

# AMERICAN BANKRUPTCY INSTITUTE JOURNAL

The Essential Resource for Today's Busy Insolvency Professional

## Top Business Bankruptcy Cases of 2009

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**Editor's Note:** *The Building Blocks column, a product of ABI's Young and New Members Committee, is dedicated to educating young and new bankruptcy professionals on some of the basics of bankruptcy law and practice. With that purpose in mind, this article briefly summarizes some important business bankruptcy decisions from 2009. In previous issues and in this issue of the Journal, other ABI members have written extensive in-depth articles analyzing these decisions and their effect on business bankruptcy practice. The citations to these articles are referenced in the footnotes herein.*

New and young bankruptcy professionals should recognize that 2009 was not a typical year. Four of the 10 largest bankruptcy cases were filed in 2009; chapter 11 business bankruptcy case filings increased by 50 percent; and the country entered a deep recession.



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Along the way, a number of important business bankruptcy issues were decided. We have selected a number of these cases for this article's roundup of the leading business bankruptcy cases of 2009. We note that

the following list is neither exhaustive, nor based on scientific studies. Nevertheless, it should become evident why we consider the identified cases to be especially important to the profession.

### About the Authors

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Though our analysis is brief, we encourage you to fully review each cited case for a more thorough understanding of the underlying facts and reasoning.

### Philadelphia Newspapers LLC: Sale Issues in Credit Bidding

The bankruptcy conference circuit was abuzz this year with §363 sale panels. This was undoubtedly due to the fact that a lack of available financing required debtors to move through the bankruptcy process quickly, often utilizing 363 sales. Indeed, two of the

largest hometown newspaper and a stalking-horse bidder led by the current management of the bidder. While not the first opinion on the topic in 2009,<sup>1</sup> the more publicized decisions that resulted in *In re Philadelphia Newspapers LLC*, 418 B.R. 548 (E.D. Pa. 2009),<sup>2</sup> raised serious questions regarding a secured creditor's right to credit-bid in certain asset-sale scenarios.



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Philadelphia Newspapers and its related debtor-entities own and operate numerous print and online publications in the Philadelphia area. 418 B.R. at 553. Following financial difficulties and the breakdown of discussions with their secured lenders to effectuate an out-of-court restructuring, the debtors filed for

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largest and most economically and culturally significant filings in U.S. history, that of General Motors Corp. (Case No. 09-50026) (GM) and Chrysler LLC (Case No. 09-50002), each involved expedited §363 sales. These cases, however, may stand for little other than the proposition that a fully invested U.S. government can achieve the impossible (a 40-day exit from bankruptcy). This "lesson" is unlikely to arise with any frequency. While the quick 363 sales of GM and Chrysler may have partially dominated headlines, other asset-sale issues may have a longer-lasting impact on bankruptcy law.

Toward the end of 2009, there were near-daily bankruptcy reports on the fight between secured creditors seeking to credit-bid on Philadelphia's

bankruptcy and quickly filed a proposed chapter 11 plan of reorganization. The plan of reorganization (not a sale under §363) provided for an asset sale by a public auction of substantially all of the debtors' assets. In connection with the asset sale, the debtors entered into an asset-purchase agreement with a "stalking-horse bidder" and submitted proposed bidding procedures to the court.

The proposed bidding procedures contained a provision that prohibited the secured lenders from submitting a credit bid. *Id.* at 554-55. After an objection and hearing on the issue, the bankruptcy court held that the bidding procedures violated

<sup>1</sup> The Fifth Circuit addressed many of the same issues in *Bank of New York Trust Co. NA v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

<sup>2</sup> For a detailed analysis of this case, see the feature article by Eric W. Anderson and Joshua J. Lewis on page 36 in this issue of the *Journal*.

§1129(b)(2)(A)(iii) of the Bankruptcy Code by denying the senior lenders their right to bid, and rejected the bidding procedures. *Id.* at 555.

On appeal, the district court found that the bankruptcy court erred in holding that where a debtor proposes to sell an undersecured creditor's collateral pursuant to a plan of reorganization under §1129, a secured creditor must be afforded either the right to make an election or the right to credit bid the amount of its secured claim. *Id.* at 564. Noting that there were three possible alternatives to satisfy plan confirmation over the objections of a dissenting class of secured creditors, the district court found that §1129(b)(2)(A)(iii) does not entitle a secured creditor the right to credit-bid at a public auction. *Id.* at 567. The district court further noted that §1129(b)(2)(A)(iii) makes no reference to the credit-bid right created by §363(k) and instead provides only that a secured creditor to receive the "indubitable equivalent" of its claim. *Id.* Determining that the plain meaning of subsection 1129(b)(2)(A)(iii) required no further inquiry into legislative history or other nonstatutory arguments, the district court ultimately held that the right to credit-bid by the secured lenders did not exist and reversed the bankruptcy court's order. *Id.* at 575.

The secured lenders appealed the district court's decision to the Third Circuit Court of Appeals. Oral argument was heard on Dec. 15, 2009, and a decision has not yet been issued. If upheld on appeal, the clear lesson from *Philadelphia Newspapers* is that the debtor can structure asset sales under a reorganization plan that can preclude credit-bidding by secured lenders. The opinion does not resolve, however, how (or whether) a debtor can satisfy the "indubitable equivalent" standard. Stay tuned.

## **TOUSA and Yellowstone: Lenders Beware?**

Two important and controversial bankruptcy court decisions issued in the last year have added greatly to secured lender concerns about credit risk. Each was subject to widespread commentary in and out of the bankruptcy community, particularly among secured lenders.

The first case we discuss, *Official Comm. of Unsecured Creditors of TOUSA Inc. v. Citicorp North America Inc.*, (*In re TOUSA Inc.*), --- B.R. ---, 2009 WL 3519403 (Bankr.

S.D. Fla. Oct. 30, 2009),<sup>3</sup> involved homebuilder TOUSA Inc.<sup>4</sup> Prior to its bankruptcy filing, TOUSA and certain subsidiaries entered into loan credit agreements to fund the settlement of claims arising out of a Florida joint-venture agreement. In exchange for approximately \$500 million in funds, TOUSA and each of its various subsidiaries granted the lenders liens on substantially all of their assets. Following the bankruptcy filing, the creditors' committee sought to avoid the transfers of the liens granted by the subsidiaries as fraudulent conveyances and preferences. 2009 WL 3519403 at \*2-5. Following a lengthy trial, the court issued a 182-page opinion.

In its opinion, the bankruptcy court first concluded that reasonably-equivalent value was not exchanged. Second, the bankruptcy court found that "savings clauses" (clauses that provide that the liens securing the loans are to be reduced, if otherwise invalid, to the extent necessary to prevent the insolvency of the obligor) were unenforceable. *Id.* at \*75. The bankruptcy court stated that "the only purpose served by the savings clauses is to ensure that the transferee can preserve its claim to every last penny of the debtor's remaining assets without providing reasonably equivalent value," thus "the savings clauses are a frontal assault on the protections that section 548 provides to other creditors" and "are entirely too cute to be enforced." *Id.* at \*76. As a result, the liens securing \$500 million in secured loans made prior to the bankruptcy filings were avoided as fraudulent transfers. The bankruptcy court's decision is currently being appealed.

The *TOUSA* court's discussion on "savings clauses" may have farther-reaching consequences as a legal matter, but it is not why the *TOUSA* opinion is so frequently discussed on both sides of the aisle. Instead, it is the bankruptcy court's overall conclusion on reasonably-equivalent value that makes the decision most noteworthy: It is not often that liens securing \$500 million in bank loans are avoided. The outcome is greatly troubling to secured lenders.

*In re Yellowstone Mountain Club LLC*, 2009 WL 3094930 (Bankr. D.

Mont. May 12, 2009),<sup>5</sup> is another case that is causing great concern among secured lenders. The case itself does not address entirely novel issues. Rather, the opinion once again applies accepted principles—this time related to equitable subordination—in a way that was largely unexpected by bankruptcy professionals and market lenders.

The *Yellowstone* case involves a membership-only master-planned unit development "club" located near Yellowstone National Park. The club was controlled by Timothy Blixseth, the CEO and controlling shareholder. Credit Suisse offered Blixseth a "syndicated term loan," a new product that was described as something akin to a home-equity line, for the club entities. Thereafter, Credit Suisse and Blixseth, on behalf of the debtors, entered into a secured \$375 million credit agreement. The proceeds of the loan, however, were not—for the most part—used by the club entities. Instead, Blixseth was allowed to dividend out approximately \$209 million of the loan proceeds to himself, his wife and certain affiliates. 2009 WL 3094930 at \*6. Following *Yellowstone's* bankruptcy filing, Credit Suisse filed a claim for the full outstanding amount due on the syndicated term loan (\$242 million). The debtors and the creditors' committee sought to have Credit Suisse's secured claim equitably subordinated.

Equitable subordination under §510(c) permits a court to subordinate claims for the purposes of distribution, according to generally accepted case law, where (1) creditor conduct is inequitable, (2) such conduct injured creditors or benefited the claim-holder and (3) subordination is not inconsistent with bankruptcy law. The *Yellowstone* court found that Credit Suisse was motivated by fees, turned "a blind eye to the Debtors' financial statements" and engaged in nearly nonexistent financial due diligence. *Id.* at \*9. The court ultimately concluded that "Credit Suisse lined its pockets on the backs of the unsecured creditors" and, accordingly, subordinated Credit Suisse's first-lien position. *Id.*

In connection with *Yellowstone's* chapter 11 plan of reorganization, the bankruptcy court later permitted Credit Suisse to submit a credit bid, but

<sup>3</sup> For a more in-depth analysis of this discussion, see Brighton, Jo Ann J. "TOUSA: Do Lenders Have the Responsibility to Protect Borrowers from Their Own Bad Judgment?," *Am. Bankr. Inst. J. Vol. XXVIII*, No. 10 (December/January 2010) 18, 72-73. See also the News at 11 article on page 38 of this issue of the *Journal*.

<sup>4</sup> Chadbourne represented Citibank, North America in *TOUSA* as the first-lien term loan agent.

<sup>5</sup> For additional insight as well as opposing perspectives on the *Yellowstone* decision, see Brighton, Jo Ann J., and Parrish, Felton E., "Yellowstone: New Standards for Lender Liability in Today's Economic Climate," *Am. Bankr. Inst. J. Vol. XXVIII* No. 7 (September 2009) 28, 84; Beckett, J. Thomas, "A Rogue Loan, Not a Rogue Decision: A Response to a Recent Analysis of *Yellowstone*," *Am. Bankr. Inst. J. Vol. XXVIII* No. 9 (November 2009) 22, 87.

required that such bid include sufficient cash funds to pay certain allowed unsecured claims, administrative fees and costs of the debtors' estates and the debtor-in-possession financing creditor, CrossHarbor Capital Partners LLC. Credit Suisse ultimately did not make the credit bid, and instead CrossHarbor purchased substantially all of the assets in connection with the confirmation of the debtors' plan. *See In re Yellowstone Mountain Club LLC*, Case No. 08-61570 (Docket No. 1026), (Bankr. D. Mont.) (June 2, 2009).

The *Yellowstone* decision is important because it appears to require lenders who participate in arm's-length transactions to perform additional due diligence on their borrowers and on the purpose of their loans. Secured lenders are now left to determine where to draw their investigative line.

### **In re Winstar Commc'ns: Who Is an "Insider" for Preference Purposes?**

In *Schubert v. Lucent Techs. Inc.* (*In re Winstar Commc'ns Inc.*), 554 F.3d 382 (3d Cir. 2009),<sup>6</sup> the Third Circuit found that an "insider" was not limited to affiliates, directors and officers. The facts and analysis of the case are rather straightforward.

Prior to its bankruptcy filing, Winstar Communications Inc. entered into a "strategic partnership" with Lucent Technologies Inc. Following Winstar's bankruptcy filing, the chapter 7 trustee sought to recover a \$188.2 million payment made to Lucent during the year prior to the bankruptcy filing as a preference. 554 F.3d at 393-94. Ultimately, the case hinged on whether Lucent could be characterized as an "insider."

The Third Circuit noted that "what began as a 'strategic partnership' to benefit both parties quickly degenerated into a relationship in which the much-larger company (Lucent) bullied and threatened the smaller (Winstar) into taking actions that were designed to benefit the larger at the expense of the smaller." *Id.* at 392-93. While the Third Circuit acknowledged "that actual control (or its close equivalent) is necessary for a person or entity to constitute an insider under [section] 101(31)

[of the Bankruptcy Code]'s 'person in control' language," this did not preclude Lucent from consideration as a "nonstatutory insider"—that is, an insider not expressly defined by the language of the statute.

In examining whether Lucent was a nonstatutory insider, the court held that "it is not necessary that a nonstatutory insider have actual control; rather, the question 'is whether there is a close relationship [between debtor and creditor] and...anything other than closeness to suggest that any transactions were not conducted at arm's length.'" *Id.* at 396-97. After determining that the arrangements between Winstar and Lucent were not arm's-length transactions, the Third Circuit concluded that the bankruptcy court's finding that Lucent was an insider was not clearly erroneous.

The teaching of *Winstar* is perhaps evident: Do not counsel creditor clients to control parties with whom they do business. This is a rule that has been clear to bank lenders for a long time.

### **General Growth Properties: Can Bankruptcy-Remote Entities Really File for Bankruptcy?**

Another important decision that has been often talked about this year is *In re General Growth Properties Inc.*, 409 B.R. 43 (Bankr. S.D. N.Y. 2009).<sup>7</sup> The decision is widely viewed as a strong attack on bankruptcy remoteness and the structured finance market.

Prior to its bankruptcy filing, General Growth Properties Inc. (GGP), a self-managed real estate investment trust and the ultimate parent company of a group of approximately 750 subsidiaries and joint ventures, participated heavily in the commercial mortgage-backed securities (CMBS) market. This participation took the form of the creation of various project-level special-purpose entities (SPEs), which directly or indirectly owned individual properties and were in turn ultimately owned by GGP. The SPEs were designed to be "bankruptcy remote" and included in their governing documents restrictions to ensure independence and separateness from their parent and other affiliates

as well as requirements to appoint one independent director obligated to consider the interests of the SPE and its creditors before the SPE filed for bankruptcy protection.

Following the contraction in the CMBS market and the downturn in the real estate market as a whole, the entire GGP group filed for bankruptcy. Included in the filing were several solvent and (seemingly) financially viable SPEs. *Id.* at 54-55. As a result, lenders of these various SPEs filed motions to dismiss the bankruptcy petitions of those entities, asserting they had been filed in bad faith. *Id.* at 55.

The bankruptcy court began its analysis by reviewing the law on bad-faith filing. Section 1112(b) of the Bankruptcy Code provides for the dismissal of a bankruptcy petition "for cause." According to the court, case law established the following two-prong test for determining when "cause" for dismissal exists: (1) a showing of objective futility or whether there was no reasonable probability that the debtor would eventually emerge from bankruptcy proceedings; and (2) a showing of subjective bad faith in filing the petition or whether there was no reasonable likelihood that the debtor intended to reorganize. *Id.* at 56.

Addressing the first prong, the court noted that those SPEs were in varying degrees of financial distress that demonstrated that the bankruptcy filings were not futile. *Id.* at 57-58. Rejecting the argument that those SPEs should have waited until they were closer to insolvency before filing for bankruptcy, the court pointed out that it is well established that nothing in the Bankruptcy Code requires a debtor to be insolvent prior to filing. *Id.* at 61. Additionally, the court pointed out that the SPE formation documents required the independent directors to consider the interests of the parent company or equityholder in determining whether to file for bankruptcy protection. *Id.* at 64-65. Addressing the second prong of the bad-faith test, the court rejected the argument that bad faith was displayed by either (1) the failure of those SPEs to negotiate with their creditors prior to filing or (2) the replacement of several SPE independent directors shortly before the bankruptcy filing decisions were made. *Id.* at 64-66.

<sup>6</sup> For in-depth consideration of the impact of *Schubert v. Lucent Techs. Inc.*, see Richman, Michael P., Salzberg, Mark A., and Lee, Matthew D., "Third Circuit Expands Insider Exposure," *Am. Bankr. Inst. J. Vol. XXVIII No. 3* (April 2009) 1, 74.

<sup>7</sup> For more comprehensive treatment of *In re General Growth Properties Inc.*, see Resnick, Brian M., and Krause, Steven C., "Not So Bankruptcy-Remote SPEs and *In re General Growth Properties Inc.*," *Am. Bankr. Inst. J. Vol. XXVIII No. 8* (October 2009) 1, 60; Cook-Dubin, Jesse, "New York Bankruptcy Court Topples Contractual Barriers to Filing Chapter 11: Part I," *Am. Bankr. Inst. J. Vol. XXVIII No. 9* (December 2009/January 2010) 28, 79; Cook-Dubin, Jesse, "New York Bankruptcy Court Topples Contractual Barriers to Filing Chapter 11: Part II," *Am. Bankr. Inst. J. Vol. XXVIII No. 10* (December/January 2010) 16, 90.

## Travelers: Supreme Court Weighs in on...Finality

A roundup of the leading business bankruptcy cases would not be complete without mentioning the one and only business bankruptcy Supreme Court decision of 2009. The case of *Travelers Indemnity Co. v. Bailey*, 129 S.Ct. 2195 (2009),<sup>8</sup> involves the infamous 1980s asbestos bankruptcy cases of Johns-Manville Corporation. As part of those bankruptcy cases, a trust was to be created to protect current and future injuries caused by asbestos. Here is where the story of the newest Johns-Manville case begins.

As part of Johns-Manville's plan of reorganization, Travelers Insurance Co. contributed \$70 million to a trust in return for a broad bankruptcy court release enjoining any and all claims relating to the underlying insurance policies that Travelers had provided Johns-Manville. Questions eventually arose—more than a decade later—as to whether the broad release granted by the bankruptcy court would protect Travelers from direct state-law claims allegedly held against Travelers by asbestos claimants. 129 S.Ct. at 2200.

The Second Circuit determined that the bankruptcy court had lacked subject-matter jurisdiction to enjoin actions against an insurer for its own misconduct. However, on appeal, rather than address the hotly disputed ability of whether a bankruptcy court can issue injunctions against claims that are not derivative of the debtor's wrongdoing (the Supreme Court agreed with the ruling of the bankruptcy court that the "claims against Travelers... 'arise out of' and are 'related to' the insurance policies"), the Court simply found that the state-law actions were barred by the 1986 injunction orders. According to the Court, once a bankruptcy court order becomes final, it "[becomes] *res judicata* to the 'parties and those in privity with them.'" *Id.* at 2198 (citations omitted).

For readers, the actual legal holding from the *Travelers* decision is not particularly surprising. What may be more surprising is what the Supreme Court fails to address in the opinion: Lower courts still lack guidance from the Supreme Court on how to deal with third-party releases, an issue that has been contested among

the circuits since the early 1990s. *Cf.*, *SEC v. Drexel Burnham Lambert Group Inc. (In re Drexel Burnham Lambert Group Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992), with *In re Boston Harbor Marina Co.*, 157 B.R. 726, 729-31 (Bankr. D. Mass. 1993). ■

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<sup>8</sup> For a more in-depth analysis of *Traveler's Indemnity Co.*, see Bowles Jr., C.R., "It's All a Matter of Interpretation: Supreme Court's Decision in *Travelers Indemnity Co. v. Bailey*," *Am. Bankr. Inst. J.* Vol. XXVIII No. 6 (July/August 2009) 50, 64.