AMERICAN COLLEGE OF BANKRUPTCY

2022 INDUCTION EDUCATION SESSION

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Strategy and Gamesmanship in Bankruptcy: Incompatible or Part of the Process?

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I. *Venue Shopping*

A. Cases Attracting Public Criticism of, without Litigated Challenges to, Venue

1. *In re Nat'l Rifle Ass'n of Am.*, 628 B.R. 262 (Bankr. N.D. Tex. 2021) (NRA was a New York nonprofit headquartered in Virginia that had publicly expressed view that New York was hostile jurisdiction; court observed, in decision dismissing bankruptcy cases of NRA and Sea Girt, LLC, NRA's Texas affiliate, that affiliate was formed within 60 days of NRA's bankruptcy filing in Northern District of Texas, "ha[d] no employees or operations and was formed to accomplish a shared bankruptcy purpose with the NRA"). *See Exhibit 1.*

2. *In re Purdue Pharma L.P.*, No. 19-23649 (RDD) (Bankr. S.D.N.Y. June 30, 2021) [Docket No. 3093] (in response to letter from debtors directed to specific district judge regarding potential future motion for withdrawal of reference, district judge criticized debtors for directing letter to her before any matters had been assigned pursuant to court procedures (however, subsequent confirmation appeals were ultimately assigned to that district judge); debtors' bankruptcy cases had previously drawn criticism based on what some viewed as improper efforts by debtors to have cases assigned to specific bankruptcy judge). *See Exhibit 2.*

B. Cases Involving Venue Disputes

1. *In re LTL Mgmt. LLC*, Case No. 21-30589, 2021 WL 5343945 (Bankr. W.D.N.C. Nov. 16, 2021) (debtor was North Carolina entity formed in connection with Texas two-step transaction two days before bankruptcy filing; court granted bankruptcy administrator's motion to transfer Texas two-step debtor's case to District of New Jersey upon finding that debtor was not merely forum shopping but "manufacturing forum" and "attempting to outsmart the purpose of the [bankruptcy venue] statute"). *See Exhibit 3*.

2. *Patterson v. Mahwah Bergen Retail Group, Inc.*, Civil No. 3:21cv167 (DJN), 2022 WL 135398 (E.D. Va. Jan. 13, 2022) ("*Ascena*") (in reversing and remanding confirmation order based on conclusion that third-party releases were impermissible under applicable precedent, court found that interests of justice warranted reassigning case to judge outside division in which bankruptcy cases were originally filed, explaining that although impartiality or integrity of presiding judge was not in question, reassignment was warranted due to original division's "practice of regularly approving third-party releases and the related concerns about forum shopping"). *See Exhibit 4*.

3. *In re Availa Bio, Inc.*, Case No. BK-S-21-14909-NMC (Bankr. D. Nev. Nov. 24, 2021) [Docket No. 143] (debtor was Nevada corporation with principal assets and place of business in New Jersey; court granted creditor's motion to transfer venue of debtor's case to District of New Jersey based on various ties to that jurisdiction, including, among others, pending litigation between creditor and debtor in New Jersey state court). *See Exhibit 5*.

4. *In re Bestwall LLC*, 605 B.R. 43 (Bankr. W.D.N.C. 2019) (debtor was formed in Texas two-step transaction approximately three months before bankruptcy filing; court denied motion to transfer venue filed by official asbestos claimants' committee where motion was filed approximately eight months into bankruptcy case and parties did not have significant connections to alternative venue sought by committee). *See Exhibit 6*.

C. Legislative Response

1. *Bankruptcy Venue Reform Act of 2021* (H.R. 4193) (bill introduced in the House on June 28, 2021 (with similar related bill (S. 2827) introduced in Senate on September 23, 2021); among other things, would amend 28 U.S.C. § 1408 to require any corporate debtor to file its bankruptcy case in (a) venue in which debtor's principal place of business or principal assets have been located for the 180 days immediately preceding the petition date (or longer portion of such 180-day period than they have been located elsewhere) or (b) district in which bankruptcy case concerning debtor's affiliate is pending, but only if affiliate directly or indirectly owns, control, or holds at least 50% of outstanding voting securities of, or is general partner of, later-filing debtor, and only if affiliate's pending case was properly filed in that district). *See Exhibit 7.*

D. Recent Amendments to Local Rules/Orders Governing Judicial Assignments

1. *Southern District of New York – General Order M-581 & Local Bankruptcy Rule 1073-1(f)* (providing that, effective December 1, 2021, "mega" chapter 11 cases (defined as those in which debtors' cumulative assets or cumulative liabilities total $100 million or more) will be randomly assigned to judge within district irrespective of courthouse in which case is filed). *See Exhibit 8*.

2. *Eastern District of Virginia – Standing Order 21-21 & Local Bankruptcy Rule 1075-2* (providing that, effective February 15, 2022, "mega" chapter 11 cases (defined as those in which debtors' "total noncontingent, liquidated and non-insider liabilities or assets" collectively exceed $100 million) shall be randomly assigned to judge within district (other than assigning chief judge) irrespective of division in which mega case is filed). *See Exhibit 9*.

II. *Bad Faith Filings*

A. Unfair Attempt to Avoid Regulatory Scheme

1. *In re Nat'l Rifle Ass'n of Am.*, 628 B.R. 262 (Bankr. N.D. Tex. 2021) (court dismissed bankruptcy cases as filed in bad faith where evidence indicated that primary purpose of bankruptcy filing was to avoid dissolution in pending regulatory action filed by New York state attorney general and debtors were admittedly solvent and had no other compelling reason for filing). *See Exhibit 1* above.

B. Chapter 15 Cases

1. *In re Culligan Ltd.*, Case No. 20-12192, 2021 WL 2787926 (Bankr. S.D.N.Y. Jul. 2, 2021) (court found that although Bankruptcy Code granted discretion to deny chapter 15 relief that was "manifestly contrary" to U.S. public policy under 11 U.S.C. § 1506, "this exception is not met by a simple finding that the Chapter 15 Petition has been filed as a litigation tactic"). *See Exhibit 10*.

2. *Samba v. Int'l Petroleum Prods. & Additives Co., Inc. (In re Black Gold S.A.R.L.)*, BAP No. NC-21-1068-BGT, 2022 WL 488438 (B.A.P. 9th Cir. Feb. 17, 2022) (court found that bad-faith nature of filing was not proper basis for denial of recognition of chapter 15

petition where all three requirements of 11 U.S.C. § 1517(a) were met and requirements for discretionary denial under 11 U.S.C. § 1506 were not). *See Exhibit 11*.

C. Divisive Mergers (aka ("Texas Two-Steps")

1. *In re Bestwall LLC*, 605 B.R. 43 (Bankr. W.D.N.C. 2019) (court denied motion to dismiss Texas two-step bankruptcy case without reaching issue of bad faith upon finding that debtor was capable of reorganizing under chapter 11). *See Exhibit 6* above.

2. *In re LTL Mgmt., LLC*, Case No. 21-30589 (MBK), 2022 WL 596617 (Bankr. D.N.J. Feb. 25, 2022) (court denied motions to dismiss debtor's Texas two-step bankruptcy case as filed in bad faith, finding that "justice will best be served by expeditiously providing critical compensation through a court-supervised, fair, and less costly settlement trust arrangement"). *See Exhibit 12*.

D. Legislative Response

1. *Nondebtor Release Prohibition Act of 2021* (H.R. 4777/S. 2497) (bill introduced on July 28, 2021; would amend 11 U.S.C. § 1112 to require dismissal of any chapter 11 case in which debtor or its predecessor was involved in divisional merger or equivalent transaction that occurred within 10-year period preceding bankruptcy filing and "had the intent or foreseeable effect of . . . [s]eparating material assets from material liabilities of an entity eligible to be a debtor under [chapter 11]; and assigning or allocating all or a substantial portion of those liabilities to the debtor, or the debtor assuming or retaining all or substantial portion of those liabilities"). *See Exhibit 13*.

2. *Testimony from February 8, 2022 Hearing before Subcommittee of Senate Judiciary Committee* (bankruptcy experts and affected tort claimant testified about corporations' use of bankruptcy to limit mass tort exposure, with discussion primarily focusing on use of Texas two-steps). *See Exhibit 14*.

III. *Equitable Mootness*

1. *In re Purdue Pharma LP,* 7:21-cv-07532-CM (S.D.N.Y. Oct. 10, 2021). Purdue Pharma opioid company case. Sackler family and their affiliates contributed billions to obtain full releases from all liability, despite alleged family fraud and willful misconduct under consumer protection statutes. Chapter 11 plan was confirmed after supermajority of creditors voted in favor of plan over objections. District Court reversed confirmation order, vacating plan confirmation. Prior to issuing the 142-page ruling on December 16, 2021, reversing confirmation, District Judge McMahon addressed issues of equitable mootness. The U.S. Trustee had filed two motions for stay pending appeal, the first before Bankruptcy Judge Drain and the second on an emergency basis before the District Court. Judge McMahon had not yet entertained argument on the stay motion, but entered a temporary restraining order, preventing any implementation of Purdue Pharma's confirmed plan until she had a chance to consider the U.S. Trustee's request for a stay pending appeal, emphasizing that she had "no intention of allowing the critically important issues on appeal to be 'equitably mooted." Currently on appeal before the Second Circuit. *See Exhibit 15.*

2. *In re Nuverra Environmental Solutions, Inc. v. Hargreaves*, 834 F. App'x 729 (3d Cir. 2022), *cert. denied sub nom. Hargreaves v. Nuverra Envtl. Solutions, Inc.*, 595 U.S. (U.S. Oct. 12, 2021) (No. 21-17) (denying without comment). Chapter 11 plan confirmed over objections of David Hargreaves, unsecured creditor, to be paid 6% under the proposed Chapter 11 plan, whereas trade creditors to be paid in full as "gift" from secured creditors who would own the debtors post-confirmation. Hargreaves filed a notice of appeal and requested a stay pending appeal (denied by district court). Debtors filed a motion to dismiss Hargreaves' appeal as equitably moot. District Court agreed and dismissed the appeal. Third Circuit affirmed after undergoing analysis of elements of Equitable Mootness: (1) whether the confirmed plan has been substantially consummated, and (2) if granting the relief requested in the appeal would "fatally scramble the plan" or significantly harm those who relied on the plan. Third Circuit focused on second factor, because the plan had been substantially consummated, and held that Hargreaves was not entitled to small sum of his individual recovery greater than other unsecured creditors in same class would receive. *See Exhibit 16*.

3. *Ascena* - Ascena and its affiliates (former owner of Ann Taylor and other brands) filed their joint chapter 11 plan to which several parties objected. Bankruptcy Court confirmed the plan. The proposed debtor releases were approved since the only evidence presented was that, in the absence of those provisions, those parties to be released would have been unwilling to financially contribute to or otherwise participate in the plan process and that would have impaired the ability to restructure. The U.S. Trustee appealed the third-party releases contained in the confirmed plan. The District Court in Virginia reversed and remanded confirmation of plan. Rejecting equitable mootness as basis for insulating the ruling from appeal, it remanded with instructions the matter be assigned to a different judge. *See Exhibit 4 above*.

4. *FishDish LLP v. VeroBlue Farms USA Inc.,* No. 19-3413, No. 19-3487, 2021 WL 3411834, *7 (8th Cir. Aug. 5, 2021). The Eight Circuit reversed the district court's decision to dismiss an appeal of plan confirmation order by preferred shareholder. The district court had found the plan's substantial consummation meant that any relief granted through the appeal would impermissibly affect third parties to the plan. On appeal, the Eighth Circuit found the district court's analysis too meager, and remanded for further consideration of "the strength of [the shareholder's] claims, the amount of time that would likely be required to resolve the merits of those claims on an expedited basis, and the equitable remedies available — including possible dismissal — to avoid undermining the plan and thereby harming *third parties.*" *See Exhibit 17*.

5. *In re Windstream Holdings, Inc.*, Case No. 20-1275-bk (2d Cir. Feb. 2021) (dismissing unsecured creditor's appeal of order permitting payment of debtors' critical vendors). Creditor GLM held a $2 million unsecured claim, and objected to the creditor vendor motion and appealed the ultimate critical vendor order to the district court. The district court affirmed. GLM appealed to the Second Circuit Court of Appeals, but did not seek a stay pending appeal. In the meantime, the Bankruptcy Court confirmed Windstream's Chapter 11 plan. The Second Circuit dismissed the appeal as equitably moot, holding that the party seeking to overcome the presumption of equitable mootness must demonstrate all five factors under the *Chateaugay* factors, and GLM had not even sought a stay pending appeal. *See Exhibit 18*.

6. *Rene Pinto-Lugo, et al. v. Financial Oversight and Management Board of Puerto Rico, et al.,* Case No. 19-1181 (1st Cir. Feb. 8, 2021) (dismissing appeal of plan of adjustment confirmation). *See Exhibit 19*.

7. *In re LCI Holding Company, Inc.*, 2015 BL 295784 (3d Cir. Sept. 15, 2015) (stating that the equitable mootness doctrine "comes into play in bankruptcy (so far as we know, its only playground) after a plan of reorganization is approved" and ruling that equitable mootness would not cut off the authority to hear an appeal outside the plan context). *See Exhibit 20*.

8. *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props. Inc. (In re Transwest Resort Props., Inc.)*, 801 F.3d 1161 (9th Cir. 2015), a divided panel of the U.S. Court of Appeals for the Ninth Circuit ruled that, despite substantial consummation of the subject plan, a creditor's appeal of a Chapter 11 plan confirmation order should not be dismissed on equitable mootness grounds. In so holding, the Ninth Circuit applied a four-part test to determine that the creditor's appeal was not equitably moot: (1) whether the appellant sought a stay pending appeal; (2) whether substantial consummation of the plan occurred; (3) whether the relief sought would affect third parties not before the court; and (4) whether the relief sought would entirely unravel the plan. The Ninth Circuit held that, although substantial consummation is a factor that weighs in favor of equitable mootness, the law requires that the court still examine the third and fourth prongs of the equitable mootness test. *See Exhibit 21*.

9. *First Southern Ntl. Bank v. Sunnyslope Housing Ltd. Partnership (In re Sunnyslope Housing Ltd. Partnership)*, No. 12-17241 (9th Cir. 2016). This decision extends the Ninth Circuit's holding in *Transwest*. Reversing the district court's judgment affirming the bankruptcy court's confirmation of a Chapter 11 plan, the Ninth Circuit held that the creditor's appeal was not equitably moot despite the fact that funding for the reorganization plan had been furnished by an equity investment from a third-party investor, and the plan had been substantially consummated. The court concluded that the plan was based on an improper valuation of a creditor's secured interest in real property and that the debtor had improperly been permitted to exercise the cram down provisions of section 506(a) of the Bankruptcy Code and to retain the property at issue in exchange for a new payment plan that permitted the debtor to pay the creditor an amount equal to the present value of the secured claim at the time of bankruptcy. *See Exhibit 22*.

10. *In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017). Creditors objected to the plan, plan was confirmed, then creditors appealed the plan confirmation order and sought stay of plan confirmation order before three different courts. Debtors sought to dismiss the appeal as equitably moot. Second Circuit declined to dismiss the appeal as equitably moot. Panel found that the reorganization plan had been substantially consummated, and analyzed the five factors under *Chateaugay II*: whether: (i) effective relief can be ordered; (ii) relief will not affect the debtor's re-emergence; (iii) relief "will not unravel intricate transactions"; (iv) affected third-parties were notified and able to participate in the appeal; and (v) appellant diligently sought a stay of the reorganization plan. Panel required all five factors to be met, but placed chief consideration on factor regarding whether appellant sought stay of confirmation. "If a stay was sought, we will provide relief if it is at all feasible, that is, unless relief would 'knock the props out from under the authorization for every transaction that has taken place and create an

unmanageable, uncontrollable situation for the Bankruptcy Court.'" Debtor argued on appeal that the relief would alter a critical piece of the Plan resulting from the intense-multi-party negotiation, thereby impacting other terms of the agreement and throwing into doubt the viability of the Plan, and that accordingly such relief "would cause debilitating financial uncertainty" to the emergent Debtor. The Second Circuit disagreed. On remand, the Second Circuit required the bankruptcy court to re-evaluate the interest to be received on the replacement notes held by the Senior-Lien Notes holders, which could require only up to $32 million of additional annual payments over seven years, with no other redistribution from other creditors or third parties that would unravel the plan, threaten Debtors' emergence, or otherwise materially implicate the concerns identified in *Chateaugay II*. *See Exhibit 23*.

IV. *Voting Issues Under Chapter 11 Plan*

A. Death-Trap Provisions

1. *In re Peabody Energy Corp.*, 933 F.3d 918 (8th Cir. 2019) (affirming confirmation of plan that included a death-trap provision and that was accepted by all classes of creditors; rejecting the argument by dissenting group of creditors that the provision was "coercive" and that the plan was not proposed in good faith). *See Exhibit 24*.

2. *In re MPM Silicones, LLC*, Case No. 14-22503-rdd, at 54-55 (Bankr. S.D.N.Y. Sept. 9, 2014) (denying motions filed under Bankruptcy Rule 3018 by classes of secured creditors that voted to reject plan that contained a death-trap to change their votes after the court had announced that it would confirm the plan) ("[F]ish-or-cut-bait, death-trap, or toggle provisions have long been customary in Chapter 11 plans. . . . There's a clear rationale behind such provisions . . . . [S]uch provisions offer a choice to avoid the expense and more importantly the uncertainty of a contested confirmation hearing. The first and 1.5 lien holders . . . made the choice to vote against the plan, and I believe it would not be proper, and that they have not shown cause now to change that vote in order to undo its consequences."). *See Exhibit 25*.

B. Plan Support and Other Voting "Lock-Up" Agreements

1. Bankruptcy Code Section 1125(b) ("An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.").

2. *In re NII Holdings, Inc.*, Case No. 02-11505 (MFW), at 59-60 (Bankr. D. Del. Oct. 22, 2002) (designating votes of creditors who delivered signature pages on agreement to vote to accept plan after the debtors filed for bankruptcy but before the court approved and the debtors disseminated a disclosure statement) ("There is no room for . . . a post petition lock-up agreement. . . . And I think I must designate the votes of those entities who had executed . . . a lock-up agreement which became effective post petition on delivery to the debtors."). *See Exhibit 26*.

3. *In re Stations Holding Co.*, Case No. 02-10882 (MFW), at 27, 44 (Bankr. D. Del. Sept. 25, 2002) (designating votes of creditors who entered into lock-up agreement with the debtor after the debtor filed for bankruptcy but before it obtained court approval for, and disseminated, a disclosure statement; rejecting argument that the agreement was enforceable because it provided that the creditors would not have to vote to accept the plan until a disclosure was approved and disseminated) ("The fact that [the agreement] was conditioned on the debtor filing a disclosure statement is irrelevant because [the agreement] does not say that [the creditors] have the right to change their vote if the disclosure statement I approve causes them to want to change their vote. . . . A lockup agreement, certainly the ones signed in this case, constitute the solicitation of a vote on a plan and [the creditors' votes] must be designated, I think, while I have discretion, I think it's clear that this process does not pass muster under 1125."). *See Exhibit 27*.

4. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 295-96 (Bankr. D. Del. 2013) (declining to designate votes of sophisticated secured creditors who executed a restructuring support agreement) ("Designation of votes in this case would be demonstrably inconsistent with the purposes of the Bankruptcy Code for at least two reasons. First, creditor suffrage is a bedrock component of Chapter 11; it would indeed be anomalous, in the absence of a showing of bad faith or wrongful conduct, to discount or ignore the votes of the overwhelming majority of the creditors and stakeholders, and thereby deny confirmation of a Plan that has been laboriously (and expensively) developed and has won broad support. Second, and perhaps more to the point, the interests that § 1125 and the disclosure requirements are intended to protect are not at material risk in this case. . . . The Restructuring Support Parties . . . are all sophisticated financial players and have been represented by able and experienced professionals throughout these proceedings. It would grossly elevate form over substance to contend that § 1125(b) requires designation of their votes because they should have been afforded the chance to review a court-approved disclosure statement prior to making or supporting a deal with the Debtor."). *See Exhibit 28*.

5. *In re Heritage Organization, LLC*, 376 B.R. 783, 791 (Bankr. N.D. Tex. 2007) (declining to designate votes of creditors who, after the filing of the petition but before they received a court-approved disclosure statement signed a "term sheet" with the debtor under which they agreed to vote to accept a plan on outlined terms; court stresses that the plan was later modified and the creditors became co-proponents of the modified plan) ("[T]he prohibition against pre-disclosure statement solicitation is simply inapplicable on the facts of this Case—*i.e.*, where the entities allegedly 'solicited' in violation of § 1125(b) are *co-proponents* of the plan. . . . [I]f a creditor believes that it has sufficient information about the case and the available alternatives to jointly propose a Chapter 11 plan with another entity (whether that co-proponent is another creditor, the debtor, or a trustee (who also believes that it has sufficient information)), it is absurd to think that the signing of a term sheet by those parties (that contains the material terms of their to-be filed joint plan and states that the co-proponent creditor(s) will vote for their agreed upon joint plan) is an improper solicitation of votes in accordance with § 1125(b)."). *See Exhibit 29*.

V. *Recent District Court (and Circuit) Decisions in Bankruptcy Appeals*

A. *In re Purdue Pharma, L.P.*, 635 B.R 26 (S.D.N.Y. 2021). *See Exhibit 30.*

B. *Ascena. See Exhibit 4 above.*

C. *In re Royal Street Bistro, L.L.C.*, No. 22-30066 (5th Cir. Feb. 16, 2022). *See Exhibit 31.*