terms (by helping to maximize the size of the bankruptcy pie distributed to stakeholders) and in relative terms (by ensuring that a greater portion of the pie is distributed to bondholders rather than to competing stakeholders with different claims and interests). Such participation, however, is not free—it requires time, expense, and risk.

### A. Idle Hands: Doing Nothing Can Be a Viable Option (but It Usually Is Not)

Most bonds are issued pursuant to an indenture which, among other things, appoints an indenture trustee to monitor and enforce the terms of the security. An indenture trustee’s duties to bondholders are generally limited to those specifically delineated in the indenture.<sup>7</sup> Absent a default, courts usually decline to imply any general fiduciary duties to the indenture trustee or otherwise obligate the indenture trustee to take any action not specifically called for under the indenture.<sup>8</sup>

The indenture trustee’s responsibilities change once an event of default occurs, such as when the issuer misses a scheduled payment, breaches a covenant, or files a bankruptcy case. Upon default, the indenture trustee owes bondholders a duty to, “as prudence dictates, exercise those singularly conferred prerogatives in order to secure the basic purpose of any trust indenture, the repayment of the underlying obligation.”<sup>9</sup> Under this “prudent person” standard, the indenture trustee typically is required to participate in an issuer’s bankruptcy case to attempt to secure payment of the bonds and otherwise protect the bondholders’ collective interests.<sup>10</sup> The Bankruptcy Code expressly recognizes indenture trustees as “parties in interest” and authorizes them to “raise and... appear and be heard on any issue in a case” under Chapter 11.<sup>11</sup>

Under this rubric, bondholders generally can count on their indenture trustee to provide at least a minimum level of vigilance in protecting their rights and interests in a bankruptcy case. The indenture trustee typically will file a proof of claim for the principal and interest due in respect of bonds,<sup>12</sup> send periodic notices to bondholders regarding the status of the proceedings, and respond to motions and other matters that have the potential of directly impacting the rights associated with the bonds (such as challenges to the priority or validity of a lien securing the bonds and direct challenges to the amount or allowability of claims in respect of the bonds).

Thus bondholders with only a small investment in a particular issuance may choose to rely on the indenture trustee (and other holders with larger economic stakes) to protect their rights in a bankruptcy case. Even then, prudence dictates that bondholders remain apprised of developments in the bankruptcy case, which can be accomplished by filing a request for notice under Bankruptcy Rule 2002(i).<sup>13</sup> There are several reasons for a bondholder to pay at least a moderate level of attention to a bankruptcy case. First, only beneficial owners of the bonds (not the indenture trustee) may vote on a proposed plan of reorganization.<sup>14</sup> Although bondholders (and other creditors) will receive a disclosure statement that describes the terms of the proposed plan and provides other information, it usually is desirable to have some background knowledge of the proceedings that led up to the filing of the proposed plan before casting a ballot. Second, the interests of bondholders with larger stakes may differ substantially from those holding smaller stakes. For example, the larger holders may have acquired their bonds (often at a discount) with the objective of ultimately exchanging them (as often happens) for an equity stake in the reorganized debtor. On the other hand, smaller holders (who often acquired their bonds at par) may desire a cash payout instead of the continuation of their investment in a failed enterprise. Continued vigilance may enable a bondholder to negotiate for options (such as an election for smaller holders to take a cash payout) that later become unavailable as the major players coalesce around the terms of a proposed reorganization.

In any event, bondholders should not rely on their indenture trustee to be a proactive advocate for bondholder interests in a reorganization case. Generally speaking, indenture trustees refuse to take proactive action (such as initiating or participating in settlement discussions regarding the bonds or their treatment under a plan of reorganization, negotiating substantive provisions of a plan, initiating litigation, and the like) without direction and satisfactory indemnity from holders of at least a majority in principal amount of the bonds.<sup>15</sup> Given this practical reality, as discussed below, bondholders with material holdings frequently band together to act as a coalition in a bankruptcy case or to direct their indenture trustee to act proactively or both.

## **B. Serving the Greater Good but at What Cost? Participating on an Official Committee**

### **1. Why and How to Participate**

Section 1102(a) of the Bankruptcy Code provides for the U.S. Trustee (an arm of the Department of Justice) to appoint “a committee of creditors holding unsecured

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claims.”<sup>16</sup> The official creditors’ committee is one of the major players in any sizable Chapter 11 case and generally has a significant impact on the course and ultimate success of the reorganization.

The role of an official committee is to maximize distribution to unsecured creditors.<sup>17</sup> To that end, the official committee has the statutory authority to—

- Hire attorneys and other professionals at the expense of the bankruptcy estate;<sup>18</sup>
- Consult with the trustee or debtor in possession concerning administration of the case;<sup>19</sup>
- Investigate the acts, conduct, assets, liability, or financial condition of the debtor or the debtor’s business, determine the desirability of the continuation of the business, and any other matter relevant to the bankruptcy case or formulation of a plan of reorganization;<sup>20</sup>
- Participate in formulating a plan and advise committee constituents of its views with respect to any proposed plan;<sup>21</sup>
- Request the appointment of a trustee or examiner;<sup>22</sup>
- Seek and obtain permission to prosecute adversary proceedings on behalf of the bankruptcy estate;<sup>23</sup> and
- Appear and be heard on any issue in a bankruptcy case.<sup>24</sup>

In addition to these specific duties, the Bankruptcy Code authorizes official committees to “perform such other services as are in the interest of those represented.”<sup>25</sup> Committees have used this reservoir of authority to take many other actions not specifically mentioned above, such as overseeing a debtor’s distribution of money held to pay unsecured creditors,<sup>26</sup> negotiating reductions in a creditor’s claim,<sup>27</sup> negotiating and proposing settlements,<sup>28</sup> and entering into contracts with secured creditors.<sup>29</sup>

In light of the committee’s role as guardians of the interests of unsecured creditors, courts typically give substantial deference to the views of an official committee, and the members of a committee therefore may have significant influence on the outcome of a reorganization case. Thus a bondholder with substantial holdings may seek to become a committee member as a way to maximize the value of its investment. Under the Bankruptcy Code, the committee “shall ordinarily be comprised of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee.”<sup>30</sup> Courts have interpreted the word “ordinarily” as providing the U.S. Trustee discretion over the exact composition of committee membership.<sup>31</sup> The only formal eligibility requirements for committee service are that a member be a creditor of the debtor holding an unsecured claim against the bankruptcy estate.<sup>32</sup> A party meeting these requirements may sit on a committee even if it is an insider,<sup>33</sup> its claim is disputed,<sup>34</sup> or its claim is not one of the seven largest unsecured claims.<sup>35</sup>

In selecting committee members, the U.S. Trustee’s focus typically is on obtaining a membership which is “fairly chosen and representative” of the committee’s creditor constituency.<sup>36</sup> Membership need not be an exact reflection of represented creditors

so long as the various interests involved have a meaningful voice.<sup>37</sup> Of particular note to bondholders who engage in prebankruptcy negotiations regarding the terms of a bankruptcy plan, the U.S. Trustee in some jurisdictions has refused a place on the committee to creditors who have signed so-called “lock-up” agreements that obligate them to vote for a prenegotiated Chapter 11 plan<sup>38</sup>—the theory being that “locked up” creditors cannot discharge the committee’s duty to negotiate a plan that is in the best interests of all creditors.<sup>39</sup> Similarly, some U.S. Trustees prefer to appoint indenture trustees to official committees, and others prefer to appoint individual bondholders as the parties with an actual economic interest in the outcome of the case.<sup>40</sup> Other potentially disqualifying facts considered by the U.S. Trustee are whether a creditor also holds secured claims against the debtor, whether the creditor is an insider, whether the debtor disputes the creditor’s claim, and whether the creditor is in active litigation with the debtor.<sup>41</sup> These disqualifying considerations can become important in large cases, where prospective committee members often lobby the U.S. Trustee to gain an appointment to the committee.

A creditor denied a seat on the committee may petition the court to change the committee’s membership. Until recently, courts disagreed about whether they had the power to overrule the U.S. Trustee’s decisions regarding committee composition.<sup>42</sup> As a result of amendments to the Bankruptcy Code made in 2005, however, bankruptcy courts now are specifically authorized to “order the United States trustee to change the membership of a committee appointed under this subsection, if the court determines that the change is necessary to ensure adequate representation of creditors or equity security holders.”<sup>43</sup> The question of “adequate representation” generally is framed in terms of whether or not the interests of a “particular group of creditors have a meaningful voice on the committee in relation to their posture in the case.”<sup>44</sup> Notwithstanding this amendment to the Bankruptcy Code, it remains an open question whether a bankruptcy court may order that a specific creditor or creditors be added to or removed from a committee, or whether the court only may “order the United States trustee to change the membership” without specifying exactly how the membership must change.<sup>45</sup>

## **2. The Perils of Participation**

Participation on an official committee is not without its costs and risks. First, committee service requires a significant commitment of time and, in some cases, money. In large and complicated cases, committees may meet several times a week for several hours at a time. Although meetings typically are conducted by telephone conference call, committee deliberation over particularly significant issues (whether to recommend a proposed plan, a sale of the business, or the ouster of management, etc.) often is conducted in person, which may necessitate out-of-town travel. Preparation for meetings can require additional hours of reading pleadings and materials prepared by committee professionals. Moreover, although the Bankruptcy Code provides for the bankruptcy estate to reimburse committee members for the out-of-pocket expenses incurred in the performance of the duties of the committee,<sup>46</sup> it does not authorize

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payment of fees or professional fees for individual members, absent a showing that the committee member made a “substantial contribution” to the bankruptcy case.<sup>47</sup>

Second, committee members typically receive confidential information regarding the debtor and its financial condition. As a result, committee members are precluded from buying or selling their claims or otherwise trading on this confidential information, by the duty of loyalty owed to the committee constituents<sup>48</sup> (more on this duty below) and by “insider trading” prohibitions of state and federal securities laws.<sup>49</sup> This creates a particular dilemma for institutional bondholders, mutual funds, hedge funds, and others who desire or are required to maintain the liquidity of their investments. Courts address this dilemma by enabling institutional committee members to establish “information walls” or “ethical screens” that create a barrier between the people who serve on the creditors’ committee or otherwise have access to any of the confidential information generated by committee service and the persons involved in trading claims and making investment decisions.

In the early decision of *Federated Department Stores*, the bankruptcy court agreed with the Securities and Exchange Commission and concluded that committee member Fidelity Management & Research Company:

Will not be violating its fiduciary duties as a committee member and accordingly, will not be subjecting its claims to possible disallowance, subordination, or other adverse treatment, by trading in securities of the Debtors.. during the pendency of these [c]ases, provided that Fidelity employs an appropriate information blocking device or “Chinese Wall” which is reasonably designed to prevent Fidelity trading personnel from receiving any nonpublic committee information through Fidelity committee personnel and to prevent Fidelity committee personnel from receiving information regarding Fidelity’s trading in securities of the Debtors... in advance of such trades.<sup>50</sup>

The screening procedures required in *Federated Department Stores* (and, with various modifications at the margins, in many subsequent cases) required that—

- The personnel performing committee work be made aware of and acknowledge in writing the information blocking procedures;
- Personnel performing committee work be prohibited from sharing confidential information with investment personnel;
- Files containing confidential committee information be physically segregated from and inaccessible by investment personnel;
- Personnel performing committee work be shielded from advance information concerning trading activities in the debtor’s securities and prohibited from reviewing the committee member’s account holdings more than once a month; and
- The committee member’s compliance department document and actively monitor the existence of the screening procedures.<sup>51</sup>

The use of such screening procedures may be impractical or impossible for bondholders in smaller institutions.<sup>52</sup> Moreover, even where they can be successfully implemented, screening procedures make it difficult or impossible for institutional bondholders to contribute to the committee the full wealth of knowledge that the institution's trading and investment personnel (who typically will remain on the "unrestricted" side of the information wall) may have accumulated through researching, investing in, and monitoring the debtor prior to and during the bankruptcy case.

The final, and perhaps most important, consideration regarding service on an official committee is one of liability. Recognizing the important role that official committees play in the bankruptcy process, courts have read into the Bankruptcy Code a limited grant of immunity for committee members taking actions within the scope of committee duties.<sup>53</sup> That immunity is limited, however, and has been held to not protect a committee member from liability for willful misconduct, actions taken without authority, or actions in breach of the committee member's fiduciary duties owed to its creditor constituents.<sup>54</sup>

In particular, members of an official committee owe a duty of loyalty to all creditors in the class or classes represented by the committee.<sup>55</sup> The duty of loyalty requires committee members to act in the membership's communal interests rather than their purely selfish interest to maximize recovery on their individual claims.<sup>56</sup> Almost by definition, this duty places committee members in a difficult position. Unlike a disinterested trustee or fiduciary, committee members, as creditors of the estate, have a direct interest in maximizing the recovery on their claims. The committee member competes with every other creditor for a larger slice of the bankruptcy pie and, in that sense, has conflicting interests with the other creditors to whom it owes a fiduciary duty.<sup>57</sup>

A committee member's duties are further complicated in large multidebtor reorganizations. Many reorganization cases in recent years have involved dozens, and sometimes hundreds, of affiliated debtors.<sup>58</sup> In such cases, creditors of different debtor affiliates compete not only with similarly situated creditors but also with creditors of the other debtors for the limited assets of the bankruptcy estates. For example, creditors of a debtor that transferred or loaned funds to an affiliate will want their debtor to assert a claim against the affiliate for recovery of the transferred or borrowed funds. Creditors of the affiliate will want their debtor to resist that claim, perhaps by characterizing the transfer as an equity contribution or by invoking principles of equitable subordination.<sup>59</sup> Yet, despite such inter-estate conflicts, the practice of the U.S. Trustee in large multidebtor cases has been to appoint a single committee of unsecured creditors to represent the unsecured creditors of all of the bankruptcy estates. As a consequence, committee members may find themselves in the untenable position of owing a duty of loyalty both to creditors of their debtor (which duty can be fulfilled by attempting to maximize the overall size of that debtor's estate) and also to creditors of an entirely different debtor (whose interests may be best served by attempting to diminish the size of the estate against which the committee member asserts its claim). In such cases, the committee itself may be forced into a posture of neutrality on interdebtor issues, effectively neutering it with respect to important components of the reorganization.

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Sanctions for breach of the duty of loyalty run the gamut from removal from the committee<sup>60</sup> to subordination of the committee member's claim<sup>61</sup> and potentially even to monetary liability.<sup>62</sup>

### **C. Band of Brothers or Watch Your Back? The World of “Ad Hoc Committees”**

#### **1. A Coalition of the Willing**

Bondholders who are unable or unwilling to serve on an official committee can nevertheless greatly influence a Chapter 11 bankruptcy case by forming or joining an “unofficial” or ad hoc committee—a coalition of similarly situated creditors. An ad hoc committee is loosely defined as an informal arrangement that permits “parties with similar interests to coordinate action and, where there is general agreement, to speak with one voice through common counsel.”<sup>63</sup> Due in part to the proliferation of hedge funds and other investors in distressed debt who often take a more active role in the reorganization process than individuals or smaller institutional par investors (like many mutual funds), such informal coalitions have played pivotal roles in recent Chapter 11 cases.

Bondholders form ad hoc committees for three primary reasons. First, ad hoc committees can increase the influence wielded by affiliated creditors.<sup>64</sup> As one court observed, “[b]y appearing as a ‘committee’ of [creditors], the members purport to speak for a group and implicitly ask the court and other parties to give their positions a degree of credibility appropriate to a unified group with large holdings.”<sup>65</sup> In particular, ad hoc committees can become extremely influential and effective if their members hold at least one third of the claims within a particular class, thereby giving the ad hoc committee a “blocking position” with respect to the votes of that class on any proposed plan of reorganization.<sup>66</sup>

Second, the members of an ad hoc committee do not assume any duties to other creditors (even their fellow committee members) and thus are able to “look out for number one” (and only number one) by protecting their own self interest during the proceedings. To that end, the members of an ad hoc committee are free to continue trading in the debtor's securities unless they voluntarily agree to receive confidential information.<sup>67</sup>

Third, the formation of an ad hoc committee enables its members to defray expenses by retaining a single set of professionals (always a lawyer and sometimes a financial professional or investment bank) to advance their cause in the bankruptcy case. The financial arrangements may differ from case to case, but ad hoc committee members typically agree to allocate the fees of their professionals according to the relative size of each creditor's holdings.<sup>68</sup>

Further, while the Bankruptcy Code does not specifically authorize reimbursement of an ad hoc committee's professional fees (in contrast to the fees incurred by an official committee), an ad hoc committee may seek payment under a provision of the Bankruptcy Code providing for the allowance of “reasonable compensation for professional services rendered by an attorney or an accountant” for “a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or

equity security holders... [who has made] a substantial contribution in a case under chapter 9 or 11 of this title.”<sup>69</sup> The policy underlying this provision is to encourage creditor participation in Chapter 11 bankruptcy cases while also minimizing costs and expenses,<sup>70</sup> a policy that ad hoc committees clearly advance. However, it is not easy to obtain a “substantial contribution” award. In seeking reimbursement, the ad hoc committee must demonstrate that it provided an “actual and demonstrable benefit to the debtor’s estate and creditors”<sup>71</sup> and that the fees requested were reasonable and necessary to obtain that benefit.<sup>72</sup> Among other things, some courts refuse to award fees when it is clear that the creditor or committee would have taken action absent any potential recompense.<sup>73</sup> Other courts seemingly take a more lenient approach and consider whether an award of fees is necessary to leave the ad hoc committee members in as good a position as similar creditors who did not participate on the committee but benefited by the committee’s efforts.<sup>74</sup>

Finally, when an ad hoc committee participates in negotiating a consensual plan of reorganization or ultimately settles its objections to a plan and agrees to support the reorganization, the plan proponent often will agree to include a plan provision that provides for payment of the ad hoc committee’s fees and expenses. The U.S. Trustee, however, has asserted in recent cases that such payment is not appropriate absent a showing that the ad hoc committee has made a “substantial contribution” to the case, and there is not yet clear guidance in the case law on this issue.<sup>75</sup>

## **2. Beware the Law of Unintended Consequences**

Participation on an ad hoc committee is not without its risks. For one thing, although unified by holdings of the same bonds, hedge funds and other members of an ad hoc committee may have conflicting interests, such as investments in other places in the debtor’s capital structure (bank debt, subordinated debt, debt of affiliates, equity, or even short positions in other securities). Because hedge funds and others zealously guard their holdings and often trade during the course of the bankruptcy case, it may be impossible for the various members of an ad hoc committee to fully understand their fellow members’ economic interests and motivations and therefore to guard against such potential conflicts. When conflicts among its members bubble to the surface, an ad hoc committee and its professionals may be paralyzed.<sup>76</sup>

Further, interesting questions arise when a creditor advocates action that may not result in a maximum recovery on the bonds held by members of an ad hoc committee in order to foster and enhance recoveries on other investments held by the creditor. Does the creditor owe any duty to fellow ad hoc committee members or other bondholders not to do so? The question is far from decided.<sup>77</sup>

Also, by participating on an ad hoc committee, a bondholder unwittingly may expose itself to a requirement that it publicly disclose sensitive information regarding all of its investments in the debtor pursuant to Bankruptcy Rule 2019. Rule 2019 provides that:

In a chapter 9 municipality or chapter 11 reorganization case... every entity or committee representing more than one creditor or equity security holder and, unless otherwise directed by the court, every indenture trustee, shall file a veri-

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fied statement setting forth (1) the name and address of the creditor or equity security holder; (2) *the nature and amount of the claim or interest and the time of acquisition thereof* unless it is alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of the entity or indenture trustee, and, in the case of a committee, the name or names of the entity or entities at whose instance, directly or indirectly, the employment was arranged or the committee was organized or agreed to act; and (4) with reference to the time of the employment of the entity, the organization or formation of the committee, or the appearance in the case of any indenture trustee, *the amounts of claims or interests owned by the entity, the members of the committee or the indenture trustee, the times when acquired, the amounts paid therefore, and any sales or other disposition thereof*. The statement shall include a copy of the instrument, if any, whereby the entity, committee, or indenture trustee is empowered to act on behalf of creditors or equity security holders.<sup>78</sup>

Until recently, Rule 2019 generally was not understood to apply to ad hoc committees (which, again, are merely coalitions of interested parties who have banded together to defray costs and enhance their negotiating power, and have not assumed duties to any other creditor or entity).<sup>79</sup> Rather, most interpreted Rule 2019 to apply only to the lawyer for an ad hoc committee, as the “entity... representing more than one creditor” and thus to require disclosure of the creditors represented by the lawyer but not the amount of those creditors’ claims or the price at which they were acquired.

A decision recently issued in the *Northwest Airlines* Chapter 11 case changed that understanding. In *Northwest Airlines*, the influential Bankruptcy Court for the Southern District of New York—a venue in which many large reorganization cases are filed—held that the members of an ad hoc committee, and not merely its counsel, were subject to Rule 2019’s disclosure requirements.<sup>80</sup> The court rejected the ad hoc committee’s argument that it was not actually a “committee” within the meaning of Rule 2019 because it did not represent any creditor/shareholder other than its members, reasoning that the ad hoc coalition appeared and participated as a unified “committee” and as a single “entity.”<sup>81</sup> The court therefore directed the individual members of the ad hoc committee to publicly disclose when they had purchased the debtor’s securities, what they had purchased, and the prices paid.<sup>82</sup>

This is sensitive information for any creditor, particularly hedge funds who may be employing proprietary investment strategies and continuing to trade in the debtor’s securities.<sup>83</sup> As such, the holding of *Northwest Airlines*, if applied in other cases, could significantly alter the incentives for bondholders to form and join ad hoc committees. Are the benefits of participation worth the public disclosure of sensitive information (information that other creditors, including members of an official committee of creditors, do not have to disclose)?

It is the authors’ view that *Northwest Airlines* was wrongly decided, both as a matter of textual interpretation and bankruptcy policy, and that it should not be followed by other courts. By its terms, Rule 2019 refers to a “committee representing more than one creditor.”<sup>84</sup> Ad hoc committees do not “represent” any creditors. Properly

conceived, they are nothing more than coalitions of interested parties who share the costs of jointly hired counsel. As one commentator has noted, the word “committee” is defined in legal and general dictionaries as “a body that is appointed/elected to act in a representative/fiduciary capacity for a larger universe of stakeholders than the committee members.”<sup>85</sup> Unlike the members of an official committee, the members of an ad hoc committee are not appointed or elected. They do not represent anyone’s interests other than their own, and they owe no fiduciary duties, even to each other. At least one court has reached this conclusion and therefore refused to apply *Northwest Airlines* to an ad hoc committee.<sup>86</sup>

Moreover, the reasoning of *Northwest Airlines* seems too literal. Under *Northwest Airlines*, creditors must file a Rule 2019 disclosure if they retain the same counsel who places the word “committee” or “ad hoc committee” at the top of its pleading. Yet if that same attorney places the creditors’ individual names on the pleadings, no such disclosure is required. This makes no sense, particularly in light of the purpose of Rule 2019. Rule 2019 was intended to police “protective committees” that purport to represent creditors who do not have individual representation in a bankruptcy case.<sup>87</sup> It requires disclosure of a committee member’s connections to a bankruptcy estate so that the court and interested parties can determine whether that committee member is furthering representative or individual interests. Since an ad hoc committee does not represent anyone other than its specific members, everyone is aware that the members of ad hoc committees pursue only their individual interests. Ad hoc committee members do not purport to represent other creditors, so disclosure under Rule 2019 is unnecessary. The premise of *Northwest Airlines*—that “Rule 2019 gives other members of the class the right to know where their champions are coming from”<sup>88</sup>—has no foundation in the context of an ad hoc coalition/committee that “champions” no interest except those of its members (whose identities are disclosed). Finally, by imposing a harsh, possibly disqualifying, sanction of disclosure on parties who otherwise would be among the most active in a bankruptcy case, *Northwest Airlines* serves to frustrate the fundamental bankruptcy policy of encouraging participation in a reorganization case.

#### **D. Selling Out or Doubling Down? Issues in Postpetition Trading of Claims**

In recent years, there has been an active market for claims against debtors in most large Chapter 11 cases, particularly bonds and other publicly traded securities. Some hedge funds and other entities with billions of dollars of cash at their disposal now specialize in buying and selling “distressed” debt. Thus a bondholder who is dissatisfied with the progress of a particular bankruptcy case or who simply wishes to liquidate its investment and move on now has a ready exit by simply selling its claim to the highest bidder. On the other side of the coin, an investor who believes that the market is undervaluing claims can continue to invest in the debtor’s securities, including bonds (perhaps with an eye toward exchanging those bonds for equity in the reorganized enterprise), after a bankruptcy petition is filed.

But not so fast. Debtors in large reorganization cases increasingly have been requesting and receiving (often on or around the first days of the bankruptcy case and

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without notice to all creditors), orders from the bankruptcy court that prohibit or severely restrict the ability of some creditors and shareholders to sell their claims and interests. The premise of such orders is the protection of the debtor's net operating losses (NOLs), which can be used to shelter from taxes the income of the reorganizing and, subject to certain limitations, the reorganized debtor. Under tax laws, NOLs may be lost or restricted if a corporation experiences a "change in ownership" through the transfer of its stock.<sup>89</sup>

Trading restriction orders seek to protect a debtor's NOLs by removing the possibility that a change in control may occur during the bankruptcy case. They often are followed by orders that restrict trading in the reorganized debtor's stock. Typically, court-imposed restrictions include requirements that transfers of large claims (usually those for which the debtor may distribute more than 5% of the equity in the reorganized enterprise) or large blocks of stock (usually more than 5% of the outstanding stock) may only be done after an order of the court or with the debtor's consent.<sup>90</sup> At least one court has declared an absolute moratorium on trading the debtor's securities.<sup>91</sup>

These orders, which are premised on the theory that NOLs are a debtor's "property" and thus protected by the automatic stay, run contrary to policies promoting free alienability of claims and securities.<sup>92</sup> Indeed, the holder of a large block of bonds may be prohibited from selling its bonds for many years during a bankruptcy case, only then to find itself forced to exchange those bonds for shares of stock in the reorganized enterprise that the bondholder then cannot sell for a period of years. This is particularly problematic if the bondholder's bonds were held in a fund, like an income fund, whose investment objectives do not permit equity investments. The underlying premise of the orders has been criticized in the absence of a showing of direct impact and compelling harm:

[Trading] by individual holders in and of themselves likely have no direct effect on the debtor's use of its property and may not affect the debtor's NOL at all, without other actions by other shareholders or claimholders. It is difficult to fathom how such transfers, made with no intention to affect the debtor and which in fact may have no effect, amount to an exercise of "control" over the debtor's property.<sup>93</sup>

Nevertheless, because NOL orders are becoming a common staple of the relief requested by large Chapter 11 debtors,<sup>94</sup> bondholders must be aware that their "exit strategy" may be impaired or delayed as a consequence of such orders. In extreme cases, bondholders with large holdings who do not wish to be forced to "ride out" a bankruptcy case involuntarily should consider either liquidating their positions before or immediately after a case has been filed or else attempting to challenge or limit the scope of any NOL order that a debtor seeks to implement.

### III. WHO GETS WHAT? A SURVEY OF ISSUES

Having considered ways in which a bondholder may participate in a reorganization, we now move from procedure to substance by examining a number of issues that can directly impact the returns that a bondholder achieves in the bankruptcy case.

Here, we are not concerned with the size of the bankruptcy pie—the total value distributable to stakeholders of the debtor. That is an area with endless factual permutations best addressed by active participants in a case (and, as noted above, the ability to assist in the maximization of value can be a primary motivating factor in the decision to become active in the reorganization in the first place). Rather, we survey here issues relating to the size of a bondholder's claim and the bondholder's entitlements vis-à-vis other bondholders and other stakeholders. These issues are where the rubber meets the road in a bankruptcy case, and they frequently are the source of litigation and conflict. A savvy bondholder with an understanding of the issues will be best positioned to achieve its objectives and maximize its returns in any case.

### **A. Caveat Emptor: A Seller's Misconduct, or Receipt of Avoidable Payments Might Taint Bonds Purchased During the Bankruptcy Case**

The Bankruptcy Code provides that claims held by the recipient of an avoidable transfer (such as a preference or a fraudulent conveyance) are disallowed unless the recipient has either paid the amount or turned over the property for which it is liable.<sup>95</sup> The Code also provides for the “equitable subordination” of claims held by an entity who has engaged in inequitable conduct that resulted in injury to creditors or conferred an unfair advantage on the claimant.<sup>96</sup>

These bankruptcy-specific remedies raise a fundamental question and, somewhat surprisingly, a new issue for the courts: what happens if the recipient of an avoidable transfer or the creditor who has engaged in inequitable conduct transfers its claim to an innocent third party? Is the transferred claim subject to disallowance or subordination just as it was in the hands of the transferor, or does the transfer “cleanse” the claim and inoculate it from disallowance or subordination? This question received little attention in case law until very recently, when it arose in the massive *Enron* bankruptcy case and fraud litigation. First, the Bankruptcy Court for the Southern District of New York (which is, as noted above, currently the predominant venue of choice for large, complex commercial reorganizations) held that the purchaser was subject to disallowance and subordination to the same extent as the seller, regardless of whether or not the sale transaction took place on the open market or in an individual, one-off transaction, and whether or not the purchaser knew of the claim's potential infirmities. The bankruptcy court observed that:

[T]he post-petition purchaser of such debt instruments either knows or should know that the issuer of these securities is a debtor, so the prices of these transfers would reflect the attendant risks that the claims might be subordinated [or disallowed]. Under those circumstances, the purchaser may well not have any available indemnity remedy against the seller, as is the case with the claims trading. But it is the market place that should address such risks in its pricing. Apprehending higher risk associated with these securities, the purchaser may demand further discounts on the prices... [N]o legal and policy basis supports the premise that transferees of bonds or notes should be treated differently than those holding the transferred loan claims. All the post-petition transferees assume the risk that their claims may be subject to subordination [and disallowance].<sup>97</sup>

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Judge Scheindlin of the District Court for the Southern District of New York, however, accepted interlocutory review of the appeal and reversed, noting that the bankruptcy court's "overreaching resulted in outcry from commentators and *amici curiae*, who have expressed great concern that the effects of these opinions will wreak havoc in the markets for distressed debt."<sup>98</sup> Judge Scheindlin accepted the interlocutory appeal in order to decide the question of first impression as to whether equitable subordination and disallowance may be applied to transferees to the same extent as if the claims were still held by the transferor based on alleged bad acts by the transferor. Judge Scheindlin held that "equitable subordination and disallowance are both personal disabilities that do not inhere in the claim."<sup>99</sup> She noted that the Second Circuit has "recognized that the appropriate focus is on the claimant, [whose conduct is questioned,] not the claim."<sup>100</sup> She then reviewed the statutory basis of equitable subordination and disallowance and reaffirmed existing case law by noting that the equitable subordination doctrine is remedial, not penal, and should be applied only to the extent necessary to offset "specific harm that creditors have suffered on account of inequitable conduct."<sup>101</sup> Judge Scheindlin emphasized that "Equitable Subordination is a remedy that belongs to the creditors—not the debtor... Indeed, a [solvent] debtor acting on its own behalf lacks standing to bring an action for equitable subordination."<sup>102</sup>

Judge Scheindlin also ruled that disallowance under section 502(d) of the Bankruptcy Code—which provides that "the court shall disallow any claim of any entity from which property is recoverable under [the avoidance provisions of the Bankruptcy Code] unless such entity... has paid the amount, or turned over any such property, for which such entity... is liable"<sup>103</sup>—cannot be applied to an innocent transferee who purchased a claim and was not the actual recipient of the otherwise avoidable transfer, noting that section 502(d) was not "intended to punish, but rather to give creditors an option to keep their transfer (and hope for no action by the trustee) or to surrender their transfers and their advantages and share equally with other creditors."<sup>104</sup>

The court found that claims are not immutably fixed on the petition date, thereby rejecting a basis for Enron's "tainted debt" theory. Judge Scheindlin then went further and held that, because equitable subordination and disallowance exposure are personal to the transferor, the question of whether these actions can be applied to downstream transferees turns on whether the transfers were effected by a sale or by a pure assignment (where the transferee actually steps into the shoes of the transferor). If the transfers were by a pure assignment (such as pursuant to a receivership or by operation of law or subrogation), then the personal disability is also transferred, and the claims may be subject to subordination or disallowance, subject to whether the transferee may maintain any defenses. In contrast, if the transfers were by sale, then the good faith transferee takes clear of these actions.

While remanding for a factual determination as to whether the subject agreements were sales or assignments, Judge Scheindlin stated that such factual determination will not always be necessary. "Sales of claims on the open markets are indisputably sales and subrogation of a surety to the rights under a claim is indisputably an assignment."<sup>105</sup> Thus, according to Judge Scheindlin, equitable subordination of claims should not be applied to open market sales. This distinction:

is particularly imperative in the distressed debt market, where sellers are often anonymous and purchasers have no way of ascertaining whether the seller (or a transferee up the line) has acted inequitably or received a voidable preference. No amount of due diligence on [the buyer's] part will reveal that information and it is unclear how the market would price such unknowable risk. Parties to true assignments, by contrast, can easily contract around the risk of equitable subordination or disallowance by entering into indemnity agreements to protect the assignee.<sup>106</sup>

The court recognized that the ruling could enable a wrongdoer to “wash” its claim and benefit from its misconduct, but it believed that the proper balance was struck by the assignment/sale dichotomy:

At the end of the day, however, there can be no dispute that in limited circumstances, a bad faith transferor may be able to sell its claim to a bona fide purchaser for value, effectively “wash” its claim in the hands of the purchaser, take the proceeds and run, to the detriment of other creditors. However, the risk of that scenario is outweighed by the countervailing policy at issue, namely the law’s consistent protection of bona fide purchasers for value. Enron focuses on the harm that will come to the creditors as a result, but the law protects bona fide purchasers for value, and this context is no different. This is a question of allocating the burden and risk of pursuing the bad actor transferor between two groups of innocents: the creditors as a whole or the transferee. The Court finds that the balance struck by the foregoing legal analysis is fair: the burden and risk is better carried by creditors as a whole in favor of the bona fide purchaser in the context of a sale, but better carried by the assignee in favor of the creditors in the context of an assignment, particularly given the ability of parties to an assignment to obtain indemnities and warranties.<sup>107</sup>

Unfortunately, however, the district court provided no criteria for distinguishing between “assignments” and “sales,” instead remanding to the bankruptcy court for consideration of the issue. Unfortunately, the parties settled this litigation before it could be appealed to the Court of Appeals for the Second Circuit. In all likelihood, the district court’s decision will engender even more litigation, thereby defeating the court’s stated aim of avoiding “havoc on the markets for distressed debt.”<sup>108</sup>

For now, the age-old watchword holds true—buyer beware!

## **B. What’s That Bond Really Worth? The Enforceability of Rights to Consideration Other Than Principal and Interest**

At the most basic level, a bondholder wants to be paid the principal and interest associated with the bonds that it owns. As shown below, however, there are a number of permutations that muddy the waters of even this seemingly straightforward objective.

### **1. “No Calls” and “Make Wholes”—Fighting for the Right Not to Be Paid (at Least Not Now)**

A bond represents the debtor’s promise to repay borrowed money over a specified period of time at a specified rate of interest. At least prior to insolvency or financial

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distress, investors acquire their bonds with the expectation that the debtor's promise will be honored in the manner and at the times specified in the indenture. When market rates fall below a bond's specified interest rate, the bond becomes more valuable, all else being equal.

That value, however, is tenuous if the debtor has the ability to refinance the bonds, repaying bondholders prior to maturity with money borrowed at the lower interest rates now demanded by the market. To avoid giving the debtor a one-way option, bond indentures often include provisions that either forbid prepayment or refinancing (so-called "no-call" provisions) or that require the payment of an amount in addition to the principal amount of the bonds in the event of prepayment (so-called "make-whole" provisions). A no-call might prohibit the debtor from redeeming the bonds for the first 10 years after issuance, and a make-whole might require the debtor to pay an amount calculated as the then-present value of the above-market interest otherwise payable for the remaining term of the bond.

What becomes of a no-call or a make-whole in the bankruptcy case? The debtor's reorganization efforts typically involve the satisfaction (in whole or in part) and discharge of outstanding debt obligations. Is a bondholder entitled to enforce a no-call or collect on a make-whole provision? As with most other bankruptcy imponderables, it depends.<sup>109</sup>

### **a. No-Call Provisions**

No-call provisions are covenants in an indenture that forbid early payment. They are unenforceable in bankruptcy, at least to the extent that the bondholder attempts to rely on a no-call to prohibit repayment or discharge the bonds in a plan of reorganization.<sup>110</sup> As one court recently stated, "[t]he 'essence of bankruptcy reorganization is to restructure debt and adjust debtor-creditor relationships.' It would violate the purpose behind the Bankruptcy Code to deny a debtor the ability to reorganize because a creditor has contractually forbidden it."<sup>111</sup>

However, in a recent high-profile decision, the Bankruptcy Court for the Southern District of New York held that, although a bondholder could not enforce its no-call provision by prohibiting prepayment, it could collect damages for the debtor's breach of the no-call when the debtor sought to pay some of the debt (with the approval of the bankruptcy court) prior to confirmation of a plan. The court reasoned that the bondholders' "expectation of an uninterrupted payment stream has been dashed giving rise to damages," and the court awarded the bondholders an unsecured "damage" claim calculated with reference to make-whole premiums included in the debtor's other bond issues.<sup>112</sup>

### **b. Make-Whole Provisions**

Make-whole provisions are covenants in an indenture that require an issuer to compensate bondholders for lost interest payments in the event of an early redemption or prepayment. They are designed to preserve a bondholder's investment by compensating the holder for the interest that would have accrued in the absence of prepayment.<sup>113</sup>

In bankruptcy, the general rule is that a bondholder may assert a claim for a make-whole premium if the premium otherwise would be enforceable under state law. Some state laws enforce make-whole provisions as they would any other contract right.<sup>114</sup> Other state laws, however, treat make-whole rights as liquidated damages provisions.<sup>115</sup> For bonds governed by laws of those states, bankruptcy courts will only enforce a claim for a make-whole premium if the bondholder can show that the provision was an honest estimate of damages at the time that the indenture was executed. This analysis, in turn, often looks to “the anticipated or actual harm caused by the [prepayment], the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.”<sup>116</sup>

Thus in *In re A.J. Lane & Co.*, a bankruptcy court refused to allow a make-whole premium equal to 1% of a loan principal, multiplied by the number of years remaining until maturity.<sup>117</sup> The court found that the make-whole provision improperly assumed that, upon prepayment, the prevailing interest rate would be at least 1% lower, and it held that the calculated make-whole was not reasonably related to the actual damages sustained by the creditor.<sup>118</sup> In contrast, in *In re AE Hotel Venture*, a bankruptcy court enforced a make-whole provision calculated as the larger of (a) the remaining principal at the time of repayment less the present value of a similar U.S. Treasury security for the same amount and maturity date, or (b) 1% of the outstanding balance at the time of prepayment.<sup>119</sup> The court found that the amount owing under the make-whole provision was a reasonable estimate of damages because it was based upon the prevailing rates of U.S. Treasury securities.<sup>120</sup> In general, a make-whole provision not based in some way on market rates or conditions at the time of prepayment runs the risk of disallowance.

Moreover, even where a make-whole provision otherwise is enforceable under state law, bankruptcy courts have refused to allow claims based upon make-whole provisions where prepayment is caused by the creditor’s acceleration rather than a voluntary election by the debtor. By definition, an obligation cannot be “prepaid” if it has already been accelerated and thus is due and payable.<sup>121</sup> Under this reasoning, courts often refuse to recognize claims for make-whole provisions on accelerated debt because the debtor is said to be paying an obligation as it becomes due.<sup>122</sup> Notably, the filing of a bankruptcy petition itself often operates to accelerate all of the debtor’s debts. However, most courts hold that acceleration as a consequence of a voluntary bankruptcy filing does not nullify an otherwise enforceable make-whole premium, reasoning that the act of filing for bankruptcy relief itself is considered a voluntary act on the part of the issuer.<sup>123</sup> A minority view holds otherwise, reasoning that filing for bankruptcy is not truly voluntary in that a good faith actor seeks bankruptcy relief only as a last resort.<sup>124</sup>

## 2. Conversion Rights—Any Independent Value?

“Convertible” bonds are something of a hybrid between traditional bonds (debt) and common stock (equity). “Converts” typically combine a traditional debt instrument (bearing interest and the promise of repayment of principal at maturity) with an option to convert the instrument into a predetermined number of shares. Holders thus

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can participate in an equity “upside” while receiving a guaranteed minimum return, while issuers can obtain financing at lower costs than typical debt instruments.<sup>125</sup>

In most cases, the treatment of convertible bonds in bankruptcy is straightforward. Holders are entitled to a claim for the “debt” component of the bond (principal and matured interest). No value is attributable to the “equity” component (the right to convert) because, in the usual case, equity of the debtor is worthless and is discharged under the plan.

What happens, however, in a case where the debtor proves to be solvent and is able to deliver a return to existing equity? Surprisingly, this issue only recently has received any attention in the reorganization proceedings of Calpine Corporation (in which the debtor’s solvency was a hotly contested issue). In that case, the debtor had issued over \$1 billion of convertible bonds. The indentures prohibited the debtor from voluntarily redeeming the bonds but stated that the commencement of a bankruptcy case would constitute an event of default upon which all notes would be “immediately due and payable.” When the debtor filed for bankruptcy, the indenture trustee filed proofs of claim seeking payment for (a) the principal and interest owing under the bonds; and (b) “breach” of the conversion rights. The debtor objected, arguing, among other things, that bondholders no longer held conversion rights under the indentures.

By the terms of the indentures, the conversion right terminated upon “maturity.” The debtor argued that the automatic acceleration of the bonds on the filing of the bankruptcy case constituted “maturity” and thereby destroyed any conversion rights. The indenture trustee and bondholders disputed that contention and argued that any breach of the conversion rights entitled them to a claim for damages equal to the value of those rights. The bankruptcy court ultimately agreed with the debtor, holding that the convertible bondholders were entitled only to a claim for the bonds’ principal and interest.<sup>126</sup> Notably, the court also held, in dicta, that even if a claim for breached conversion rights was cognizable, it would be subordinated to the level of equity “as claims arising from the purchase or sale of a security if [sic] the debtors” under section 510(b) of the Bankruptcy Code.<sup>127</sup> Section 510(b) provides that claims for damages arising from the purchase of the debtor’s securities are subordinated to all claims or interests senior to those securities. A claim typically is subject to subordination under section 510(b) if the creditor (1) took on the risk and return expectations of a shareholder rather than a creditor, or (2) seeks to recover a contribution to the equity pool presumably relied upon by creditors in deciding whether to extend credit to the debtor.<sup>128</sup> Implicit in the *Calpine* decision is a finding that convertible bonds are, by their very nature, contracts for the purchase of securities that inherently involve risk and return expectations similar to a shareholder.

Ultimately, this latter discussion may prove the most important aspect of the *Calpine* decision. While *Calpine*’s actual holding is based largely on the specific language of the indentures at issue, which provided for the right of conversion to terminate upon “maturity”—an undefined term—a conclusion that any claim for breach of conversion rights must be subordinated to the level of equity would make the pursuit of any such claim unproductive in all but the most solvent of cases.

### **C. Original Issue Discount—When a \$100 Bond Is Not Really a \$100 Bond**

The issues summarized above—involving the fight for claims in excess of principal and accrued interest on a bond—are relatively desirable problems. In other instances, a bondholder may have to fight to maintain a claim just for the stated principal amount of the bond.

Those instances involve “original issue discount” (OID), which results when the proceeds received by an issuer are less than the face amount of the bond. Simply stated, OID can be calculated as (a) the stated principal/redemption price at maturity of the bond, less (b) the “issue price” of the bond (the amount paid by the investor).<sup>129</sup> This may occur when, after the issuer specifies an interest rate for a proposed issuance, the issuer is unable to sell the bonds at that rate (because the market demands a higher interest rate to account for the issuer’s poor credit risk). OID results when the bonds are then sold for a smaller amount of proceeds but keep the previously stated “principal” amount.

For tax and accounting purposes, OID typically is amortized over the life of the bond with the face value scheduled to be paid upon maturity. When an issuer files for bankruptcy relief before a bond’s maturity, issues arise with respect to the amount of the claim that can be allowed in respect of the bonds. In some respects, the impact of OID is clear. Section 502(b)(2) of the Bankruptcy Code provides that a claim may not be allowed to the extent that “such claim is for unmatured interest.” The House Committee report for this provision states:

Interest disallowed under this paragraph includes postpetition interest that is not yet due and payable, and any portion of prepaid interest that represents an original discounting of the claim, yet that would not have been earned on the date of bankruptcy. For example, a claim on a \$1,000 note issued the day before bankruptcy would only be allowed to the extent of the cash actually advanced. If the original issue discount was 10% so that the cash advanced was only \$900, then notwithstanding the face amount of [the] note, only \$900 would be allowed. If \$900 was advanced under the note some time before bankruptcy, the interest component of the note would have to be pro-rated and disallowed to the extent it was for interest after the commencement of the case.<sup>130</sup>

Relying on the plain meaning of section 502(b)(2) and its associated legislative history, bankruptcy courts unanimously have held that nonamortized OID is not allowable as a claim in bankruptcy.<sup>131</sup> As one court stated, section 502(b)(2) is designed to “prevent creditors from claiming disguised, unearned interest—regardless of context.”<sup>132</sup>

A more difficult question arises when an issuer makes a debt-for-debt exchange prepetition. In that scenario, “bondholders exchange their old bonds for new bonds. The debtor hopes that the exchange, by changing the terms of the debt, will enable the debtor to avoid default. The bondholders hope that by increasing the likelihood of payment on their bonds, the exchange will benefit them as well.”<sup>133</sup> In a “face value exchange,” the new bonds have the same face amount as the old bonds; the only difference between old and new are changes in the terms of the new bonds.<sup>134</sup> Through a

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face value exchange, a corporation might gain the short-term benefit of increased time to maturity, loosening of restrictive covenants, or relief from imminent sinking fund or redemption payments, while bondholders receive new bonds for the same principal amount as the originally issued bonds.<sup>135</sup>

In bankruptcy, thorny issues arise. The saga of *Chateaugay Corporation* is a good example. In *Chateaugay*, the debtor had executed a face value exchange in an attempted out-of-court workout of its debts but later filed a Chapter 11 case. The Bankruptcy Court for the Southern District of New York held that new bonds issued through the face value exchange created OID.<sup>136</sup> Since the terms and conditions of the new bonds differed from the old bonds, the bankruptcy court held that the face value exchange created new debt,<sup>137</sup> which had a face value higher than the old bonds' market value (even though the face value of the old bonds was the same as that of the new bonds). The court held that the difference between the new face value and the old market value was OID. Since OID is not allowable under section 502(b)(2), the court disallowed the bondholders' claims by the amount of the OID.<sup>138</sup>

The district court in *Chateaugay* affirmed,<sup>139</sup> but the Court of Appeals for the Second Circuit reversed.<sup>140</sup> The Second Circuit was persuaded that there is an overarching policy of favoring "the speedy, inexpensive, negotiated resolution of disputes" out of court<sup>141</sup> and concluded that, if face value exchanges created new OID, bondholders would be penalized for accommodating a debtor's attempts to work out their financial troubles outside of bankruptcy. The Second Circuit held that it would make no sense for "exchanging holders [to] have a lower claim than those who did not exchange, even though the overall debt obligation of the company has not been altered."<sup>142</sup> The circuit thus held that a face value exchange does not create OID, it merely reaffirms and modifies the underlying debt. If OID existed with the old debt, it is simply carried through to the new debt.<sup>143</sup> The Court of Appeals for the Fifth Circuit also has adopted this reasoning.<sup>144</sup>

It should be noted, however, that the holdings of *Chateaugay* and *Pengo* were limited to face value debt-for-debt exchanges.<sup>145</sup> At least one court has said that OID is created from a debt-for-equity exchange.<sup>146</sup> Also, the courts in *Chateaugay* and *Pengo* made a specific distinction between debt-for-debt exchanges and debt-for-equity exchanges.<sup>147</sup>

### **D. Seniority, Subordination, and Absolute Priority: Who Gets First Dibs?**

Another issue bondholders frequently confront in both out-of-court restructurings and bankruptcy cases is the nature and effect of payment and collateral subordination provisions in the governing bond indentures and debt documents. The general rule, pursuant to section 510(a) of the Bankruptcy Code, is that subordination agreements are enforceable in bankruptcy to the extent that they are enforceable under applicable nonbankruptcy law.<sup>148</sup> Bankruptcy, however, adds a number of wrinkles to that straightforward proposition, several of which are explored below.

### 1. The “Silent” Second (and Third)

In recent years, financial markets have seen an explosion of financing through indentures and credit agreements secured by second-lien (and third-lien) positions on collateral already encumbered to secure the debtor’s primary first-lien indebtedness. These financings offer borrowers an alternative to traditional cash flow lending and expand financing options available to less creditworthy borrowers.<sup>149</sup> Hedge funds and other investors who are not constrained by rigid internal credit risk ratings are attracted to the second-lien financing because they can offer premium returns with some downside collateral protection.

First-lien holders typically refuse to allow the debtor to grant a second-priority lien on their collateral absent a subordination agreement containing special protections for the first position that, in theory, serve to severely restrict the fundamental rights and remedies that otherwise would be available to the holders of the second-lien debt, including many basic rights afforded to creditors in a bankruptcy case. Such protections often include an agreement by the second-lien holders:

- Not to object to the validity, priority, or enforceability of the first-lien holder’s position;
- Not to object to debtor-in-possession financing in a bankruptcy proceeding if such financing is supported by the first lien-holder;
- To abide by the first lien-holder’s positions with respect to adequate protection, use of cash collateral, and the sale of assets in bankruptcy; and
- Waiver of the second-lien holder’s right to vote on any proposed Chapter 11 plan of reorganization in bankruptcy.

Because these relinquished rights are among the most fundamental and sacred creditor protections provided by the Bankruptcy Code, the question becomes whether these waivers and restrictions actually are enforceable in a bankruptcy case.

The case law addressing these provisions is sparse, perhaps because many of the issues arise early in a bankruptcy proceeding and require speedy resolution, often leading to resolution by the parties themselves. In several instances, however, notwithstanding the seemingly straightforward command of section 510(a) that subordination agreements should be enforced in a bankruptcy case to the extent enforceable outside of bankruptcy, bankruptcy courts have refused to enforce provisions that they deemed to run afoul of basic, and apparently inalienable, bankruptcy rights. For example, in the early case of *Hart Ski Manufacturing*, the court held that:

The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. These rights include the right to assert and prove its claim, the right to seek court-ordered protection for its security, the right to have a stay lifted under prior circumstances, the right to participate in the voting for confirmation or rejection of any plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable. The above rights and others not related to contract priority of distribution pursuant to *Section 510(a)*

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cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination agreement, the “subordinator” gives up all its rights to the “subordinate” would be totally inequitable.<sup>150</sup>

Likewise, in *203 North LaSalle Street Partnership*, the court recently refused to recognize a first-lienholder’s attempt to cast a second-lienholder’s Chapter 11 ballot pursuant to a provision of a prepetition intercreditor agreement. The court held that “prebankruptcy agreements do not override contrary provisions of the Bankruptcy Code” and, as a consequence, that the prepetition waiver of voting rights conflicted with section 1126(a) of the Bankruptcy Code, which states that only “[t]he holder of a claim or interest allowed under section 502” may vote for or against a Chapter 11 plan of reorganization.<sup>151</sup>

In contrast, in the recent case of *Aerosol Packaging*, the court enforced waiver of a second-lienholder’s voting rights under a theory of general agency law, finding authority for the waiver in Bankruptcy Rules 3018 and 9010, which “explicitly permit[] agents and other representatives to take actions, including voting, on behalf of parties.”<sup>152</sup> Characterizing the subordination agreement as an agency agreement between the first-lienholders and second-lienholders, the court accepted both ballots cast by the first-lienholder even though “the agent acts in its own interests, and not those of the purported principal.”<sup>153</sup>

Taken as a whole, these cases suggest that treatment of “silent” second liens and restrictive prohibitions in which first-lienholders and senior creditors attempt to protect their position by neutering rights otherwise available to junior creditors is, at best, unpredictable. As a consequence, junior creditors may be able to exploit the leverage arising from that uncertainty to negotiate for more favorable results than those dictated by the terms of the subordination agreements to which they are parties.

### **2. Postpetition Interest and the “Rule of Explicitness”**

One fundamental rule of bankruptcy law is that interest accruing on unsecured (and undersecured) debt after the date of the bankruptcy petition is not allowable. “[This] rule takes account of the fact that the debtor’s delay in repayment after the petition date results by operation of law and prevents creditors from profiting or suffering a loss in relation to each other because of the delay.”<sup>154</sup> Is this basic rule altered when a junior creditor or bondholder agrees to subordinate repayment on its claim to the payment “in full” of senior bonds or claims? Stated another way, does payment “in full” of senior claims include the payment of postpetition interest that otherwise would not be allowable under bankruptcy law?

The common understanding of that term would indicate so: payment “in full” logically should include all amounts due in respect of the senior debt in accord with the governing debt instruments. Prior to enactment of the Bankruptcy Code, courts paid lip service to that notion, agreeing that “[e]nforcing such [subordination] agreements was necessary to prevent junior creditors from receiving windfalls after having explicitly agreed to accept less lucrative payment arrangements.”<sup>155</sup> However, perhaps recog-

nizing that the subordinated creditors could be unduly harmed by the subordination of their claims to claims for postpetition interest accruing on senior debt over the course of bankruptcy proceedings that could take years to resolve, the courts developed what became known as the “Rule of Explicitness” as a way to deny postpetition interest to senior creditors at the expense of junior creditors.

The Rule of Explicitness required that a subordination agreement must provide “unequivocal language” specifically manifesting an intent that the senior creditor receive postpetition interest and fees before the junior creditor can receive its distribution—subordination to payment “in full” of senior debt was held not to be a sufficient statement of intent to subordinate to otherwise disallowed postpetition interest.<sup>156</sup> As a consequence, the Rule of Explicitness served to deny senior creditors postpetition interest at the expense of their subordinated counterparts.

It was generally presumed that the judge-made Rule of Explicitness survived the enactment of the Bankruptcy Code in 1978, even though the Code specifically requires enforcement of subordination agreements through section 510(a) (which, as noted above, provides that “[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law”). In *Southeast Banking Corp.*, however, the Eleventh Circuit held that section 510(a) abrogated the Rule of Explicitness, on the theory that the Rule of Explicitness was a creature of federal bankruptcy policy and equity and that it did not constitute “applicable nonbankruptcy law.” Honoring the language and perceived intent of section 510(a), the circuit held that questions regarding the enforceability of subordination provisions vis-à-vis disallowed postpetition interest must be considered under applicable state law.<sup>157</sup> To that end, the circuit certified to the New York State Court of Appeals the question of whether state law requires bankruptcy courts to apply the Rule of Explicitness to subordination agreements,<sup>158</sup> a question ultimately answered in the affirmative by that state court.<sup>159</sup>

The First Circuit in *Bank of New England* agreed that the Rule of Explicitness is valid only to the extent required by state law<sup>160</sup> but disagreed with the Eleventh Circuit’s decision to allow a state court to determine a rule specific to bankruptcy.<sup>161</sup> Instead, the First Circuit held that the Rule of Explicitness is only applicable if it applies as a matter of general contract law; in other words, it must apply equally to all subordination contracts regardless of the context (bankruptcy or otherwise).<sup>162</sup> Upon finding that New York state courts had not developed a general rule of explicitness, the *Bank of New England* court remanded the case with instructions to apply general principles of contract law to determine whether the parties to the subordination agreement intended the agreement to apply to interest accrual.<sup>163</sup>

The holdings of *Southeast Banking* and *Bank of New England* present a philosophical dichotomy which, in the end, may be a distinction without a difference. Both decisions agree that the Rule of Explicitness applies only to the extent that it arises under state law. The Eleventh Circuit would apply the Rule of Explicitness if state law requires its application in bankruptcy (apparently even if state law would require such a result only in bankruptcy). The First Circuit would apply the Rule only if state law applies it to subordination agreements universally or otherwise to the extent that the

parties manifest an intention to apply the Rule. Under either holding, if parties are explicit in their contracts and indentures as to their intent that subordination agreements should govern accrued interest, then the bankruptcy courts will honor that intent.<sup>164</sup>

### 3. Allowability of Postpetition Interest Among Creditors of Affiliated Debtors

As stated earlier, the general rule in bankruptcy is that unsecured creditors are not entitled to receive postpetition interest on their claims.<sup>165</sup> This is one of the oldest bankruptcy rules in existence, finding its roots in English common law. As long ago as 1911, Justice Holmes observed that the rule had existed for “more than a century and a half” under the English bankruptcy system and that “[n]o one doubts that interest on unsecured debts stops” as of the bankruptcy petition date.<sup>166</sup> The rule is grounded in equity, intended to avoid unfairness between competing creditors. Bankruptcy causes delay, and it would be inequitable for one creditor (who may have a claim that bears a lower interest rate or no interest at all) to bear the cost of that delay to the benefit of another (who may have a claim with a higher interest rate).<sup>167</sup>

There is an exception to this rule. If a debtor is solvent, unsecured creditors are entitled to receive postpetition interest before the debtor receives any surplus.<sup>168</sup> Like the rule itself, the exception is grounded in equitable principles:

So why does the Bankruptcy Code award post-petition interest to creditors who are otherwise expressly prohibited from charging interest to the debtor as part of their allowed claims? The answer is elegantly simple: it would be unfair to give any excess funds in a bankruptcy case back to the debtor whose filing caused creditors to suffer delay in the satisfaction of their claims without first compensating those creditors for that delay. The equitable distribution... is designed to prevent debtors from receiving an unfair windfall, at the expense of their creditors.<sup>169</sup>

In the age of multientity corporate conglomerates, with different affiliated entities issuing their own debt, this exception to the rule against postpetition interest begs an interesting question—does the exception apply in a case in which affiliated debtors, some solvent and some insolvent, are jointly administered in a single bankruptcy proceeding? The recent *Adelphia Communications* bankruptcy cases provide an interesting example of the difficulties that may arise in such circumstances. The *Adelphia* cases involved multiple debtors who filed one proposed plan of reorganization.<sup>170</sup> Some of the debtors were assumed to be solvent and some to be insolvent. The plan proposed to pay postpetition interest to unsecured creditors of the solvent debtors and proposed to pay less than full distributions to unsecured creditors of the insolvent debtors. Unsecured creditors of the insolvent debtors objected to confirmation, arguing that the rule allowing postpetition interest applies only if outside equity holders of the debtor will receive a distribution (which was assumed not to be the case in *Adelphia*). The objecting creditors argued that it would be unfair to force the creditors of the insolvent debtors to bear the costs of delay of the proceedings, essentially paying for that delay through postpetition interest on the claims of creditors of the solvent

debtors, given that all creditors were delayed the same period of time and were forced to litigate the same issues.

The *Adelphia* court held that it was appropriate to pay postpetition interest to creditors of the solvent debtors even though creditors of their insolvent affiliates were not to receive a return of principal. It reasoned that the “fair and equitable” standard of section 1129(b) of the Code required that creditors of the solvent entities be paid postpetition interest at the rates specified in their contracts, essentially burdening creditors of the insolvent debtors with the costs of delay of the jointly administered proceedings.<sup>171</sup>

#### 4. The Infamous “X Clause”

As part of a plan of reorganization, it is common for a debtor to distribute securities issued by the reorganized debtor in satisfaction of prepetition claims and interests. Where intercreditor subordination agreements require junior creditors to turn over all distributions to the senior creditors until the senior creditors are paid in full, junior creditors must deliver those securities received under a plan to the senior creditors. In recognition that this could result in a windfall for the senior creditors (where the total distributions, over time, would result in payment of more than the total amount due in respect of the senior debt), subordination agreements often contain an exception to the general rule through what has become known as the “X Clause.”

An X Clause provides that, in the event of distribution in a bankruptcy proceeding, a junior creditor may receive a distribution of securities so long as any and all distributions and dividends on those securities remain subordinated to payment in full of senior creditors.<sup>172</sup> Thus, for example, an X Clause enables junior creditors to receive or retain shares of stock that will have value in the event that senior debtholders are paid in full according to the enforcement of the subordination provisions, provided that the new stock or securities issued pursuant to the X Clause are subordinated to the same extent as the prior subordinated debt. This benefits debtors because it avoids cumbersome, administratively difficult plan provisions that would require senior creditors, upon payment in full of the senior debt, to turn over excess payments or consideration to the junior class of creditors.<sup>173</sup> “This approach assures that the junior creditor remains fully subordinated without requiring it to yield assets that are not required for full payment of the senior creditor and that would therefore make a round-trip to the senior creditor and back, with the attendant delay, friction and transaction cost.”<sup>174</sup> The Seventh Circuit has noted that, “[t]he X Clause shortcuts this cumbersome procedure and enhances the marketability of the securities received by the junior creditors, since their right to possess (as distinct from pocket the proceeds of) the securities is uninterrupted.”<sup>175</sup>

However, in practice, junior creditors often try to exploit the presence of an X Clause by initiating litigation as a way to leverage distributions to which they otherwise would not be entitled. For example, in *Envirodyne*, the debtor’s plan proposed to pay different classes of bondholders, one subordinated to the other, with the same class of common stock. Logically, the stock distributed to creditors should be valued at the time of plan confirmation, and all stock received by the junior creditors up to the value necessary to pay the senior debt in full should be turned over the senior creditors. The junior creditors, however, argued that they were entitled to keep the shares of stock

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on the ground that the X Clause permitted the distribution of equity “pooled with the senior creditors.”<sup>176</sup> The bankruptcy and appellate courts rejected that position.

Similarly, in *Metromedia Fiber Network*, the junior creditors argued that they were entitled to keep warrants to purchase stock in the reorganized debtor, on the theory that warrants were subordinate to the common stock distributed to senior creditors. Again, after litigation, the courts rejected that argument: “If appellants can keep their warrants, they would be able to buy the same class of common stock allocated to the Senior Indebtedness, giving appellants and the Senior Indebtedness equal priority to any future distribution. Therefore, allowing appellants to retain the warrants would effect an impairment of seniority.”<sup>177</sup>

These decisions would seem to make it clear that courts will not use an X Clause to enable junior creditors to avoid the subordination bargain struck with their senior counterparts, but holders of senior debt nevertheless should be alert to the presence of an X Clause in their documentation and should be wary of efforts by junior creditors to exploit such a provision in an effort to keep distributions before the senior debt is paid in full.

### 5. Absolute Priority, “Gifting,” and Reverse Cramdown

The “absolute priority” rule is a bedrock bankruptcy concept. In its most basic sense, the rule requires that senior creditors be paid before junior creditors, who in turn must be paid before equity holders.<sup>178</sup> “The reason for such a limitation was the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor’s owners.”<sup>179</sup> The rule is codified in section 1129(b) of the Bankruptcy Code, which provides in relevant part that, unless all impaired classes accept a proposed plan, either the senior classes are paid in full or “the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.”<sup>180</sup>

Notwithstanding the “absolute” nature of the rule, senior creditors occasionally desire to enhance the distributions payable in respect of junior debt in order to encourage the junior creditors to accept a proposed plan, perhaps to avoid lengthy and costly litigation over valuation or the validity, priority, or enforceability of the senior debt. When the junior creditor or interest holder favored with such a gift is next in priority, no problems arise. However, when the gift causes a payment to “skip” a priority level—and hence to disregard the absolute priority rule—litigation and controversy ensue.

The early leading case on this issue is *SPM Manufacturing*.<sup>181</sup> In *SPM*, the First Circuit held that a secured creditor could “gift” some of its distributions to unsecured creditors—who otherwise would have received no distribution—even though priority tax debts went unpaid.<sup>182</sup> The circuit reasoned that all the funds in the bankruptcy estate belonged to the secured creditor “in satisfaction of its lien, leaving nothing for the estate to distribute to other creditors, including the I.R.S... Any sharing between [the secured creditor] and the general, unsecured creditors was to occur after distribution of the estate property, having no effect whatever on the bankruptcy distributions

to other creditors.”<sup>183</sup> Other courts have cited *SPM* in confirming Chapter 11 plans of reorganization that contained similar gifting provisions.<sup>184</sup>

However, in *Armstrong World Industries*, the Third Circuit rejected the extension of *SPM* for the broad use of “gifting” to evade the absolute priority rule. In *Armstrong*, the debtor’s proposed plan would have distributed some of the senior creditors’ share of warrants to existing shareholders, bypassing an impaired class of creditors. The “gifting” was to be done by class vote and thus a deemed waiver of some of their plan distributions.<sup>185</sup> The Third Circuit held that this was impermissible and distinguished *SPM* in two important ways: (1) it held that *SPM* involved a distribution in a Chapter 7 liquidation rather than in a Chapter 11 reorganization, in which the absolute priority rule comes into play; and (2) the senior creditor in *SPM* was a secured creditor who held a perfected security interest which precluded any distribution to other creditors, meaning that the distribution in *SPM* was a “carve out” whereby the secured creditor allowed a portion of its lien proceeds to be paid to others.<sup>186</sup> The Third Circuit held that the absolute priority rule governs in Chapter 11 and that *SPM* and its progeny “do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B).”<sup>187</sup>

No other court of appeals has followed the *Armstrong* decision, and this is certain to be a controversial and litigated issue in future plans. Proponents of “gifting” or “reverse cramdown” plans will argue that the distribution scheme of section 507 of the Bankruptcy Code and the absolute priority rule of section 1129 do not even come into play until all valid liens are satisfied, secured creditors are paid in full, and there are excess proceeds available to the bankruptcy estate. Proponents may contend that, since the Bankruptcy Code does not govern the rights of creditors to transfer or receive property that is not property of the estate, if funds or property are distributed from the collateral of a senior secured creditor, they can do with their proceeds what they want.<sup>188</sup> On the other hand, opponents will argue that all creditors—even secured or senior creditors—have to play by the rules of the game when receiving distributions in a Chapter 11 case. Those rules arguably include the Bankruptcy Code’s detailed priority scheme.

In *Armstrong*’s wake, however, it will be harder for senior creditors, particularly unsecured creditor classes, to make gifts to junior classes in an effort to win support for a Chapter 11 plan, a result likely to engender more litigation and less compromise in the often-heated contests over the fate of a debtor’s reorganization.

#### IV. CONCLUSION

In this article, we have considered the various ways in which corporate bondholders may participate in a bankruptcy case involving the issuer of their bonds as well as the risks and rewards associated with differing levels of participation. We also have discussed ways in which a bondholder may be ensnared in a bankruptcy proceeding—through injunctions against trading and potential application of bankruptcy-related defenses arising from the conduct of the entity from whom a bondholder bought its

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bonds – even if the holder has no desire to participate in the proceedings. Armed with this knowledge, bondholders can make informed decisions about the securities that they buy and the way in which they choose to influence the bankruptcy case, if at all.

We also have surveyed a number of issues that can impact what bondholders receive as distributions on their bonds. While those issues usually are complex and often highly fact-intensive, our survey should help bondholders “issue spot”—both before buying into a particular issuance and when considering whether to sell. As with the financial and economic information about the issuer itself, this knowledge of the unique legal risks and opportunities that may arise in the context of the issuer’s insolvency should help bondholders make informed decisions regarding their investments.

### Research References:

Bankr. Serv., L Ed §§ 42:447, 42:450, 45:480; Norton Bankr. L. & Prac. 3d §§ 49:15, 100:2, 103:1, 112:37, 163:74; Norton Bankr. L. & Prac. 3d 11 U.S.C. § 1109

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### NOTES

1. See Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors’ Committees*, 43 UCLA L. Rev. 1547 (June 1996); C.R. Bowles, Jr. & Nancy B. Rapoport, *Bankruptcy Ethics: Has the DIP’s Attorney Become the Ultimate Creditors’ Lawyer in Bankruptcy Reorganization Cases?*, 5 Am. Bankr. L. Rev. 47, 59 (Spring 1997) (“Although civil litigation has been (accurately) described as ‘warfare without guns and bombs,’ bankruptcy—with its lengthy negotiations, ever-shifting alliances among various parties, and numerous administrative requirements—can best be described as diplomacy without embassies or spies”).

2. Depending on their repayment term, whether or not secured by collateral, and other characteristics, long-term corporate debt securities can be called “bonds,” “notes,” or “debentures.” For ease of reference, we refer to all such debt instruments simply as “bonds.”

3. Altman High Yield Bond Default and Return Report, February 6, 2008, NYU Salomon Center, Leonard N. Stern School of Business (the Altman Report), at 5.

4. Altman Report, at 6.

5. Altman Report, at 6.

6. Altman Report, Exhibit C.

7. For example, the Revised Model Simplified Indenture prepared by the American Bar Association (the Model Indenture) provides that, except during the continuance of an event of default, “[t]he Trustee need perform only those duties that are specifically set forth in this Indenture.” Model Indenture § 7.01(b), reprinted in 55 Bus. Law. 1115 (2000). The ABA’s commentaries to the Model Indenture describe an indenture trustee’s predefault duties as “very limited.”

8. In re E.F. Hutton Southwest Properties II, Ltd., 953 F.2d 963, Bankr. L. Rep. (CCH) P 74524, Fed. Sec. L. Rep. (CCH) P 96961 (5th Cir. 1992); *Peak Partners, LP v. Republic Bank*, 191 Fed. Appx. 118 (3d Cir. 2006).

9. *Philip v. Rothschild*, 2000 WL 1263554 (S.D. N.Y. 2000); *Peak Partners*, 191 Fed. Appx. 118. This “prudent person” is codified in the Trust Indenture Act and is expressly reflected in the Model Indenture. 15 U.S.C.A. § 7700o(c); Model Indenture § 7.01(a) (“If an Event of Default has occurred and is continuing, the Trustee shall exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of its own affairs”).

10. In re Flight Transp. Corp. Securities Litigation, 874 F.2d 576, 581, 19 Bankr. Ct. Dec. (CRR) 584, Bankr. L. Rep. (CCH) P 72878 (8th Cir. 1989); In re American Business Financial Services, Inc., 362 B.R. 135 (Bankr. D. Del. 2007).

11. 11 U.S.C.A. § 1109(b).

12. Rule 3003(c)(3) of the Federal Rules of Bankruptcy Procedure provides for the bankruptcy court to fix a date by which proofs of claim or interest may be filed in a Chapter 11 case. The Bankruptcy Rules and most indentures specifically authorize the indenture trustee to file a proof of claim. See Fed. R. Bankr. P. 3003(c)(1); Model Indenture § 6.10 (authorizing trustee to “file a claim for the unpaid balance of the Securities”). Note, however, that indenture trustees are generally not authorized to file claims that are personal to individual bondholders, such as claims for fraud or securities law violations in connection with the purchase or sale of the bonds. See Model Indenture cmt. to § 6.03 (citing *Central Bank of Denver, N.A. v. Deloitte & Touche*, 928 P.2d 754, 758 (Colo. Ct. App. 1996)); *Nationsbank, N.A. v. McGraw-Hill Co.*, 94-0882, 1996 U.S. Dist. LEXIS 22414 (S.D. Tex. 1996). Further, bondholders should not rely on an indenture trustee to assert bond-related claims for amounts other than principal and interest due on the bonds, such as claims for breach of a no-call provision, for other damages for breach of the indenture, or for theories of recovery not readily apparent from the terms of the indenture itself. See, *infra*, at Part III(B), for an example of some of such claims.

13. The Bankruptcy Rules require that all creditors be given notice of a small set of case-defining events, such as the filing of a proposed disclosure statement and the hearing on confirmation of a proposed plan of reorganization. See Fed. R. Bankr. P. 2002(b). However, for other important matters (such as the sale of estate property and proposed settlements), the bankruptcy court can and usually does order that notice be limited to the major players in the proceedings (such as the debtor, the official committee of creditors, and the debtor’s secured lenders). See Fed. R. Bankr. P. 2002(a). Bondholders and other parties in interest can demand notice of such other matters by filing a request pursuant to Bankruptcy Rule 2002(i).

14. See Fed. R. Bankr. P. 3017(e); Model Indenture § 6.10 (prohibiting indenture trustee from voting on or accepting a plan).

15. See Model Indenture § 6.05:

The Holders of a majority in Principal amount of the Securities may direct the time, method and place of conducting any proceeding for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee. However, the Trustee may refuse to follow any direction that conflicts with law or this Indenture, is unduly prejudicial to the rights of other Securityholders, or would involve the Trustee in personal liability or expense for which the Trustee has not received a satisfactory indemnity.

Also see § 7.01(c)(4) (“[t]he Trustee may refuse to perform any duty or exercise any right or power which would require it to expend its own funds or risk any liability if it shall reasonably believe that repayment of such funds or adequate indemnity against such risk is not reasonably assured to it”).

16. 11 U.S.C.A. § 1102(a)(1). The U.S. Trustee may appoint additional committees of creditors, or of equity holders, as it “deems appropriate.” 11 U.S.C.A. § 1102(a)(1). Further, parties in interest may request that the bankruptcy court appoint additional committees “if necessary to assure adequate representation of creditors or of equity security holders.” 11 U.S.C.A. § 1102(a)(2).

17. In re Enron Corp., 279 B.R. 671, 48 Collier Bankr. Cas. 2d (MB) 564 (Bankr. S.D. N.Y. 2002); In re Hydro-Action, Inc., 341 B.R. 186, 46 Bankr. Ct. Dec. (CRR) 96 (Bankr. E.D. Tex. 2006) (describing the committee members as “watchmen on the tower”); In re Garden Ridge Corp., 321 B.R. 669, 53 Collier Bankr. Cas. 2d (MB) 1236, Bankr. L. Rep. (CCH) P 80245 (Bankr. D. Del. 2005).

18. 11 U.S.C.A. § 1103(a); In re Buran, 363 BR 358 (Bankr. S.D.N.Y. 2007); In re Dragone, 324 BR 445 (Bankr. D. Conn. 2005).

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19. 11 U.S.C.A. § 1103(c).
20. 11 U.S.C.A. § 1103(c).
21. 11 U.S.C.A. § 1103(c); *In re Refco Inc.*, 336 B.R. 187, 195, 45 Bankr. Ct. Dec. (CRR) 250, 56 Collier Bankr. Cas. 2d (MB) 100 (Bankr. S.D. N.Y. 2006) (describing committees as the “primary negotiating bodies for a chapter 11 plan”).
22. 11 U.S.C.A. § 1103(c).
23. *In re Hydro-Action, Inc.*, 341 B.R. 186, 46 Bankr. Ct. Dec. (CRR) 96 (Bankr. E.D. Tex. 2006); *In re LTV Steel Co., Inc.*, 333 B.R. 397 (Bankr. N.D. Ohio 2005).
24. 11 U.S.C.A. § 1109(b); see also *Refco*, 336 BR at 195 n.7 (“an official committee may consider and challenge virtually everything important that a debtor undertakes”).
25. 11 U.S.C.A. § 1103(c).
26. *In re Kings River Resorts, Inc.*, 2007 WL 2505566 (Bankr. E.D. Cal. 2007).
27. *In re Worldwide Direct, Inc.*, 259 B.R. 56, 60, 37 Bankr. Ct. Dec. (CRR) 114 (Bankr. D. Del. 2001) (citing *First Merchants Acceptance Corp. v. J.C. Bradford & Co.*, 198 F.3d 394, 399, 35 Bankr. Ct. Dec. (CRR) 96, 43 Collier Bankr. Cas. 2d (MB) 442, Bankr. L. Rep. (CCH) P 78072 (3d Cir. 1999)).
28. *In re Guy F. Atkinson Co. of California*, 242 B.R. 497, 502, 35 Bankr. Ct. Dec. (CRR) 107 (B.A.P. 9th Cir. 1999).
29. *In re SPM Mfg. Corp.*, 984 F.2d 1305, 1315, 23 Bankr. Ct. Dec. (CRR) 1529, 28 Collier Bankr. Cas. 2d (MB) 451, Bankr. L. Rep. (CCH) P 75090 (1st Cir. 1993).
30. 11 U.S.C.A. § 1102(b)(1). The Bankruptcy Code also gives the U.S. Trustee the discretion to appoint “the members of a committee organized by creditors before the commencement of the case... if such committee was fairly chosen and is representative of the different kinds of claims to be represented.” 11 U.S.C.A. § 1102(b)(1); see *Fed. R. Bankr. P. 2007* (providing for review of the membership of a prepetition committee).
31. *In re Venturelink Holdings, Inc.*, 299 B.R. 420, 41 Bankr. Ct. Dec. (CRR) 266, 50 Collier Bankr. Cas. 2d (MB) 1592 (Bankr. N.D. Tex. 2003).
32. *In re Richmond Tank Car Co.*, 93 B.R. 504 (Bankr. S.D. Tex. 1988).
33. *In re Laclede Cab Co.*, 145 B.R. 308, 23 Bankr. Ct. Dec. (CRR) 795 (Bankr. E.D. Mo. 1992).
34. *In re Nyack Autopartstores Holding Co., Inc.*, 98 B.R. 659 (Bankr. S.D. N.Y. 1989).
35. *Matter of Columbia Gas System, Inc.*, 224 B.R. 540, 554 (Bankr. D. Del. 1998), *aff’d*, 2000 WL 1456298 (D. Del. 2000).
36. *In re Pierce*, 237 B.R. 748, 34 Bankr. Ct. Dec. (CRR) 654, 42 Collier Bankr. Cas. 2d (MB) 411 (Bankr. E.D. Cal. 1999).
37. *In re Dow Corning Corp.*, 194 B.R. 121, 28 Bankr. Ct. Dec. (CRR) 1002 (Bankr. E.D. Mich. 1996), *order rev’d*, 212 B.R. 258 (E.D. Mich. 1997); *Garden Ridge*, 321 B.R. 669.
38. See, e.g., *Objection of the Acting United States Trustee to the Emergency Motion of the Ad Hoc Bondholder Committee to Expand Official Committee of Unsecured Creditors to Include Bondholder Representatives or, in the alternative, Appoint a Separate Committee of Bondholders Pursuant to Bankruptcy Code Section 1102(a)(2), In re NII Holdings*, 02-11505 at \*6 (Bankr. D. Del. June 17, 2002):

The Bondholder Committee’s members, acting in their own self-interest, have committed their support to the Debtors’ reorganization proposal. Under these circumstances, the Bondholder Committee cannot have undivided loyalty to the [Official Committee’s] constituency. Such commitment places the Bondholder Committee in a conflicted position, one which violates the ancient fiduciary precept against servicing two masters. (quotations omitted).

39. Lockup agreements can also impact a party's right to vote for a Chapter 11 plan of reorganization. See Kurt A. Mayr, *Unlocking the Lockup: The Revival of Plan Support Agreements Under New § 1125(g) of the Bankruptcy Code*, 15 J. Bankr. L. & Prac. 6 Art. 1 (December 2006); Josef S. Athanas & Caroline A. Reckler, *Lock-Up Agreements—Valuable Tool or Violation of the Bankruptcy Code?*, 15 J. Bankr. L. & Prac. 4 Art. 4 (August 2006).

40. The U.S. Trustee Manual provides:

If beneficial owners of significant amounts of the outstanding debt can be identified, the participation of the indenture trustee as a voting member of the creditors' committee may not be necessary... On the other hand, the appointment of an indenture trustee as a voting member... may be the only way to assure adequate representation of the public debt holders where large institutional investors cannot be identified or do not exist. Accordingly, the policy with respect to the appointment of indenture trustees to unsecured creditors' committees as members cannot be expressed as a per se rule, but rather must depend on the circumstances of the case and the need to include or exclude indenture trustees in order to assure adequate representation.

United States Trustee Manual § 3-4.4.1.9 (October 1998).

41. *In re Fas Mart Convenience Stores, Inc.*, 265 B.R. 427 (Bankr. E.D. Va. 2001) (creditor removed from committee where it asserted that certain funds were not property of the estate and pursued lengthy litigation to delay administration of the case); *In re America West Airlines*, 142 B.R. 901, 22 Bankr. Ct. Dec. (CRR) 1493 (Bankr. D. Ariz. 1992) (no committee service for creditor whose interests were "diametrically opposed" to the interests of represented creditors).

42. Compare *In re Wheeler Technology, Inc.*, 139 B.R. 235, Bankr. L. Rep. (CCH) P 74583 (B.A.P. 9th Cir. 1992); *In re Dow Corning Corp.*, 212 B.R. 258 (E.D. Mich. 1997) (holding that courts lack discretion to change a committee's composition); with *Fas Convenience Stores*, 265 B.R. 427; *In re Barney's, Inc.*, 197 B.R. 431, 36 Collier Bankr. Cas. 2d (MB) 368, Bankr. L. Rep. (CCH) P 77021 (Bankr. S.D. N.Y. 1996).

43. 11 U.S.C.A. § 1102(a)(4).

44. *In re Dow Corning Corp.*, 194 B.R. 121, 141, 28 Bankr. Ct. Dec. (CRR) 1002 (Bankr. E.D. Mich. 1996), order rev'd, 212 B.R. 258 (E.D. Mich. 1997).

45. *In re Doehler-Jarvis Inc.*, 1997 WL 827396 (D. Del. 1997) ("the Court does not have the statutory authority to order the Trustee to appoint a particular entity to an official committee of unsecured creditors") (citing *Matter of Gates Engineering Co., Inc.*, 104 B.R. 653, 654 (Bankr. D. Del. 1989)).

46. 11 U.S.C.A. § 503(b)(3)(F).

47. *In re County of Orange*, 179 B.R. 195, 202, 26 Bankr. Ct. Dec. (CRR) 1110, 36 Collier Bankr. Cas. 2d (MB) 1356 (Bankr. C.D. Cal. 1995). The "substantial contribution" standard of section 503(b)(3)(D) is discussed in Part II(C)(1), *infra*.

48. *Refco*, 336 B.R. at 196.

49. See Securities and Exchange Commission's Annual Report for 1995 at \*146; 17 C.F.R. 243.100 (2007).

50. *Matter of Federated Dept. Stores, Inc.*, 1991 WL 79143 (Bankr. S.D. Ohio 1991).

51. *Federated Dept. Stores*, 1991 WL 79143.

52. See *Cheng v. GAF Corp.*, 631 F.2d 1052, 23 Fair Empl. Prac. Cas. (BNA) 1576, 24 Empl. Prac. Dec. (CCH) P 31316 (2d Cir. 1980), judgment vacated, 450 U.S. 903, 101 S. Ct. 1338, 67 L. Ed. 2d 327, 24 Fair Empl. Prac. Cas. (BNA) 1827, 25 Empl. Prac. Dec. (CCH) P 31523 (1981) (holding that a "Chinese wall" employed by a law firm to preclude ethical concerns was insufficient where the size of the firm's office was too small to preclude an attorney's familiarity with a case).

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53. See, e.g., *In re PWS Holding Corp.*, 228 F.3d 224, 246, 36 Bankr. Ct. Dec. (CRR) 955, 44 Collier Bankr. Cas. 2d (MB) 1647 (3d Cir. 2000); *Rothschild Holdings*, 163 B.R. at 49. The Bankruptcy Code also expressly provides a “safe harbor” for actions taken in good faith in connection with the solicitation of votes on, or the sale or issuance of, securities under a plan of reorganization. 11 U.S.C.A. § 1125(e).

54. *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438 (S.D. N.Y. 1994); *In re Tucker Freight Lines, Inc.*, 62 B.R. 213, 15 Collier Bankr. Cas. 2d (MB) 220, Bankr. L. Rep. (CCH) P 71235 (Bankr. W.D. Mich. 1986).

55. *In re Envirodyne Industries, Inc.*, 174 B.R. 955 (Bankr. N.D. Ill. 1994); *Pan Am*, 175 B.R. 438. The duty is owed only to the committee’s creditor constituents and not to the bankruptcy estate as a whole or to the debtor. *Pan Am*, 175 B.R. at 514. “The Creditors Committee owed a fiduciary duty only to the class of creditors it represents, not to the Debtor, Delta, or any other party in the bankruptcy case.”

56. *In re Nationwide Sports Distributors, Inc.*, 227 B.R. 455, 463 (Bankr. E.D. Pa. 1998).

57. See, e.g., *In re Rickel & Associates, Inc.*, 272 B.R. 74, 100 (Bankr. S.D. N.Y. 2002) (“Although Committee members owe fiduciary duties, they are hybrids who serve more than one master. Every member of the Committee is, by definition, a creditor. Thus, he is [in] competition with every other creditor for a piece of a shrinking pie”).

58. See, e.g. *In re Adelphia Communications Corp.*, 352 B.R. 578, 47 Bankr. Ct. Dec. (CRR) 39 (Bankr. S.D. N.Y. 2006), clarified on denial of reconsideration, 2006 WL 2927222 (Bankr. S.D. N.Y. 2006) (involving 231 debtors); *In re Calpine Corp.*, 05-60200 (Bankr. S.D.N.Y.) (257 debtors); *In re Enron Corp.*, 01-16034 (Bankr. S.D.N.Y.) (15 debtors with over 3,500 subsidiaries).

59. *In re Adelphia Communications Corp.*, 336 B.R. 610, 617, 45 Bankr. Ct. Dec. (CRR) 260 (Bankr. S.D. N.Y. 2006), judgment aff’d, 342 B.R. 122 (S.D. N.Y. 2006).

60. *In re Venturelink Holdings, Inc.*, 299 B.R. 420, 423, 41 Bankr. Ct. Dec. (CRR) 266, 50 Collier Bankr. Cas. 2d (MB) 1592 (Bankr. N.D. Tex. 2003) (finding that the U.S. Trustee acted arbitrarily and capriciously in refusing to remove a creditor from a committee, and ordering the creditor’s removal where the creditor was defending in state court against the debtor’s allegations that the creditor breached fiduciary duties owing to the debtor); *In re Barney’s, Inc.*, 197 B.R. 431, 442, 36 Collier Bankr. Cas. 2d (MB) 368, Bankr. L. Rep. (CCH) P 77021 (Bankr. S.D. N.Y. 1996); *Fas Mart Convenience Stores*, 265 B.R. at 432; *In re First Republic Bank Corp.*, 95 B.R. 58, 61 (Bankr. N.D. Tex. 1988) (“[a] conflict of interest that amounts to a breach of that fiduciary duty constitutes the type of conflict that would mandate removal of the creditor from the committee”).

61. See *In re FiberMark, Inc.*, 330 B.R. 480, 45 Bankr. Ct. Dec. (CRR) 61 (Bankr. D. Vt. 2005); *In re Toy King Distributors, Inc.*, 256 B.R. 1, 175 n.187, 43 U.C.C. Rep. Serv. 2d 23 (Bankr. M.D. Fla. 2000) (“[t]he usual remedy for the improper purchase of claims at a discount by a fiduciary is to subordinate or disallow the fiduciary’s claim to the extent its face amount exceeds the amount paid”); see also *In re S.M. Acquisitions Co.*, 332 B.R. 346, 351, 45 Bankr. Ct. Dec. (CRR) 185 (Bankr. N.D. Ill. 2005), aff’d in part, rev’d in part and remanded, 46 Bankr. Ct. Dec. (CRR) 279, 2006 WL 2290990 (N.D. Ill. 2006) (discussing the standard for equitable subordination relating to insiders).

62. See *In re Rickel & Associates, Inc.*, 272 B.R. 74 (Bankr. S.D. N.Y. 2002) (denying a motion to dismiss a damages claim alleging that a committee member breached his duty of loyalty).

63. Evan D. Flaschen and Kurt A. Mayr, *Bankruptcy Rule 2019 and the Unwarranted Attack on Hedge Funds*, 26-7 *ABI Journal* 16 (September 2007). As explained below, the term “committee” has generated some controversy as a result of the ruling in *Northwest Airlines* that “ad hoc committees” unwittingly may assume duties to creditors who have not agreed to become members of the coalition. We use the term “ad hoc committee” in the loosest sense to mean only a coalition of interested parties who band together to defray professional fees and increase their influence in the bankruptcy proceedings.

64. Evan D. Flaschen & Kurt A. Mayr, *Ad Hoc Committees and the Misuse of Bankruptcy Rule 2019*, 16 *Norton J. Bankr. L. & Prac.* 986 (December 2007).

65. *In re Northwest Airlines Corp.*, 363 B.R. 701, 703, 47 *Bankr. Ct. Dec. (CRR)* 248 (*Bankr. S.D. N.Y.* 2007).

66. A class of claims accepts a plan only if creditors holding at least two thirds in amount and more than one-half in number of the claims voted in a particular class vote to accept the plan. 11 U.S.C.A. § 1126(c). Because the proponent of a plan may seek confirmation over the rejection by a class of creditors (known as a “cramdown”), see 11 U.S.C.A. § 1129(b), a blocking position in a particular class does not necessarily amount to a veto right over the plan. Nevertheless, because a “cramdown” is difficult, and sometimes impossible, to achieve, a blocking position affords an ad hoc committee substantial leverage in the plan process.

67. The flip side of this freedom is that, without access to confidential information, the members of an ad hoc committee may be unable to participate in a dialogue regarding the restructuring, in confidential settlement negotiations, or in other critical aspects of the bankruptcy case. Although ad hoc committees may confront this issue by having their professionals screen and receive confidential information, and instructing the professionals not to disclose the confidential information to the committee members themselves, this measure only goes so far. When the time for a decision arrives (whether it be a decision to support a plan, to settle litigation, or otherwise), the committee members will want and need full information—including confidential information—to make an informed decision. Often, ad hoc committees will negotiate for a short “restricted period,” in which committee members receive confidential information and are prohibited from trading, followed by a “cleansing,” in which the debtor or other parties makes a public disclosure of the formerly confidential information and thereby free up the members to begin trading again.

68. See *Northwest Airlines*, 363 B.R. at 702. This can create a delicate situation for the ad hoc committee’s professionals, as many hedge funds and investors are reluctant to disclose to their fellow committee members—who usually are competitors—the amount of their holdings. Professionals typically confront this dilemma by keeping each committee member’s holdings confidential from the other members and by sending out individual invoices that list only a particular member’s share of the aggregate fees and expenses.

69. 11 U.S.C.A. § 503(b)(3)(D) and (b)(4). Note that the statutory text provides reimbursement for fees of “an attorney or an accountant.” There is disagreement in the case law about whether a qualifying creditor can receive reimbursement for the fees of other professionals (such as financial consultants, investment bankers, and expert witnesses). Compare *In re Granite Partners*, 213 B.R. 440, 454, 31 *Bankr. Ct. Dec. (CRR)* 699 (*Bankr. S.D. N.Y.* 1997) (“[f]inancial advisors... cannot be compensated on a substantial contribution basis”); *Matter of Columbia Gas System, Inc.*, 224 B.R. 540 (*Bankr. D. Del.* 1998), *aff’d*, 2000 WL 1456298 (*D. Del.* 2000), with *In re Northwest Airlines Corp.*, No. 05-17930 (*Bankr. S.D.N.Y.* May 17, 2007).

70. *Matter of DP Partners Ltd. Partnership*, 106 F.3d 667, 30 *Bankr. Ct. Dec. (CRR)* 624, 37 *Collier Bankr. Cas.* 2d (MB) 809, *Bankr. L. Rep. (CCH)* P 77294 (5th Cir. 1997); *Lebron v. Mechem Financial Inc.*, 27 F.3d 937, 25 *Bankr. Ct. Dec. (CRR)* 1341, *Bankr. L. Rep. (CCH)* P 75983 (3d Cir. 1994) (rejected by, *In re Celotex Corp.*, 227 F.3d 1336, 36 *Bankr. Ct. Dec. (CRR)* 213, 44 *Collier Bankr. Cas.* 2d (MB) 1406, *Bankr. L. Rep. (CCH)* P 78276 (11th Cir. 2000)); *In re American Plumbing & Mechanical, Inc.*, 327 B.R. 273 (*Bankr. W.D. Tex.* 2005).

71. *Lebron*, 27 F.3d 937; *Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1253, 14 *Bankr. Ct. Dec. (CRR)* 401, *Bankr. L. Rep. (CCH)* P 71061 (5th Cir. 1986); *In re Flight Transp. Corp. Securities Litigation*, 874 F.2d 576, 19 *Bankr. Ct. Dec. (CRR)* 584, *Bankr. L. Rep. (CCH)* P 72878 (8th Cir. 1989).

72. *DP Partners*, 106 F.3d at 672-73.

73. *Lebron*, 27 F.3d at 944 (“[s]ubstantial contribution should be applied in a manner that excludes reimbursement in connection with activities of creditors and other interested parties which are designed primarily to serve their own interests and which, accordingly, would have

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been undertaken absent an expectation of reimbursement from the estate”); *Lister*, 846 F.2d at 57; *In re Big Rivers Elec. Corp.*, 233 B.R. 739, 748 (W.D. Ky. 1998).

74. *In re Mirant Corp.*, 354 B.R. 113, 135 (Bankr. N.D. Tex. 2006).

75. *Adelphia*, 368 B.R. at 270 (“At this juncture, I’m unaware of any basis for awarding the requested fees except to the extent that applications are filed for them and they pass muster under sections 503(b)(3) and (b)(4), but I’m willing to keep an open mind”).

76. For example, a lawyer representing an ad hoc committee (which in reality is nothing more than a coalition of parties who have engaged the same professionals) has an attorney-client relationship with each of the committee’s members. Absent an informed waiver by all of the affected parties, when conflicts arise among the members the lawyer may be unable to continue its representation of the committee or any of its members. Stephen F. Chiccarelli & Michael A. Crawford, *Court Disqualifies Counsel for Cajun Electric’s Members’ Committee*, 16-6 Am. Bankr. Inst. J. 32 (July 1997) (discussing *In re Cajun Electric Power Cooperative Inc.*, 94-11474 (Bankr. M.D. La. Jan. 10, 1997)).

77. Compare *Hackettstown Nat. Bank v. D.G. Yuengling Brewing Co.*, 74 F. 110 (C.C.A. 2d Cir. 1896) (holding that a majority bondholder has a duty to minority bondholders) with *Aladdin Hotel Co. v. Bloom*, 200 F.2d 627 (8th Cir. 1953) (“The rights of the bondholders, however, are to be determined by their contract and courts will not make or remake a contract merely because one of the parties thereto may become dissatisfied with its provisions, but if legal will interpret and enforce it”).

78. Fed. R. Bankr. P. 2019(a) (emphasis added)

79. *Flaschen and Mayr*, 16 Norton J. Bankr. L. & Prac. at 986.

80. *Northwest Airlines*, 363 B.R. 701.

81. *Northwest Airlines*, 363 B.R. at 703.

The Rule cannot be so blithely avoided. KBT&F’s clients [the committee members] appeared in these Chapter 11 cases as a ‘Committee.’ Their notice of appearance was as a committee, and it is the ‘Ad Hoc Committee’ that has moved for the appointment of an official shareholders’ committee and has been actively litigating discovery issues in numerous hearings and conferences before the Court. Counsel was retained by the ‘Committee’ and is compensated by the ‘Committee’ on the basis of work performed for the Committee (and not each individual member). The law firm does not purport to represent the separate interests of any Committee member; it takes its instructions from the Committee as a whole and represents one entity for purposes of the Rule.

82. *Northwest Airlines*, 363 B.R. at 704 (refusing to seal the required disclosures).

83. See Eric B. Fisher and Andrew L. Buck, *Hedge Funds and the Changing Face of Corporate Bankruptcy Practice*, 24-10 Am. Bankr. Inst. J. 24 (January 2007) (“[disclosure] is anathema to hedge funds, as the disclosure of detailed trading histories could reveal the proprietary and highly confidential methodologies of their investment strategies”); but see *Northwest Airlines*, 363 B.R. at 707 (deeming it “improbable” that Rule 2019 disclosure would reveal investment strategies).

84. Fed. R. Bankr. P. 2019.

85. *Fisher and Buck*, 24-10 Am. Bankr. Inst. J. 24.

86. *Order Denying Scotia Pacific Company LLC’s Motion for an Order Compelling the Ad Hoc Noteholder Group to Fully Comply with Bankruptcy Rule 2019(A) by Filing a Complete and Proper Verified Statement Disclosing its Membership and their Interests*, *In re Scotia Development, LLC*, 07-20027 (Bankr. S.D. Tex. April 18, 2007).

87. *Flaschen and Mayr*, 26-7 Am. Bankr. Inst. J. 16.

88. *Northwest Airlines*, 363 B.R. at 709.

89. Jean Morris, Imposition of Transfer Limitations on Claims and Equity Interests During Corporate Debtor's Chapter 11 Case to Preserve the Debtor's Net Operating Loss Carryforward: Examining the Emerging Trend, 77 Am. Bankr. L. J. 285, 286 (Summer 2003).

90. See Geoffrey Groshong, Trading Claims in Bankruptcy: Debtor Issues, 10 Am. Bankr. Inst. L. Rev. 625, 625 (Winter, 2002) (citing First Merchants Acceptance Corp., 1998 Bankr. LEXIS 1816 (Bankr. D. Del. Jan. 20, 1998); In re Service Merchandise Co., 2000 Bankr. LEXIS 1523 at \*1 (M.D. Tenn. Dec. 20, 2000)).

91. In re Phar-Mor, Inc., 152 B.R. 924, 24 Bankr. Ct. Dec. (CRR) 160 (Bankr. N.D. Ohio 1993).

92. See Collier on Bankruptcy ¶ 3001.08 (15th ed. 2007) (discussing the intent of amendments to Bankruptcy Rule 3001 to restrict judicial oversight of claims trading).

93. Morris, 77 Am. Bankr. L. J. at 296.

94. Concepts such as the "NOL order" tend to be like bankruptcy viruses. Once successfully adopted in a particular case, the bankruptcy bar rushes to implement them in all other cases.

95. 11 U.S.C.A. § 502(d).

96. 11 U.S.C.A. § 510(c). The widely adopted *Mobile Steel* test provides for equitable subordination where (1) the claimant engaged in inequitable conduct, (2) the misconduct resulted in injury to the creditors or conferred an unfair advantage on the claimant, and (3) equitable subordination of the claim is not inconsistent with the provisions of the Bankruptcy Code. Matter of Mobile Steel Co., 563 F.2d 692, 700, 15 C.B.C. 1 (5th Cir. 1977).

97. In re Enron Corp., 333 B.R. 205, 230 n.15, 45 Bankr. Ct. Dec. (CRR) 181 (Bankr. S.D. N.Y. 2005), leave to appeal granted, 2006 WL 2548592 (S.D. N.Y. 2006); In re Enron Corp., 340 B.R. 180, 201 n.23, 46 Bankr. Ct. Dec. (CRR) 71 (Bankr. S.D. N.Y. 2006), leave to appeal granted, 2006 WL 2548592 (S.D. N.Y. 2006) and vacated and remanded, 379 B.R. 425, 48 Bankr. Ct. Dec. (CRR) 213, Bankr. L. Rep. (CCH) P 81029 (S.D. N.Y. 2007), motion to certify appeal denied, 2007 WL 2780394 (S.D. N.Y. 2007).

98. In re Enron Corp., 379 B.R. 425, 428, 48 Bankr. Ct. Dec. (CRR) 213, Bankr. L. Rep. (CCH) P 81029 (S.D. N.Y. 2007), motion to certify appeal denied, 2007 WL 2780394 (S.D. N.Y. 2007).

99. Enron Corp., 379 B.R. at 439.

100. Enron Corp., 379 B.R. at 441.

101. Enron Corp., 379 B.R. at 434.

102. Enron Corp., 379 B.R. at 441, n. 87.

103. 11 U.S.C.A. § 502(d).

104. Enron Corp., 379 B.R. at 443.

105. Enron Corp., 379 B.R. at 446, n. 104.

106. Enron Corp., 379 B.R. at 442.

107. Enron Corp., 379 B.R. at 448.

108. Enron Corp., 379 B.R. at 448.

109. For a comprehensive analysis of these issues, see Scott K. Charles and Emil A. Kleinhaus, Prepayment Clauses in Bankruptcy, 15 Am. Bank. L.J. 537 (2007).

110. In re Calpine Corp., 365 B.R. 392, 397 (Bankr. S.D. N.Y. 2007); see also Adelphia Communications, 342 B.R. at 153 n. 31; Skyler Ridge, 80 B.R. at 503.

111. Calpine, 365 B.R. at 397 (quoting In re Ridgewood Apartments of DeKalb County, Ltd., 174 B.R. 712, 720 (Bankr. S.D. Ohio 1994)).

112. Calpine, 365 B.R. at 399.

113. Chester L. Fisher III, Make-Whole Prepayment Premiums Under Attack, 45 Bus. Law. 15, 3 (November 1989).

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114. See, e.g., *In re Anchor Resolution Corp.*, 221 B.R. 330, 340 (Bankr. D. Del. 1998) (applying New York law).

115. *In re A.J. Lane & Co., Inc.*, 113 B.R. 821, 20 Bankr. Ct. Dec. (CRR) 869, 23 Collier Bankr. Cas. 2d (MB) 576 (Bankr. D. Mass. 1990) (applying Massachusetts law and looking to the Uniform Commercial Code); *In re Schaumburg Hotel Owner Ltd. Partnership*, 97 B.R. 943 (Bankr. N.D. Ill. 1989) (applying Illinois law); *In re Lappin Elec. Co., Inc.*, 245 B.R. 326, 35 Bankr. Ct. Dec. (CRR) 205 (Bankr. E.D. Wis. 2000) (applying Illinois law).

116. *A.J. Lane*, 113 B.R. at 828 (adopting and quoting UCC § 2-718(1)); see also *In re AE Hotel Venture*, 321 B.R. 209, 220, 44 Bankr. Ct. Dec. (CRR) 92 (Bankr. N.D. Ill. 2005) (holding that for a make-whole provision to be enforceable, (a) the parties must have intended to agree in advance on damages from a breach; (b) the amount must have been reasonable as of the time of contracting; and (c) the amount of actual damages must be uncertain and difficult to prove).

117. *A.J. Lane*, 113 B.R. at 829.

118. *A.J. Lane*, 113 B.R. at 829.

119. *AE Hotel Venture*, 321 B.R. at 213.

120. *AE Hotel Venture*, 321 B.R. at 220 (“AE Hotel has not disputed that the formula for the premium precisely determines the securitization trust’s losses, so that the premium always corresponds perfectly to the damages from a prepayment. An exact relation to actual damages more than satisfies the need for ‘some relation’”).

121. *Matter of LHD Realty Corp.*, 726 F.2d 327, 330 (7th Cir. 1984); *AE Hotel Venture v. GMAC Commercial Mortgage Corp.*, 2006 U.S. Dist. LEXIS 2040 at \*9 (N.D. Ill. Jan. 20, 2006).

122. See, e.g., *LHD Realty*, 726 F.2d at 330; but see *In re Imperial Coronado Partners, Ltd.*, 96 B.R. 997, 1000 (B.A.P. 9th Cir. 1989) (making a distinction between involuntary acceleration and cases where a debtor may de-accelerate an obligation).

123. *In re Granite Broadcasting Corp.*, 369 B.R. 120, 48 Bankr. Ct. Dec. (CRR) 81 (Bankr. S.D. N.Y. 2007), appeal dismissed, 385 B.R. 41 (S.D. N.Y. 2008); *In re 433 South Beverly Drive*, 117 B.R. 563, 24 Collier Bankr. Cas. 2d (MB) 177, Bankr. L. Rep. (CCH) P 73585 (Bankr. C.D. Cal. 1990) (abrogated by, *General Elec. Capital Corp. v. Future Media Productions, Inc.*, 2008 WL 2610459 (9th Cir. 2008)).

124. *In re Public Service Co. of New Hampshire*, 114 B.R. 813, 818, 20 Bankr. Ct. Dec. (CRR) 852, 114 Pub. Util. Rep. 4th (PUR) 195 (Bankr. D. N.H. 1990) (“[t]o enforce a penalty provision for prepayment when no other feasible alternative exists, looks to form over substance and overlooks the equitable nature of the bankruptcy forum”) (quoting *In re Imperial Coronado Partners, Ltd.*, 96 B.R. 997 (B.A.P. 9th Cir. 1989) (Mooreman, J. dissenting)); *In re Planvest Equity Income Partners IV*, 94 B.R. 644, 18 Bankr. Ct. Dec. (CRR) 1107, Bankr. L. Rep. (CCH) P 72593 (Bankr. D. Ariz. 1988).

125. William W. Bratton, Jr., *The Economics and Jurisprudence of Convertible Bonds*, 1984 Wis. L. Rev. 667, 673 (1984).

126. Transcript of Proceedings at 100, *In re Calpine*, 05-60200 (Bankr. S.D.N.Y. Aug. 8, 2007) [Docket # 5599].

127. Transcript of Proceedings at 101.

128. *In re Med Diversified, Inc.*, 461 F.3d 251, 46 Bankr. Ct. Dec. (CRR) 276, Bankr. L. Rep. (CCH) P 80695 (2d Cir. 2006).

129. *Custom Chrome, Inc. v. C.I.R.*, 217 F.3d 1117, 1123 n.7, 2000-2 U.S. Tax Cas. (CCH) P 50566, 86 A.F.T.R.2d 2000-5156 (9th Cir. 2000); *Security State Bank v. C.I.R.*, 214 F.3d 1254, 1258, 2000-2 U.S. Tax Cas. (CCH) P 50549, 85 A.F.T.R.2d 2000-1980 (10th Cir. 2000), acquiescence recommended, AOD-2001-1, 2001 WL 75699 (I.R.S. AOD 2001) and acq., 2001-1 C.B.xix; Katherine Pratt, *Shifting Biases: Troubled Company Debt Restructurings After the 1993 Tax Act*, 68 Am. Bankr. L.J. 23, 41 (Winter 1994).

130. H. Rep. No. 595, 95th Cong., 1st Sess. 352-53 (1977).

131. See, e.g., *In re Chateaugay Corp.*, 961 F.2d 378, 22 Bankr. Ct. Dec. (CRR) 1347, 26 Collier Bankr. Cas. 2d (MB) 1174, Bankr. L. Rep. (CCH) P 74550 (2d Cir. 1992); *Pengo Indus.*, 962 F.2d 543; *In re Public Service Co. of New Hampshire*, 114 B.R. 800, 20 Bankr. Ct. Dec. (CRR) 850, Bankr. L. Rep. (CCH) P 73424 (Bankr. D. N.H. 1990); *In re Allegheny Intern., Inc.*, 100 B.R. 247, 19 Bankr. Ct. Dec. (CRR) 751, 23 Collier Bankr. Cas. 2d (MB) 71, Bankr. L. Rep. (CCH) P 72966 (Bankr. W.D. Pa. 1989).
132. *Pengo Indus.*, 962 F.2d at 547.
133. *Chateaugay*, 961 F.2d at 381.
134. See *Chateaugay*, 961 F.2d at 382.
135. See *Pengo Indus.*, 962 F.2d at 547.
136. *In re Chateaugay Corp.*, 109 B.R. 51, 22 Collier Bankr. Cas. 2d (MB) 530, Bankr. L. Rep. (CCH) P 73204 (Bankr. S.D. N.Y. 1990), decision aff'd, 130 B.R. 403 (S.D. N.Y. 1991), judgment aff'd in part, rev'd in part, 961 F.2d 378, 22 Bankr. Ct. Dec. (CRR) 1347, 26 Collier Bankr. Cas. 2d (MB) 1174, Bankr. L. Rep. (CCH) P 74550 (2d Cir. 1992).
137. *Chateaugay*, 109 B.R. at 56 (“The respondents also argue that the exchange of the Old Debentures for the New Notes was merely a ‘bookkeeping’ entry... This strained interpretation of the facts flies in the face of even a cursory reading of the instruments. Maturity dates, interest rates, and sinking fund requirements have all been changed in the New Notes”).
138. *Chateaugay*, 109 B.R. at 57.
139. *In re Chateaugay Corp.*, 130 B.R. 403 (S.D. N.Y. 1991), judgment aff'd in part, rev'd in part, 961 F.2d 378, 22 Bankr. Ct. Dec. (CRR) 1347, 26 Collier Bankr. Cas. 2d (MB) 1174, Bankr. L. Rep. (CCH) P 74550 (2d Cir. 1992).
140. *In re Chateaugay Corp.*, 961 F.2d 378, 22 Bankr. Ct. Dec. (CRR) 1347, 26 Collier Bankr. Cas. 2d (MB) 1174, Bankr. L. Rep. (CCH) P 74550 (2d Cir. 1992).
141. *Chateaugay*, 961 F.2d at 382.
142. *Pengo Indus.*, 962 F.2d at 548 (quoting Marc S. Kirschner, Dan A. Kusnetz, Laurence Y. Solarsh & Craig S. Gatarz, *Prepackaged Bankruptcy Plans: The Deleveraging Tool of the ‘90’s in the Wake of OID and Tax Concerns*, 21 *Seton Hall L. Rev.* 643, 647 (1991)).
143. *Chateaugay*, 961 F.2d at 382.
144. *Pengo Indus.*, 962 F.2d 543.
145. See *Pengo Indus.*, 962 F.2d at 549 (“As heretofore discussed, we decide only the narrow issue of whether a debt-for-debt face value exchange generates OID not allowed under section 502(b)(2)"); see also *In re ICH Corp.*, 230 B.R. 88, 93 (N.D. Tex. 1999).
146. *In re Allegheny Intern., Inc.*, 100 B.R. 247, 19 Bankr. Ct. Dec. (CRR) 751, 23 Collier Bankr. Cas. 2d (MB) 71, Bankr. L. Rep. (CCH) P 72966 (Bankr. W.D. Pa. 1989).
147. *Chateaugay*, 961 F.2d at 383; *Pengo Indus.*, 962 F.2d at 550.
148. 11 U.S.C.A. § 510(a) (“[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law”).
149. See Jo Ann J. Brighton, *Silent Second Lien Financings: Popular Lending Structure May Give Rise to Enforcement Problems*, 24-1 *Am. Bankr. Inst. J.* 22 (February 2005).
150. *In re Hart Ski Mfg. Co., Inc.*, 5 B.R. 734, 735, 6 Bankr. Ct. Dec. (CRR) 968, 2 Collier Bankr. Cas. 2d (MB) 1189, Bankr. L. Rep. (CCH) P 67691 (Bankr. D. Minn. 1980).
151. *In re 203 North LaSalle Street Partnership*, 246 B.R. 325, 331, 35 Bankr. Ct. Dec. (CRR) 219, 43 Collier Bankr. Cas. 2d (MB) 1463 (Bankr. N.D. Ill. 2000).
152. *In re Aerosol Packaging, LLC*, 362 B.R. 43, 47 (Bankr. N.D. Ga. 2006).
153. *Aerosol Packaging*, 362 B.R. at 47.
154. *In re Southeast Banking Corp.*, 156 F.3d 1114, 1120, 33 Bankr. Ct. Dec. (CRR) 302, 40 Collier Bankr. Cas. 2d (MB) 1238, Bankr. L. Rep. (CCH) P 77809 (11th Cir. 1998), certified question

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accepted, 92 N.Y.2d 945, 681 N.Y.S.2d 468, 704 N.E.2d 221 (1998), certified question answered, 93 N.Y.2d 178, 688 N.Y.S.2d 484, 710 N.E.2d 1083, 34 Bankr. Ct. Dec. (CRR) 326 (1999).

155. *In re Bank of New England Corp.*, 364 F.3d 355, 362, 42 Bankr. Ct. Dec. (CRR) 243, 51 Collier Bankr. Cas. 2d (MB) 1634, Bankr. L. Rep. (CCH) P 80079 (1st Cir. 2004).

156. *Bank of New England*, 364 F.3d at 362; *In re Time Sales Finance Corp.*, 491 F.2d 841 (3d Cir. 1974); *Matter of King Resources Co.*, 528 F.2d 789 (10th Cir. 1976); *In re Kingsboro Mortg. Corp.*, 514 F.2d 400 (2d Cir. 1975).

157. *Southeast Banking*, 156 F.3d at 1121-22 (“section 510(a)’s instruction to enforce subordination agreements on par with other contracts under nonbankruptcy law constitutes a plain departure from the prior practice of enforcing and interpreting those agreements pursuant to the bankruptcy courts’ equitable powers”).

158. *Southeast Banking*, 156 F.3d at 1126.

159. *In re Southeast Banking Corp.*, 93 N.Y.2d 178, 688 N.Y.S.2d 484, 710 N.E.2d 1083, 34 Bankr. Ct. Dec. (CRR) 326 (1999).

160. *Bank of New England*, 364 F.3d at 363.

161. *Bank of New England*, 364 F.3d at 364-365; see also Richard E. Mikels, Adrienne K. Walker & Sara R. Bollerup, *On the Edge: Subordination Agreement Case Highlights Conflict With State Law*, 23-10 Am. Bankr. Inst. L.J. 12 (January 2005).

162. *Bank of New England*, 364 F.3d at 365.

163. *Bank of New England*, 364 F.3d at 365.

164. But see David Line Batty and Jo Ann J. Brighton, “Silent” Second Liens—Will Bankruptcy Courts Keep The Peace?, 9 N.C. Banking Inst. 1, 27 (April 2005) (“perhaps the post-petition interest issue is lost, as it slips into a dark tunnel of controversy concerning conflict of law provisions and the intersection of federal bankruptcy policy and state law”).

165. 11 U.S.C.A. § 502(b)(2); *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 246, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. (CRR) 1150, Bankr. L. Rep. (CCH) P 72575, 89-1 U.S. Tax Cas. (CCH) P 9179, 63 A.F.T.R.2d 89-652 (1989).

166. *Sexton v. Dreyfus*, 219 U.S. 339, 344, 31 S. Ct. 256, 55 L. Ed. 244 (1911).

167. *Nicholas v. U.S.*, 1966-2 C.B. 511, 384 U.S. 678, 683-84, 86 S. Ct. 1674, 16 L. Ed. 2d 853, 66-1 U.S. Tax Cas. (CCH) P 9465, 17 A.F.T.R.2d 1194 (1966).

168. 11 U.S.C.A. § 726(a)(5) (providing for the payment of postpetition interest to creditors before any distribution is made to the debtor).

169. *In re El Paso Refinery, L.P.*, 244 B.R. 613, 621 (Bankr. W.D. Tex. 2000).

170. *Adelphia*, 368 B.R. 140.

171. Transcript of Court Decision on Joint Motion in Aid, Rate and Computation of Post-Petition Interest at 14, *In re Adelphia Communications, Inc.*, 02-41729 (Bankr. S.D.N.Y. April 27, 2006) [Docket #11149]:

On balance, I think the fact that parent creditors must recover from the entity with whom they dealt—and that the parent’s interest in its subs was in law and substance equity—is a matter not just of form, but also of substance. For purposes of analysis in a multi-debtor, parent/subsidiary, case where creditors would have justifiably focused on what we refer to in bankruptcy parlance as ‘structural seniority,’ that structural seniority must be taken into account. And I believe that the ‘structural seniority’ of subsidiaries and subsidiary creditors’ rights of priority to subsidiary assets was something that senior creditors know about, or should have when they bought their bonds.

See also *Adelphia*, 368 B.R. 140.

172. *Metromedia Fiber Network*, 416 F.3d at 140.

173. *In re Dura Automotive Systems, Inc.*, 379 B.R. 257, 265-66 (Bankr. D. Del. 2007) (X Clauses serve to avoid “delay, friction, and transaction cost[s]”).

174. Dura Automotive Systems, 379 B.R. at 265-66.
175. Matter of Envirodyne Industries, Inc., 29 F.3d 301, 306, 25 Bankr. Ct. Dec. (CRR) 1447 (7th Cir. 1994).
176. Envirodyne, 29 F.3d at 306.
177. Metromedia Fiber Network, 416 F.3d at 140-41.
178. 203 N. LaSalle, 526 U.S. at 444; Armstrong World Indus., 432 F.3d at 512.
179. 203 N. LaSalle, 526 U.S. at 444.
180. 11 U.S.C.A. § 1129(b)(2)(B).
181. In re SPM Mfg. Corp., 984 F.2d 1305, 23 Bankr. Ct. Dec. (CRR) 1529, 28 Collier Bankr. Cas. 2d (MB) 451, Bankr. L. Rep. (CCH) P 75090 (1st Cir. 1993).
182. SPM Mfg., 984 F.2d at 1312-13.
183. SPM Mfg., 984 F.2d at 1312.
184. See In re Genesis Health Ventures, Inc., 266 B.R. 591, 601-02, 38 Bankr. Ct. Dec. (CRR) 112 (Bankr. D. Del. 2001); In re MCorp Financial, Inc., 160 B.R. 941, 960 (S.D. Tex. 1993).
185. Armstrong World Indus., 432 F.3d 507.
186. Armstrong World Indus., 432 F.3d at 514.
187. Armstrong World Indus., 432 F.3d at 514.
188. See, e.g., Keach, R., La Salle, The Market Test and Competing Plans: Still in the Fog, 21 American Bankruptcy Institute Journal 18, 50 (Jan. 2003) (“[t]he senior classes are free to allocate their property as they wish without violating the absolute priority rule”); Houser, B., Disclosure Statements, Confirmation and Cramdown of Chapter 11 Plans, SH054 ALI-ABA, 337, 383 (May 2003) (“[s]imilarly, the absolute priority rule is not violated where the value being given to old equity comes from funds which would otherwise be distributed to a senior class but is instead distributed to old equity with the senior class’s consent”).