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Kathryn R. Heidt Memorial Award Goes To Jeffrey M. Sklarz

By Justin Henderson

This year's Kathryn R. Heidt Memorial Award was given to Jeffrey M. Sklarz of Green & Sklarz, LLC at the fall meeting of the ABA Business Bankruptcy Committee in San Francisco. The Kathryn R. Heidt award honors Kate Heidt, who was the chair of the ABA Section of Business Law's Business Bankruptcy Committee at the time of her death. In addition to her leadership roles at the ABA, she served in leadership capacities at the American Association of Law School's Section on Creditors' and Debtors' Rights. She was a counselor in the truest sense of the word -- a wonderful mother, a friend to many, a dedicated mentor to students and young lawyers, and a trusted voice of wisdom. The Award is designed to serve as a lasting tribute to her and to recognize the importance of bankruptcy education and scholarship to the ABA Business Bankruptcy Committee and the bankruptcy profession.

The Heidt Award is given annually to a member of the ABA who demonstrates a commitment to the values that Kate thought were important for young lawyers to have. The recipient of the Heidt Award must be 45 or younger, have published a recent bankruptcy-related article or produced a significant report or other work product in connection with the ABA, have demonstrated leadership potential, and displayed "generosity of spirit."

Jeff graduated from Colby College with a B.A. in government. He earned his J.D. from the University of Connecticut School of Law. Jeff practices with Green & Sklarz LLC in New Haven, Connecticut. As he said during his acceptance speech, Jeff takes pride in helping to "save businesses from themselves."

Third Circuit Weighs in on Make-Whole Debate

By Ravi Vohra

Recently, the Third Circuit Court of Appeals reversed the Delaware Bankruptcy and District Courts in *Delaware Trust Co. v. Energy Future Intermediate Holding Company LLC (In re Energy Future Holdings Corp.)* , 842 F.3d 247 (3d Cir. 2016) and held that Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (collectively, "EFIH") were subject to certain notes' make-whole provisions when they refinanced those notes shortly after filing for bankruptcy.

The Indentures

During the first months of its bankruptcy case, EFIH refinanced its first lien notes and a portion of its second lien notes, which were issued under indentures that contain an "essentially identical" provision titled "Optional Redemption." That provision allows EFIH to redeem "all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium . . . and accrued and unpaid interest" if redeemed before December 1, 2015 under the first lien indenture and May 15, 2016 and March 1, 2017 under the second lien indenture (depending on the maturity dates). *Id.* at 251 (quoting §

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3.07 of the first lien indenture) (emphasis in original). The first lien indenture also contains an acceleration clause that makes "all outstanding Notes . . . due and payable immediately," but also gives the first lien noteholders the right to rescind the acceleration and its accompanying consequences. Id. (quoting § 6.02 of the first lien indenture). The second lien indenture contains a different acceleration clause, which, in addition to making the outstanding principal amount of the notes due and payable immediately, also makes a "premium, if any" and "other monetary obligations" due and payable immediately. *Id.* (quoting § 6.02 of the second lien indenture). Like the first lien indenture, the second lien indenture gives the second lien noteholders the right to rescind the acceleration. *Id.*

EFIH'S Bankruptcy Filing & Bankruptcy Court Decision

EFIH filed for bankruptcy on April 29, 2014, six months after it disclosed in an 8-K filing that it believed a bankruptcy would shield it from its make-whole obligations. *Id.* at 251-52. After filing, EFIH filed a motion with the bankruptcy court seeking leave to refinance the first lien notes. *Id.* The bankruptcy filing caused the first and second lien notes to become due and payable immediately as a result of the acceleration clause in each of the indentures. *Id.* at 252. Soon after the bankruptcy filing, the Trustee for the first lien notes filed an adversary proceeding seeking a declaration that any refinancing within the bankruptcy would trigger the make-whole premium and that it could rescind the acceleration without violating the automatic stay *Id.* The Trustee also requested that the court lift the automatic stay if it applied.

The bankruptcy court eventually granted EFIH leave to refinance the first lien notes and held that the automatic stay prevented the first lien noteholders from rescinding the acceleration. *Id.* at 252-53. With respect to the make-whole amount, the bankruptcy court held that none was due because Section 6.02, or the acceleration clause, in the first lien indenture did not mention the make-whole premium. On appeal, the district court affirmed the bankruptcy court's rulings. The second lien noteholders, who were also litigating with EFIH over the refinancing and make-whole premium in their indenture, were met with the same fate based on the reasoning from the first lien litigation. The first and second lien Trustees appealed to the Third Circuit, which consolidated the two appeals. *Id.* at 253.

The Third Circuit's Decision

The Third Circuit, relying on state law, began its analysis with the basic tenet that a contract must be interpreted in light of the parties' intent. *Id.* Since the issue before the court was whether the make-whole obligations applied to EFIH, it needed to determine whether: (1) there was a redemption; (2) such redemption was optional; and (3) the redemption occurred before December 1, 2015. *Id.* at 254. There was no dispute that the refinancings occurred before the stated date in each indenture's make-whole provision.

To determine whether there was a redemption, which is not defined in either indenture, the court first looked to Black's Law Dictionary, which defines "redemption" as usually referring "to the repurchase of a bond before maturity." *Id.*at 254-55 (quoting *Redemption*, Black's Law Dictionary (9th ed. 2009)). EFIH argued that since the refinancing occurred post-maturity (by virtue of the acceleration clause), the refinancing should not be characterized as a redemption. The court rejected this argument because New York state and federal courts have held that pre- and post-maturity repayments of debt can be characterized as redemptions. *Id.* at 255 (collecting cases).

The court next determined whether the redemption was optional. EFIH argued that any redemption was mandatory due to the acceleration clause in the indenture. *Id.* The court, however, noted the following facts that led it to conclude the redemption was optional: (1) EFIH voluntarily filed for chapter 11; (2) instead of reinstating the notes, which it could have done, it paid them off immediately; (3) it did exactly what it stated it would in its earlier 8-K filing; (4) after filing for bankruptcy, it stated that it may, "but was under no obligation" to redeem the second lien notes in a subsequent 8-K filing; and (5) it redeemed the notes over the objection of the noteholders, who wanted to decelerate the maturity. *Id.*

In arriving at its holding through the above analysis and reasoning, the court rejected EFIH's arguments that the indenture's make-whole and acceleration clauses were mutually exclusive. *Id.* at 256. EFIH argued that since a post-maturity refinancing occurred, the acceleration clause was the relevant clause for purposes of the litigation. Further, it argued that the acceleration clause's failure to mention the make-whole premium "sap[ped]" the make-whole clause's effect. *Id.* at 256. EFIH relied on a Second Circuit opinion in the American Airlines bankruptcy case in support of its argument, but the court dismissed EFIH's reliance on that case because the acceleration clause in American Airlines' indenture explicitly stated that a make-whole premium would not be due and payable in the event of an acceleration. *Id.* Further, if the court had accepted EFIH's interpretation of the case, it would have also run afoul of a New York Court of Appeals case in which the Court found that "[w]hile it is understood that acceleration advances the maturity date of the debt, there is no rule of New York law declaring that other terms of the contract not necessarily impacted by the acceleration . . . automatically cease to be enforceable after acceleration." *Id.* at 256-57 (quoting *NML Capital v. Rep. of Argentina*, 952 N.E.2d 482, 492 (N.Y. 2011).

EFIH alternatively argued that the acceleration and make-whole clauses were mutually exclusive because of the disparate notice requirements for redemption versus acceleration. It argued that it could not have redeemed the notes since it did not comply with the "detailed notice procedures" found in the make-whole clause. *Id.* at 257. The court stated that EFIH could not "use its own failure to notify to absolve its duty to pay the make-whole" and dismissed any conflict between the clauses as "illusory." *Id.*

With respect to the additional language in the acceleration clause in the second lien indenture, EFIH argued that the acceleration clause's reference to "premium, if any" could have been more specific by referencing the premium owed under § 3.07 of the second lien indenture. *Id.* at 257 (relying on *In re MPM Silicones, LLC*, No. 14-22503-rdd, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd, U.S. Bank N.A. v. Wilmington Sav. Fund Soc., FSB (In re MPM Silicones, LLC)*, 531 B.R. 321(S.D.N.Y. 2015), *appeal docketed*, No. 15-1771 (2d Cir. argued Nov. 9, 2016)) ("*Momentive*"). The court rejected the argument and declined to follow the relied-on opinion because it conflicts "with that indenture's text and fails to honor the parties' bargain." *Id.*

EFIH's last argument in support of its contention that it was not on the hook for its make-whole obligations came from a New York trial court opinion in *Northwestern Mutual Life Insurance Co. v. Uniondale Realty Associates*, 816 N.Y.S.2d 831 (N.Y. Sup. Ct. 2006) in which the court held that, absent a clause permitting it, a "mortgage lender who chose to foreclose following default was not entitled to a 'prepayment premium' because foreclosure has advanced the debt's maturity date." *Id.* at 258. However the court distinguished prepayments from redemptions because the former generally cannot occur absent a clause in the contract, but the latter can. *Id.* at 259 (citing *Chesapeake Energy Corp. v. Bank of N.Y. Mellon*, 773 F.3d 110, 116 (2d Cir. 2014)).

The court concluded by reiterating that "[r]edemptions, not prepayments, occurred here, they were at the election of EFIH, and they occurred before the respective dates [in both indentures]." *Id.* at 261. The Third Circuit reversed the judgments and remanded the case back to the Delaware bankruptcy court for further proceedings with instructions that "[a]ny future appeals shall return to this panel." *Id.*

Drinker Biddle & Reath LLP represents Delaware Trust Company, the indenture trustee for the notes.

Will the Supreme Court Disapprove of Class Skipping Structured Dismissals in Jevic?

By Clay Roberts

The Supreme Court recently heard oral argument in *Czyzewski v. Jevic Holding Corp.* ("*Jevic"*). The question presented is whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme within the Bankruptcy Code. The Third Circuit Court of Appeals affirmed the bankruptcy court's approval of the "structured dismissal" under which unsecured creditors would receive a payment while certain priority unsecured creditors would not. The debtor ("Jevic") and secured creditor ("CIT Group") struck the deal for the structured dismissal, under which $1.7 million in distributions would skip over certain priority unsecured claims in favor of general unsecured claims. The skipped priority wage claimants (the "Priority Claimants" or "Petitioners") are former truck drivers for Jevic Transportation who successfully sued Jevic under the Worker Adjustment and Retraining Notification Act ("WARN Act"). The official committee of unsecured creditors for Jevic then filed a fraudulent transfer action against CIT Group and another secured creditor. By the time the creditors' committee filed the lawsuit, the Jevic bankruptcy case was administratively insolvent because the administrative and priority claims exceeded the value of the estate's unencumbered assets.

The settlement provided for dismissal of the fraudulent transfer case, payment of the committee's legal fees, payment of $1.7 million for unsecured creditors, and dismissal of the Chapter 11 case. The Priority Claimants would receive nothing. Jevic filed a Rule 9019 settlement motion and motion to dismiss the bankruptcy case. The Priority Claimants and the U.S. Government objected to the class skipping nature of the settlement. After a hearing, the Bankruptcy Court approved the Rule 9019 motion and dismissed the bankruptcy case. The Bankruptcy Court found that "dire circumstances" warranted the relief, including no prospect of a confirmable Chapter 11 plan of reorganization or liquidation being filed; conversion to Chapter 7 would be unavailing because the Debtor had insufficient funds that were unencumbered; and the secured creditors would not agree to the deal if the case were converted to Chapter 7. The Bankruptcy Court also determined that the settlement and dismissal did not violate the Bankruptcy Code because the Code only requires that Chapter 11 plans comply with the absolute priority rule, not settlements. Finally, the Bankruptcy Court determined that success in the fraudulent transfer action was "uncertain at best" and that a lawyer taking the case should have "his head examined." The District Court and Third Circuit Court of Appeals affirmed the Bankruptcy Court. *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015), *as amended* (Aug. 18, 2015). The Supreme Court granted certiorari on June 28, 2016 and the case was argued on December 7, 2016.

Counsel for the Priority Claimants argued that no provision of the Bankruptcy Code permits an order dismissing a Chapter 11 case while distributing assets of the estate to creditors but skipping priority claims. Transcript of Oral Argument at 3. *Czyzewski v. Jevic Holding Corp*., 136 S. Ct. 2541, 195 L. Ed. 2d 867 (2016) (No. 15-649), https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/15-649_l5gm.pdf. Counsel asserted that the only options are a Chapter 11 plan, conversion to Chapter 7, or dismissal of the case without distribution. *Id*.

The Justices were initially concerned with the question presented which was whether a bankruptcy court may authorize a settlement that violates the priority scheme. *Id.* at 7. Counsel for Petitioners clarified that the Petitioners seek a holding that a structured dismissal may not take estate assets and distribute them in violation of the priority scheme in the Bankruptcy Code. *Id.* at 9. Justice Alito asked if it can ever be lawful for the priority scheme to change and in response counsel for Petitioners explained that Section 510 of the Bankruptcy Code permits subordination of claims. *Id.* at 17. Counsel for Petitioners also explained that other bankruptcy practices need not be reached by the Supreme Court, such as critical vendors, based on the Doctrine of Necessity. *Id.* at 17-18.

Counsel for the Solicitor General supporting the Petitioners as amicus curiae asserted that "Congress enacted the priority scheme precisely to prohibit the kind of collusive looking agreements that happened here, where you have high-priority and low-priority creditors . . . squeezing out the middle creditors. . . .[T]he Court should not allow parties to make an end run around that prohibition by just slapping the name 'settlement' or 'structured dismissal' on what is really, in essence, an unconfirmable plan." *Id.* at 29. The Chief Justice asked whether there must be an exception for the dire circumstances cited by the Bankruptcy Court. *Id.* at 19. Counsel for the Solicitor General stated there should not be an exception because an "extraordinary circumstances" exception would apply frequently as many bankruptcy cases end up administratively insolvent. *Id.*

Counsel for Respondents began by asserting that the absolute priority rule in Section 1129 only applies to Chapter 11 plans, not to dismissals in the broad fashion supposed by Petitioners. *Id.* at 30. Justice Breyer asked about whether the committee's fraudulent transfer claim was an asset of the estate and if that claim was settled, whether it would need to be distributed to the creditors in the waterfall of priorities in Section 507. *Id.* at 32-34. Counsel for Respondents explained that in *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007) and the Third Circuit decision below, conformity to the absolute priority rule is of high importance, but not required in a settlement. *Id.* at 36-37. Justice Kagan expressed concern that unconfirmable plans in Chapter 11 will just end up taking the route the debtor and secured creditor took in Jevic and seek to dispose of the case in a way that violates the priority scheme. *Id.* at 55.

Overall, it appears the Justices are concerned about the implications of two questions: (1) whether affirming the Bankruptcy Court's decision will embolden parties to skip priority classes when a Chapter 11 plan is unconfirmable, and (2) whether reversing will cause unintended consequences as to when, if at all, the priority scheme may be deviated from. The Justices must carefully consider the practical effect of their ruling as it could drastically change Chapter 11 practice for years to come unless Congress creates another solution to this issue.

Whose (Credit) Line Is It Anyway?: Practical Tips For Managing Voidable Transaction Risk When Underwriting And Structuring Credit To Affiliated Borrowers

By Greg J. David and Carolyn L. Payne

Bankruptcy counsel and lenders' lawyers are usually familiar with voidable transactions, also known as fraudulent transfers. The most problematic type of voidable transaction is commonly known as the constructive fraudulent transfer (a term which the Uniform Law Commission has called "oxymoronic and confusing"). While understanding the theory may be enough for litigators, less commonly discussed is what the transactional lawyer can do to mitigate voidable transaction risks up front. This article aims to provide a practical roadmap for lenders' lawyers and corporate counsel.

Here is the problem: business leaders often struggle to understand the distinction between themselves and their companies. They can, at times, take assets from one company and put them in another, almost as if the different companies are extensions of themselves (or different pockets in their pants). These transfers can be characterized for legal and accounting purposes in various ways: as an (often undocumented) intercompany loan, as a personal loan followed by an equity infusion, as a transfer pricing arrangement, or even just as a bare transfer of assets with no clear legal or economic justification. While this tendency is most acute in the case of privately-held companies, influential public company principals (such as Tesla's Elon Musk) are not immune.

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