January 2016

In This Issue

Business Law Section Spring Meeting

Featured Articles

Kathryn R. Heidt Memorial Award Goes To Monique Hayes

To Disclose Or Not To Disclose: The Case of Pre-petition Insider Payments

Protection for Trademark Licensees in Licensor Bankruptcies Remains Uncertain: In re Tempnology, LLC

Threading the Needle: Bankruptcy Court Ruling Reconciles Chapter 15 and Barnett

Dairy Farms Are Risky Business: Interest Risk Rate For Secured Claims in Chapter 12 Cases

Useful Links

Submit Articles for the Business Bankruptcy Newsletter

Business Bankruptcy Committee Materials From The 2015 National Conference Of Bankruptcy Judges

Business Bankruptcy Committee Materials From Programs At Last Year’s Business Law Section Spring Meeting

Important Dates

Business Law Section Spring Meeting
April 7-9, 2016
Montréal, QC, Canada

Business Law Section Annual Meeting
September 8-10, 2016
Boston, MA

---

Business Law Section Spring Meeting

April 7-9, 2016
Montréal, QC, Canada

Kathryn R. Heidt Memorial Award Goes To Monique Hayes

By Krista Faltin

At this year's Fall Meeting of the ABA Section of Business Law Business Bankruptcy Committee in Miami, Florida, the annual Kathryn R. Heidt Memorial Award was awarded to Miami-based Monique D. Hayes of Genovese Joblove & Battista, P.A. The Kathryn R. Heidt Memorial Award is meant to honor Kate Heidt, who at the time of her passing was the chair of the ABA Section of Business Law’s Business Bankruptcy Committee. The award is awarded to those individuals who embody the qualities that Kate sought to instill in young lawyers.

Ms. Hayes' achievements and dedication to her community has demonstrated her leadership potential and has shown herself over the years to be truly deserving of the Kate Heidt award. During the award ceremony, Ms. Hayes spoke of her gratitude in receiving the honor. Her words moved the audience as she described the hardships and struggles she faced and the immense support that she has received over the years from the ABA Business Bankruptcy Committee.

Read more...

To Disclose Or Not To Disclose: The Case of Pre-petition Insider Payments

By Lesley Welwarth

The Bankruptcy Code's drafters have sought to prevent a company from paying excessive compensation to its executives, in both the periods prior to a bankruptcy filing and during the bankruptcy proceeding. They decided that full insider compensation disclosure is required to foster that intention. Once in bankruptcy, a debtor is required to seek bankruptcy court approval for certain business activities, including making severance payments and retention bonuses to executives. With an eye toward monitoring executive compensation, the 2005 BAPCPA amendments: added material limitations, under Section 503(c), to a debtor's ability to implement a key employee retention plan; and, under Section 548(a)(1)(B)(iv), discouraged distressed companies from paying, just prior to bankruptcy, hefty amounts to insiders.

Likewise, Section 521 of the Bankruptcy Code and Rule 1007 of the Federal Rules of Bankruptcy Procedure provide that a company in bankruptcy is to make sweeping disclosures of its pre-petition financial transactions, including the disclosure of payments made to the company's insiders on its Statement of Financial Affairs. Part 2, Question 4 of Official Form 207 requires the debtor to identify "Payments or other transfers of property made within 1 year before filing this case that benefited any insider." Form 207 (which was slightly revised as of December 1, 2015) instructs the debtor to "list payments or transfers, including..."
Business Bankruptcy Committee Meeting and National Conference of Bankruptcy Judges
October 26-29, 2016
San Francisco, CA

Kay Standridge Kress
Chair, Committee on Business Bankruptcy
kressk@pepperlaw.com

Editorial Board

Brett D. Fallon
Editor-in-Chief
Morris James LLP
Wilmington, DE
BFallon@morrisjames.com

Mariaelena Gayo-Guitian
Co-Editor-in-Chief
Genovese Joblove & Battista, P.A.
Miami, FL
mguitian@gjb-law.com

Krista Faltin
Co-Editor-in-Chief
Moritt, Hock & Hamroff LLP
Garden City, NY
KFaltin@moritthock.com

expense reimbursements, made within 1 year before filing this case on debts owed to an insider . . . unless the aggregate value of all property transferred to or for the benefit of the insider is less than $6,225. Insiders include officers, directors, and anyone in control of a corporate debtor and their relatives; general partners of a partnership debtor and their relatives; affiliates of the debtor and insiders of such affiliates; and any managing agent of the debtor. 11 U.S.C. § 101(31).” In particular, Form 207 requires that the debtor list (a) the name and address of the insider, (b) the insider's relationship to the debtor, (c) the date of the payment, (d) the total amount of the payment or value of the transfer, and (e) the reasons for payment or transfer.

Read more...

Protection for Trademark Licensees in Licensor Bankruptcies Remains Uncertain: In re Tempnology, LLC
By Kevin Grzebielski

The licensing of intellectual property ("IP") - such as patents, copyrights, and trademarks - can mean big business for licensors (the IP's owner) and licensees (the users of the IP). IP may be among the most valuable assets of a licensor, generating significant royalties. A licensee, in turn, may build its entire business around the utilization of licensed IP, including the use of the licensor's trademarks.

However, when an IP licensor files a bankruptcy case, the interests of the debtor-licensor and the licensee can clash. The debtor-licensor often seeks to sell the valuable IP unencumbered. Conversely, the licensee may have incurred significant expenses in order to utilize the licensed IP and will want to retain those rights.

Read more...

Threading the Needle: Bankruptcy Court Ruling Reconciles Chapter 15 and Barnett
By Dustin Smith

For the last two years, representatives of foreign debtors considering Chapter 15 protection have found themselves asking a series of existentialist questions. "Do I need property in the United States?" "How much property is enough property?" "What happens if I don't have enough property?"

This reasoned reflection is spurred by the Second Circuit's ruling in Drawbridge Opportunities Fund LP v. Barnett (In re Barnett) which held that a foreign representative must satisfy the property requirements of Section 109(a) before being granted recognition of their foreign main proceeding under Chapter 15. Drawbridge Special Opportunities Fund, LP v. Katherine Elizabeth Barnett (In re Barnett), 737 F. 3d 238 (2d Cir. 2013). This ruling has been a focal point for other courts and bankruptcy commentators on the basis that it undermines the goals of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (the "Model Law"), which was incorporated into the Bankruptcy Code as Chapter 15.

Read more...

Dairy Farms Are Risky Business: Interest Risk Rate For Secured Claims in Chapter 12 Cases
By Daniel Molina-Lopez

Read more...
Chapter 12 cases (farmers and fishermen) are a rare breed amongst the myriad of bankruptcy cases filed every year in all districts. During the year 2014, only 372 out of 963,739 bankruptcy filings nationwide were made under Chapter 12. Administrative Office of the U.S. Courts, Bankruptcy Cases Commenced, Terminated and Pending During the 12-Month Periods Ending September 30, 2014 and 2015, as published on October 28, 2015. Information obtained here.

Thus, it is not surprising nor uncommon for a bankruptcy court faced with a Chapter 12 case to look for guidance in Chapter 13 proceedings, except in those specific instances where the Bankruptcy Code explicitly forbids such treatment (such as adequate protection). In doing so, when faced with the confirmation of a proposed plan of reorganization some courts have determined that the interest rate proposed by a debtor in Chapter 12 plans of reorganization should be similar to the interest rate fixed in Chapter 13 plans where the Debtor is allowed to vary the terms of the original loan. Under 11 U.S.C. §1322(b)(2), a Chapter 13 debtor can modify the rights of holders of secured claims, except if the claim is secured by a lien encumbering Debtor's principal residence.

Read more...

Submit Article for the Business Bankruptcy Newsletter

The Business Bankruptcy Committee invites you to submit articles for possible publication in future issues. The articles do not need to be long or in-depth, and it is a great way to get involved in the Business Bankruptcy Committee. Articles can survey the law nationally or locally, discuss particular business bankruptcy issues, or examine a specific case. If you are interested in submitting an article, please contact Newsletter Editors-in-Chief Brett D. Fallon at bfallon@morrisjames.com, Editor Mariaelena Gayo-Guitian at mguitian@gjtlaw.com, or Krista Faltin at KFaltin@moritthock.com.
At this year's Fall Meeting of the ABA Section of Business Law Business Bankruptcy Committee in Miami, Florida, the annual Kathryn R. Heidt Memorial Award was awarded to Miami-based Monique D. Hayes of Genovese Joblove & Battista, P.A. The Kathryn R. Heidt Memorial Award is meant to honor Kate Heidt, who at the time of her passing was the chair of the ABA Section of Business Law's Business Bankruptcy Committee. The award is awarded to those individuals who embody the qualities that Kate sought to instill in young lawyers.

Ms. Hayes' achievements and dedication to her community has demonstrated her leadership potential and has shown herself over the years to be truly deserving of the Kate Heidt award. During the award ceremony, Ms. Hayes spoke of her gratitude in receiving the honor. Her words moved the audience as she described the hardships and struggles she faced and the immense support that she has received over the years from the ABA Business Bankruptcy Committee.

Ms. Hayes graduated from the University of South Florida with an undergraduate degree in political science. Thereafter she attended the University of Miami School of Law from which she received her juris doctor cum laude. While she was in law school, she was a member of the Bar and Gavel Honor Society, named to the Dean's List, awarded the Dean's Honor Scholarship, and received The Center for Computer-Assisted Legal Instruction (CALI) Excellence for the Future Award in Chapter 11 Bankruptcy Skills.

Ms. Hayes is currently an associate at the firm Genovese, Joblove & Battista, P.A. in Miami, Florida. She practices in the area of corporate restructuring, bankruptcy, business litigation and transactions. Prior to joining the firm, Ms. Hayes served as a law clerk to the Honorable Laurel Myerson Isicoff, U.S. Bankruptcy Judge for the Southern District of Florida. Ms. Hayes was also a staff attorney at Legal Services of Greater Miami, Inc., where she represented low income clients in landlord/tenant disputes and consumer bankruptcy proceedings.

Ms. Hayes has been actively involved in many professional organizations over the years. Ms. Hayes is a member of the American Bar Association's Business Law Section and ABA Business Bankruptcy Committee, the Bankruptcy Bar Association of the Southern District of Florida, the Dade County Bar Association, the American Bankruptcy Institute, the International Women's Insolvency and Restructuring Confederation (IWIRC) and the Wilkie D. Ferguson Jr. Bar Association. In addition, she served as the co-chair of the Florida Network for IWIRC. She has distinguished herself from her peers within these organizations. In 2011, she was named IWIRC's Rising Star. In 2008, Ms. Hayes was granted the Blackshear Fellowship Award, which is bestowed upon select candidates each year by the National Conference of Bankruptcy Judges.

Within the ABA's Business Bankruptcy Committee, Ms. Hayes is an active participant who graciously volunteers her time and frequently publishes articles and speaks on panels during the last few years. Among her many accomplishments in this area, she was appointed to the ABA Business Law Section Business Bankruptcy Committee liaison to IWIRC. Earlier this year, Ms. Hayes authored an article entitled *When the Tides Turn: Fiduciary Duties of Directors and Officers of Distressed Companies*, which was published in the ABA's Business Law Today. Since 2010, Ms. Hayes has also revised and updated the ABA Business Bankruptcy Subcommittee's *Survey of Developments Regarding Claims in Bankruptcy*. In 2014, she also served as program chair for a Business Bankruptcy Committee sponsored program entitled *What Every Business Lawyer Should Know About Avoidance Actions in Bankruptcy*. In addition, Ms. Hayes has served as a panelist for the Current Developments program for the Business Bankruptcy Committee for 2013 as well as for *(Almost) Everything You Wanted to Know About Getting Retained: A high Stakes Job Interview* which was presented at the Business Bankruptcy fall meeting in 2009. Ms. Hayes was also selected to serve as a 2013-2015 Fellow for the Business Bankruptcy Committee.

Not only is Ms. Hayes active in professional organizations including the Business Bankruptcy Committee but she is also active in her community. She is a member of the Junior League of Miami. Ms. Hayes also serves on the Board of Directors for Kristi House, a private, non-profit organization dedicated to healing and eradicating child sexual abuse. She has been recognized among the United Way Miami-Dade Young Leaders and, in 2010, she was included in the 40 under 40 Outstanding Lawyers of Miami-Dade County by the Cystic Fibrosis Foundation.

The Business Bankruptcy Committee looks forward to seeing Ms. Hayes’ future contributions to the Business Bankruptcy Committee and the broader legal community.
To Disclose Or Not To Disclose: The Case of Pre-petition Insider Payments
By Lesley Welwarth

The Bankruptcy Code’s drafters have sought to prevent a company from paying excessive compensation to its executives, in both the periods prior to a bankruptcy filing and during the bankruptcy proceeding. They decided that full insider compensation disclosure is required to foster that intention. Once in bankruptcy, a debtor is required to seek bankruptcy court approval for certain business activities, including making severance payments and retention bonuses to executives. With an eye toward monitoring executive compensation, the 2005 BAPCPA amendments: added material limitations, under Section 503(c), to a debtor’s ability to implement a key employee retention plan; and, under Section 548(a)(1)(B)(iv), discouraged distressed companies from paying, just prior to bankruptcy, hefty amounts to insiders.

Likewise, Section 521 of the Bankruptcy Code and Rule 1007 of the Federal Rules of Bankruptcy Procedure provide that a company in bankruptcy is to make sweeping disclosures of its pre-petition financial transactions, including the disclosure of payments made to the company's insiders on its Statement of Financial Affairs. Part 2, Question 4 of Official Form 207 requires the debtor to identify “Payments or other transfers of property made within 1 year before filing this case that benefited any insider.” Form 207 (which was slightly revised as of December 1, 2015) instructs the debtor to “list payments or transfers, including expense reimbursements, made within 1 year before filing this case on debts owed to an insider . . . unless the aggregate value of all property transferred to or for the benefit of the insider is less than $6,225. Insiders include officers, directors, and anyone in control of a corporate debtor and their relatives; general partners of a partnership debtor and their relatives; affiliates of the debtor and insiders of such affiliates; and any managing agent of the debtor. 11 U.S.C. § 101(31).” In particular, Form 207 requires that the debtor list (a) the name and address of the insider, (b) the insider’s relationship to the debtor, (c) the date of the payment, (d) the total amount of the payment or value of the transfer, and (e) the reasons for payment or transfer.

The information provided in a debtor’s complete Statement of Financial Affairs is important to the debtor’s creditors and the court as it promotes a full understanding of the company’s overall financial state, business dealings and missteps. The transparency as to the debtor’s financial information is critical to ensure a fair and open process to all stakeholders and constituents, including those creditors facing a haircut on their valid claims. Thus, in order to reap the benefits of bankruptcy, a debtor is required to accept the burdens, such as disclosure of confidential insider compensation, notwithstanding the potential negative implications that such disclosure may impose. For one thing, excessive compensation paid to insiders on the heels of a company’s bankruptcy filing may be ripe for avoidance actions and claw back.

Despite these clear obligations, a recent trend captured by The Wall Street Journal demonstrates that about one in 13 debtor companies provided less-than-full disclosures by either replacing employee names with their identification numbers (like A&P and Relativity Media did this year, for example), by redacting payment amounts, by reporting only lump sum amounts or some variation of these options. “Transparency Is the Rule in Chapter 11 - Except for CEOs,” The Wall Street Journal, Peg Brickley and Patrick Fitzgerald, April 24, 2013; “A&P Insiders Took Home Millions in Year Before Bankruptcy,” The Wall Street Journal, Peg Brickley, September 18, 2015; “Relativity Media Hides Names of Top Moneymakers in Court Filings,” The Wall Street Journal, Peg Brickley, October 1, 2015. In fact, some companies have attempted to exclude all pre-petition insider compensation details (like Patriot Coal). “Patriot Coal Won’t Disclose Insider Pay Leading Up to Second Bankruptcy,” The Wall Street Journal, Peg Brickley, June 29, 2015.

In its review of 250 Chapter 11 cases filed between 2008 and 2013, The Wall Street Journal found that out of the 19 companies that attempted to conceal insider pay details, 17 companies were successful. Further, most of the companies that declined to disclose insider pay information did not seek prior court authorization to do so.

Debtor s which have filed motions with the bankruptcy court for permission to redact insider compensation details have argued that full public disclosure is prejudicial as it may cause undue media scrutiny and privacy invasions on the company and the executives themselves. These debtors have also claimed that publicly disclosing confidential salary information could have a negative impact on the debtor’s ability to retain employees because the debtor’s competitors could use this data to poach valuable personnel. If there is a legitimate reason for concealing insider pay details, the statutory framework provides that the bankruptcy court is to weigh the need for public transparency with the costs borne to the employees and the company. Section 107 of the Bankruptcy Code provides the bankruptcy court with a framework for protection of certain information from public disclosure.

The issue of whether compensation details should be disclosed is a question separate and apart from whether the compensation paid was excessive. In turn, full disclosure does not necessarily mean that the insiders will face preference or fraudulent transfer claims. After review of insider compensation history, constituents and ultimately as the final arbiter, the court, may determine that the pre-petition compensation was fully in line with market rates and justified, especially given the stressful climate leading up to bankruptcy.

Allowing companies in bankruptcy free reign to make limited disclosures – or to make no disclosure whatsoever – invites debtors to test the limits and shelter other critical data points that they may not want the media, the general
public and their creditors to see. A debtor should not be entitled to autonomously skirt clear requirements that have been carefully balanced under the statutory framework of the Bankruptcy Code; anything less than full disclosure must be made only after court approval.
Protection for Trademark Licensees in Licensor Bankruptcies Remains Uncertain: In re Tempnology, LLC
By Kevin Grzebielski

The licensing of intellectual property ("IP") – such as patents, copyrights, and trademarks – can mean big business for licensors (the IP's owner) and licensees (the users of the IP). IP may be among the most valuable assets of a licensor, generating significant royalties. A licensee, in turn, may build its entire business around the utilization of licensed IP, including the use of the licensor's trademarks.

However, when an IP licensor files a bankruptcy case, the interests of the debtor-licensor and the licensee can clash. The debtor-licensor often seeks to sell the valuable IP unencumbered. Conversely, the licensee may have incurred significant expenses in order to utilize the licensed IP and will want to retain those rights.

In 2012 and 2014, the Seventh Circuit Court of Appeals and the Bankruptcy Court for the District of New Jersey, respectively, issued opinions providing greater protection for a licensee's rights to use IP in a debtor-licensor's bankruptcy case – specifically, a licensor's trademark. However, a recent decision from the Bankruptcy Court for the District of New Hampshire in favor of a debtor-licensor demonstrates that this issue remains unsettled.

Background: Lubrizol Enterprises and Congress' Response

Over thirty years ago, the Fourth Circuit Court of Appeals decided Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. In Lubrizol, a debtor-licensor sought to reject an IP license that it had granted to a licensee. The Fourth Circuit allowed the rejection under Section 365 of the Bankruptcy Code. As the rejection constituted a breach, Section 365(g) entitled the licensee to monetary damages. However, the Fourth Circuit held that the licensee could not retain its contractual rights to use the debtor's IP; the licensee was thus stripped of the rights it previously held under the licensing agreement.

The Lubrizol decision raised concern among licensees that a licensor could use the bankruptcy process to invalidate a license that would have been unassailable outside bankruptcy. In response to those concerns, Congress added Section 365(n) to the Bankruptcy Code, which protects the rights of a non-debtor licensee to use licensed IP when a debtor-licensor rejects the license. Section 365(n) allows a non-debtor licensee to retain its rights under the license for the duration of the license and any permitted extensions, provided that it continues to make all royalty payments due. However, the Bankruptcy Code's definition of "intellectual property" contains a key omission: it defines "intellectual property" to include patents, copyrights, and trade secrets, but not trademarks. See 11 U.S.C. 101(35A).

Sunbeam: The Pendulum Starts to Swing in Favor of Licensees

Twenty-seven years after Lubrizol, the Seventh Circuit Court of Appeals issued an opinion seen as a major win for licensees in Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC. In Sunbeam, the debtor-licensor Lakewood Engineering & Manufacturing Co. ("Lakewood") made and sold box fans that were covered by its patents and trademarks. However, after losing money on its box fans, Lakewood contracted the manufacturing of Lakewood-trademarked box fans to Chicago American Manufacturing ("CAM"), granting CAM a license to the relevant patents and trademarks. Recognizing Lakewood's financial distress and CAM's investment in its business of manufacturing the box fans, the parties agreed to allow CAM to directly sell the fans, with Lakewood's trademarks, for CAM's own account, if Lakewood did not purchase them.

Subsequently, Lakewood was forced into involuntary bankruptcy. Lakewood's trustee sold Lakewood's assets, including the patents and trademarks, to Sunbeam Consumer Products ("Sunbeam"). Sunbeam, already in the business of selling fans, did not want its products to compete with CAM's "Lakewood"-branded fans. The trustee, therefore, rejected the agreement. Nonetheless, CAM continued to sell the remaining trademarked fans, and Sunbeam sued CAM for infringement.

The Bankruptcy Court held in CAM's favor, interpreting the agreement to allow CAM to sell the remaining fans. On appeal, the Seventh Circuit Court of Appeals affirmed, holding that the trustee's rejection of the agreement, and specifically the trademark license, did not affect CAM's right to sell the trademarked fans. Because the Bankruptcy Code treats rejection of the license as a breach by Lakewood and Lakewood could not use its own breach to deprive CAM of its rights outside bankruptcy, the Appellate Panel reasoned that rejection could not deprive CAM of those rights, either.

At the time, the Sunbeam decision was the first circuit-level decision to part from Lubrizol's method of handling how rejection impacts an IP license.

In re Crumbs Bake Shop, Inc.

After the Sunbeam decision, the Bankruptcy Court for the District of New Jersey followed Sunbeam's lead. In In re Crumbs Bake Shop, Inc., the debtor-licensor Crumbs Bake Shop ("Crumbs") and various third-parties entered into licensing agreements that allowed the third-party licensees to utilize the Crumbs trademark and trade secrets, selling cupcakes, baked goods, and beverages under the "Crumbs" brand.
Subsequently, Crumbs ceased operations and filed for bankruptcy relief under Chapter 11. Crumbs then entered into an asset purchase agreement with Lemonis Fischer Acquisition Company ("LFAC"), whereunder LFAC would receive substantially all of the debtors' assets, free and clear of liens, claims, encumbrances, and interests.

Because LFAC did not want to license the "Crumbs" mark to the other third-party licensees, it instructed the debtor to reject many of the licenses. The Crumbs Court concluded, however, that such rejection could not deprive the trademark licensees of their rights. The Court adopted two separate rationales: first, it argued that "equity" allowed the Court to expand the scope of the definition of "intellectual property" in Section 101(35A) of the Bankruptcy Code to encompass trademarks; second, it adopted the reasoning of the Seventh Circuit in Sunbeam.

In re Tempnology, LLC

After Crumbs, momentum appeared to be building in favor of protecting licensees of trademarks in the bankruptcy cases of debtor-licensors, notwithstanding the language of Bankruptcy Code Section 101(35A). However, on November 25, 2015, the Bankruptcy Court for the District of New Hampshire ruled in favor of the debtor-licensor in In re Tempnology, LLC. In Tempnology, debtor-licensor Tempnology, LLC ("Tempnology") entered into an agreement with Mission Product Holdings, Inc. ("Mission") for the sale and distribution of certain cooling material products developed by Tempnology. The agreement gave Mission exclusive distribution rights in the United States, and Tempnology agreed that it would not license or sell the products to anyone other than Mission during the term of the agreement. Tempnology also agreed not to take actions that would directly or indirectly frustrate its exclusivity obligations and agreed to enforce Tempnology's IP rights and contractual rights against third parties. The court categorized these provisions as the "exclusive distribution rights." The agreement also granted Mission a non-exclusive license to use Tempnology's trademark and logo for the limited purpose of performing the obligations under the agreement.

On September 1, 2015, Tempnology commenced a case under chapter 11 and moved to reject the agreement. The parties disagreed on whether Mission retained its exclusive distribution rights and rights to Tempnology's trademarks.

The Tempnology Court held that the rejection deprived Mission of both sets of rights. The Court first decided that Section 365(n)'s exclusivity and other protections of extended only to the intellectual property rights in the agreement. The court held that the exclusive distribution rights that Tempnology granted to Mission were not a right to intellectual property, even if the products were patented. The Court, therefore, held that the exclusive distribution rights perished with the rejection of the agreement.

With regarding to the trademark license, the Court declined to follow the ruling in Crumbs. Instead, the Court relied on the fact that the definition of intellectual property in Section 101(35A) does not include trademarks. Thus, following the Lubrizol reasoning, the Court held that Section 365(n) did not protect the trademark license after the rejection.

Takeaway

Despite the recent cases that cut against the decision in Lubrizol, the Tempnology Court returned to that decision to hold that the rejection of the license agreement resulted in Mission losing any continued rights to the trademark license. (Although the Tempnology Court rejected the holding in Crumbs, it did not mention the Sunbeam decision.)

The Tempnology decision that Section 365(n) protects only licenses of "intellectual property" as defined in Section 101(35A) of Bankruptcy Code suggests that only a revision of that definition by Congress will finally resolve the issue.
Threading the Needle: Bankruptcy Court Ruling Reconciles Chapter 15 and Barnett

By Dustin Smith

For the last two years, representatives of foreign debtors considering Chapter 15 protection have found themselves asking a series of existentialist questions. "Do I need property in the United States?" "How much property is enough property?" "What happens if I don't have enough property?"

This reasoned reflection is spurred by the Second Circuit’s ruling in Drawbridge Opportunities Fund LP v. Barnett (In re Barnet) which held that a foreign representative must satisfy the property requirements of Section 109(a) before being granted recognition of their foreign main proceeding under Chapter 15. Drawbridge Special Opportunities Fund, LP v. Katherine Elizabeth Barnett (In re Barnet), 737 F. 3d 238 (2d Cir. 2013). This ruling has been a focal point for other courts and bankruptcy commentators on the basis that it undermines the goals of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (the “Model Law”), which was incorporated into the Bankruptcy Code as Chapter 15.

A recent decision by Judge Martin Glenn of the United States Bankruptcy Court for the Southern District of New York In re Berau Capital Resources PTE Ltd. has reconciled these competing positions. In re Berau Capital Resources Pte Ltd, 540 B.R. 80 (Bankr. S.D.N.Y. 2015). In In re Berau, Judge Glenn found that debt issued pursuant to an indenture that contained New York choice of law and forum selection clauses was sufficient to satisfy the requirements of Section 109(a) and allow a bankruptcy court to grant Chapter 15 recognition to the foreign debtor. This expansive interpretation of the Barnett decision gives effect to Section 109(a) while preserving the overall goals of Chapter 15, and should clarify the requirements of obtaining foreign recognition.

Barnett and the Section 109(a) Requirement:

The Second Circuit’s ruling in Barnett created uncertainty as to when a foreign debtor could seek the protections of being recognized as a foreign main proceeding under Chapter 15. Chapter 15 recognition is often vital for foreign debtors in order to prevent ancillary litigation against the foreign debtor from being commenced in the United States and to maximize and protect the assets of the foreign debtor’s estate. In Barnett the Second Circuit applied a “plain meaning” approach to conclude that satisfaction of Section 109(a)’s requirement that a debtor have property located in the United States was a precondition to obtaining Chapter 15 recognition. Drawbridge Special Opportunities Fund, LP v. Katherine Elizabeth Barnett (In re Barnett), 737 F. 3d 238, 247-251 (2d Cir. 2013). The Second Circuit’s holding relied on Section 103(a) which makes all of Chapter 1 of the Bankruptcy Code, including the requirements of Section 109(a), applicable to the sections of Chapter 15 governing recognition. Id. at 247.

In reaching its holding, the Second Circuit rejected multiple arguments raised by the representatives of Barnett. First, the court rejected the foreign representatives’ argument that they were only seeking recognition of the foreign main proceeding and not recognition of the foreign debtor itself on the basis that focus of the “debtor” was “inextricably intertwined with the very nature of a Chapter 15 proceeding, both in terms of how such a proceeding is defined and in terms of the relief that can be granted.” Id. at 248. Second, the court rejected the foreign representatives argument that they only needed to satisfy the more limited definition contained in Section 1502, which defines a “debtor” for the purposes of Chapter 15 as “an entity subject to a foreign proceeding” on the basis that the requirements of Section 109(a) supplements (and is not superseded by) Section 1502. Id. at 249. Finally, the Court rejected the argument that the application of section 109(a) would undermine the purpose of Chapter 15, which was to adopt the Model Laws, on the basis that the additional requirement of Section 109(a) did not block the Model Law’s goals of promoting international cooperation, legal certainty, and protection and maximization of assets. Id. at 250-251.

Dissenting voices quickly appeared in the wake of the Barnett decision. In a bench ruling issued in In re Bemarmara Consulting A.S., (In re Bemarmara Consulting A.S., Case No. 13-13037 (Bankr. D. Del. Dec. 17, 2013.)) Judge Kevin Gross from the Bankruptcy Court for the District of Delaware granted recognition to a foreign representative despite the fact that the debtor did not have assets in the United States. In his ruling, Judge Gross specifically stated that “[Barnett] is not controlling on this Court. And this Court does not agree with the decision of the Second Circuit. And it is the Court’s belief that there is a strong likelihood that the Third Circuit, likewise, would not agree with that decision.” Id. Judge Gross also mused that “[c]ommentators have reflected on the possibility that it was a scrivener’s error and that the intent was that 109(a) not apply.” Id. Other bankruptcy commentators have also argued that the Second Circuit’s decision does in fact frustrate the clear purposes of Chapter 15, which, as the American adoption of the Model Law, was designed to provide assistance to courts and representatives in connection with foreign insolvency proceedings. See e.g. Daniel M Glosband & Jay Lawrence Westbrook, Chapter 15 Recognition in the United States: Is a Debtor “Presence” Required?, 24 INTL INSOLV. REV. 28 (2015).

In Re Berau

Judge Glenn’s decision in In re Berau, however, has reconciled Barnett and its detractors by applying a pragmatic reading of Barnett that allows for the application of Section 109(a) and the realization of the Model Law’s goals in the majority of Chapter 15 cases. As background, the foreign representatives of Berau Capital Resources Pte Ltd
The Bankruptcy Court was presented with two potential bases for Chapter 15 eligibility: (i) an attorney retainer held by Berau's New York counsel, and (ii) $450 million in dollar denominated debt that was issued pursuant to an indenture with New York choice of law and choice of forum clauses (which also required numerous debt related actions be taken in New York). The Bankruptcy Court was easily satisfied that the attorney retainer alone was a sufficient basis for Chapter 15 protection based on its prior decisions holding that attorney retainers, bank accounts and similar deposits were a sufficient basis for Chapter 15 eligibility. See in re Octaviar Admin. Pty Ltd, 511 B.R. 361, 369-74 (Bankr. S.D.N.Y 2014). However, Judge Glenn continued his analysis as to debt issued pursuant to the indenture and concluded that “the presence of the New York choice of law and forum selection clauses in the Berau indenture satisfies the section 109(a) ‘property in the United States’ eligibility requirement.” In re Berau Capital Resources Pte Ltd, 540 B.R. 80, 84 (Bankr. S.D.N.Y. 2015).

In reaching this conclusion, the Bankruptcy Court relied on the substantial body of case law finding that intangible property, such as the contract rights created by the indenture, could be deemed property located in New York. Specifically, Judge Glenn cited to the influential opinion by Chief Judge Cardozo in Severnoe Securities Corporation v. London and Lancashire Insurance Company (Severnoe Sec. Corp. v. London Lancashire Ins. Co., 255 N.Y. 120, 174 N.E. 299, 300 (1931)) which established that “justice or convenience” can often require that the situs of intangibles be different places for different purposes and determined that the relevant situs for the debt was New York as the indentures were to be discharged in New York City and the other attributes of the indenture, such as the governing law and forum selection provisions, implicated New York as well. In re Berau Capital Resources Pte Ltd, 540 B.R. 80, 84 (Bankr. S.D.N.Y. 2015).

Additionally, the Bankruptcy Court identified three sections of the New York General Obligation Law that also supported the determination that the indentures satisfied the property requirement of Section 109. Specifically, the Bankruptcy Court cited to N.Y. General Obligations Law § 5-1401, which allows parties to agree that New York law will govern a contract, N.Y. General Obligations Law § 5-1402, which provides that an action against a foreign corporation arising from such a contract may be maintained in New York, and CPLR 327(b), which prevents a court from dismissing such an action on the grounds of inconvenient forum. Judge Glenn found that these sections indicated a clear legislative policy to establish New York as a situs for contracts even when the contract has a situs elsewhere for other purposes. Id. The court also noted the practical inconsistency that would arise “if a foreign debtor’s creditors could sue to enforce the debt in New York, but in the event of a foreign insolvency proceeding, the foreign representative could not file and obtain protection under Chapter 15 from a New York Bankruptcy Court.” Id. At 83.

The Impact of the Berau Ruling:

In addition to bridging the competing viewpoints on the merits of Barnet, the ruling in Berau should help foreign representatives in seeking Chapter 15 recognition. The vast majority of debt documents are governed by New York law, and the Berau decision will provide a foundation for foreign debtors to seek Chapter 15 protection when they would otherwise lack sufficient property in the United States. One practical benefit of this result is that foreign debtors will be better able to protect themselves from ancillary lawsuits arising from debt governed by New York law that may interfere with their main restructuring efforts. Additionally, although Berau only directly addresses debt indentures governed by New York law, it raises the possibility that other intangible property, such as patents, trademarks or other intellectual property, may serve as a basis for Chapter 15 recognition. Overall, the Berau opinion should pique the interest of foreign debtors considering United States Bankruptcy Court protection.
Chapter 12 cases (farmers and fishermen) are a rare breed amongst the myriad of bankruptcy cases filed every year in all districts. During the year 2014, only 372 out of 963,739 bankruptcy filings nationwide were made under Chapter 12. Administrative Office of the U.S. Courts, Bankruptcy Cases Commenced, Terminated and Pending During the 12-Month Periods Ending September 30, 2014 and 2015, as published on October 28, 2015. Information obtained from http://www.uscourts.gov/news/2015/10/28/fiscal-year-bankruptcy-filings-continue-fall.

Thus, it is not surprising nor uncommon for a bankruptcy court faced with a Chapter 12 case to look for guidance in Chapter 13 proceedings, except in those specific instances where the Bankruptcy Code explicitly forbids such treatment (such as adequate protection). In doing so, when faced with the confirmation of a proposed plan of reorganization some courts have determined that the interest rate proposed by a debtor in Chapter 12 plans of reorganization should be similar to the interest rate fixed in Chapter 13 plans where the Debtor is allowed to vary the terms of the original loan. Under 11 U.S.C. §1322(b)(2), a Chapter 13 debtor can modify the rights of holders of secured claims, except if the claim is secured by a lien encumbering Debtor’s principal residence.

After the Supreme Court’s decision in Till v. SCS Credit Corporation, 541 U.S. 465 (2004), a Chapter 13 Debtor will propose, and the Bankruptcy Court will usually approve, an interest rate composed of a nominal risk rate over the current prime rate. Usually a bankruptcy court will approve one or two points over prime. Considering that as of October 28, 2015, the prime rate was 3.25%, a Chapter 13 plan may be approved proposing an interest rate of 4.25% to 5%.

However, using in Chapter 12 plans risk rates similar to those proposed in Chapter 13 plans, fails to consider the inherent risks related to dairy farm operations, which are usually non-existent in, nor associated with, regular wage earner debtors who file for protection under the provisions of Chapter 13 of the Bankruptcy Code.

Usually a secured lender’s collateral in a regular wage earner bankruptcy case is a house or other real property. The debt-to-value ratio of the secured loan tends to be appropriate enough, and the value of such collateral is usually easily ascertainable and maintained. Depreciation or deterioration can also be easily ascertained, and the loss of value occurs usually at a slower pace. Collateral policing by the secured creditor can be achieved as often as needed by regular off-the-mill appraisals, and sometimes, even without having to enter the property itself.

In Chapter 12 cases, although the book value in the lender’s records may appear to be the appropriate, it is seldom so. The secured lender’s collateral can be as varied as the farm operation itself. Sometimes the dairy farm is operated in a property or parcel of land which is not owned by the bankruptcy debtor, but rather, just leased to a non-bankrupt relative. Thus, the secured lender’s main repayment source may not even come from the debtor’s Estate. This presents the problem of whether the dairy farm may continue operating if the executory contract is not timely assumed by the Debtor, or if pending confirmation of the plan, the tenancy is terminated by the landlord.

Oftentimes a milk quota or allocation made by a governmental entity is also pledged as collateral to the secured lender. In Puerto Rico, the Milk Industry Regulatory Office (ORIL) assigns a milk quota to each dairy farm. The value of the quota, however, is not fixed by the regulatory board, but rather, is open to the fluctuations of a free market. The milk quota market is significantly more volatile and fluid than the real estate market. Thus, a milk quota that may have been originally pledged at the inception of the loan at $18.00 per quart, may on the petition date be worth only $14.00, or less, depending on the market’s whim.

In some instances a portion from the milk quota proceeds is also assigned to the secured creditor as collateral, or even, as direct payment of the indebtedness. Although a farmer may have a milk quota assigned of 50,000.00 liters, the real proceeds from the milk quota will ultimately depend on the dairy farm’s actual production. Thus, if disease affects the cattle, and the herd is significantly reduced due to attrition, the secured creditor’s collateral will exist only in paper, or the direct payments may immediately cease to flow to the secured lender.

Case in point, the recent drought in Puerto Rico during this year, 2015. Yes, we have a tropical rain forest, but even here prolonged periods of draught affect farmers, and dairy farms in particular. The mortality rate of the heard increases, the milk production per cow decreases, the nutrients provided by dried grass severely affect milk production, thus increasing the farmer’s dependency on purchased feed and fodder. Malnutrition also causes an increase in the number of culled and sick cows, which in turn increase expenses related to veterinary services. To cover these increases in operating expenses bankruptcy debtors usually have to make use and tap, with or without the Bankruptcy Court’s approval, the secured lender’s cash collateral, notwithstanding the provisions of 11 U.S.C. §363(c)(2).

Therefore, the risks involved in Chapter 12 to a secured lender are significantly higher and different from a secured lender of a regular wage earner. Only by allowing a significantly higher risk factor in Chapter 12 plans’ interest computation can the Bankruptcy Court really protect the secured party’s interests.