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DETROIT GETS A FRESH START AND PENSION DEBT IS AT RISK

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Bankruptcy Judge Steven Rhodes ruled from the bench on December 3, 2013 (followed by a written opinion on December 5, 2013) that Detroit is eligible for bankruptcy protection, allowing the city to attempt to restructure $18.5 billion of debt. Thus begins the largest American municipal bankruptcy case. After nine days of trial, the judge ruled that although the city did not negotiate in good faith prior to bankruptcy, it was impossible for the city to do so. He concluded that the city was insolvent, it desires to effect a plan that adjusts its debts, and it filed its bankruptcy petition in good faith. In addition, in an equally important ruling, Judge Rhodes ruled that even though the Michigan Constitution provides that pension rights may not be "impaired or diminished," pension debt has no greater protection than ordinary contract debt and can be subject to impairment in a federal bankruptcy proceeding. He cautioned, however, that he will not lightly exercise the power under the federal bankruptcy law to impair such pension debt. Appeals on both rulings are expected, perhaps directly to the Court of Appeals for the Sixth Circuit.

UK SUPREME COURT FINDS CERTAIN PENSION LIABILITIES ARE NOT ENTITLED TO PRIORITY TREATMENT, IN *NORTEL* AND *LEHMAN* DECISIONS

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CASE SNAPSHOT

In the matter of the Nortel Companies, the UK Supreme Court found that pension liabilities attributed to a company that arose prior to the occurrence of an insolvency event were not entitled to priority treatment, even if the first demand for payment was only made after the insolvency event occurred.

FACTUAL BACKGROUND

The Pensions Act

The UK Pensions Act of 2004 (the "UK Pensions Act") established, among other things, a regime to protect employees from underfunded occupational pension schemes in the event of their employer's insolvency. As part of this law, the Pension Protection Fund (the "PPF") was established as a statutory body that maintains a fund for members of eligible pension plans financed through levies on pension plans (similar to private insurance premiums) to compensate beneficiaries if their pension plan is inadequately funded.

This UK Pensions Act regime is in addition to the existing protections available under section 75 of the Pensions Act 1995 (the "1995 Act"), which provides that upon the occurrence of an insolvency event, an amount equal to any shortfall in the assets of an occupational pension scheme (a "scheme") that exists immediately prior to the insolvency event, is a "section 75 debt" due from the trustees of the scheme. Although an insolvency event was initially limited to an employer going into an insolvent liquidation, it was extended by the UK Pensions Act to administrations. Section 75(8) of the 1995 Act provides that a section 75 debt is treated as a provable debt (i.e., a general unsecured claim) arising immediately prior to the insolvency.

The UK Pensions Act recognized that when it established the PPF, it also needed to include protections to prevent companies from passing along pension obligations to the PPF by, for example, having a group of companies use a single service company to employ the workers for the larger group of companies, while limiting the pension obligations to the service company and effectively trying to ring-fence the pension liabilities of a group in the service company. To combat any attempts to avoid rightful liability, the Pensions Regulator was established. Among its powers, the Pensions Regulator may (i) issue a financial support direction (an "FSD") to some or all of the other group companies (known as "targets"), which is an obligation to provide reasonable financial support to an under-funded scheme or the service company or insufficiently resourced employer; and (ii) impose a contribution notice (a "CN") imposing a specific monetary liability payable by the target to the pension trustees if the FSD is not complied with.

Insolvency and Administrations

A number of procedures are available in the UK that can be utilized when a company becomes insolvent, including liquidation and administration. Liquidation (commonly called "winding-up") can be used by both a solvent and insolvent company, although an insolvent liquidation is more common. Administrations are governed by the Insolvency Act 1986 (the "1986 Act"). The 1986 Act initially did not allow for distributions to creditors while the administration was ongoing. If the administration was not successful in rescuing the company, it was expected that a winding-up would follow and the available assets would then be distributed to creditors. Following the Enterprise Act 2002, it is now possible for assets to be distributed to creditors by administrators, and thus a separate winding-up can be avoided.

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AMOUNT OF CREDIT BID MUST BE INCLUDED IN CALCULATION OF QUARTERLY FEE

In re WM Six Forks, LLC, Case No. 12-05854-8-ATS, 2013 WL 5354748 (Bankr. E.D.N.C., Sept. 23, 2013)

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CASE SNAPSHOT

Pursuant to section 363(k), a secured creditor made a credit bid on its collateral—a mixed-use building owned by the debtor—and the sale was approved by the court. The debtor, however, did not include the $31 million credit bid when it calculated the quarterly fee owed to the U.S. Trustee. On the motion of the bankruptcy administrator, the court entered an order directing the debtor to appear and show cause for its failure to pay the full quarterly fee. Applying a broad reading, the Bankruptcy Court for the Eastern District of North Carolina held that a credit bid exercised by a secured creditor pursuant to section 363(k) of the Bankruptcy Code was a "disbursement" for purposes of calculating the quarterly fee due under 28 U.S.C. § 1930(a)(6).

FACTUAL BACKGROUND

Debtor, the owner of a mixed-use building, filed a voluntary chapter 11 petition. Pre-petition, the debtor executed a building loan agreement that was secured by a deed of trust and assignment of rents, profits and income from the building. Debtor also entered into a security agreement and financing statement covering "collateral…now or thereafter located on the premises of, related to, or used in connection with the construction, financing, repair, ownership, management, and operations of" the building. The creditor, successor-by-assignment to the original lender, filed a proof of claim based on the foregoing security instruments in the total amount in excess of $39 million.

A few months after the debtor filed its chapter 11 petition, the debtor and creditor entered into a purchase agreement by which the creditor would purchase the building for approximately $37 million. The purchase agreement also entitled the creditor "to exercise its credit bid right pursuant to section 363(k) of the Bankruptcy Code on account of its allowed secured claim in an amount not less than" the amount of its proof of claim. Thereafter, the court entered an order confirming the debtor's amended plan of liquidation, which provided for the transfer of the building to the creditor in full satisfaction of its claim following court approval of the purchase agreement and certain bidding procedures. The court entered an order approving the sale of the building to the creditor, and the creditor then transferred its rights to a successor-by-assignment in consideration of the credit bid.

When the debtor filed its quarterly fee statement and post-confirmation report, it stated that the building was sold to the creditor and listed total disbursements of approximately $111,000, which resulted in a quarterly fee of $975. The debtor did not include the credit bid in its fee statement.

The bankruptcy administrator filed a motion arguing that the debtor owed the maximum quarterly fee of $30,000 pursuant to 28 U.S.C. § 1930(a)(6), based on its contention that the creditor's credit bid of approximately $37 million was a "disbursement" under section 1930(a)(6). The court entered an order directing the debtor to appear and show cause for its failure to pay the correct quarterly fee amount. The parties disagreed on whether a credit bid is a "disbursement" under section 1930(a)(6).

COURT ANALYSIS

The court began its analysis with the plain language of section 1930(a)(6). Section 1930(a)(6) requires that debtors pay the U.S. Trustee quarterly fees, which are calculated on a graduated scale based on "disbursements" made during a given quarter. The court held that the definition of the term "disbursements" was critical, but noted that neither the Bankruptcy Code nor the legislative history defined the term.

The bankruptcy administrator urged the court to adopt a broad interpretation of the term "disbursements" to include the successful credit bid in calculating the debtor's quarterly fee, arguing that a broad interpretation was consistent both with the plain meaning of the term as well as with the purposes and legislative history of section 1930(a)(6). The debtor, pointing to language in the closing statement indicating that the debtor neither received nor made payments totaling $37 million in exchange for the building or for partial satisfaction of the existing debt, disputed the administrator's claim that the credit bid was a "disbursement."

The court looked to *Black's Law Dictionary and Merriam-Webster's Dictionary and Thesaurus*, both of which defined "disbursement" as the act of paying out money. The court also looked at sections 326(a) and 543 of the Bankruptcy Code for guidance. Section 326(a) sets trustee compensation limits based on "moneys disbursed." The court cited opinions from the Third Circuit and the Ninth Circuit BAP standing for the proposition that the value of credit bids were not included in "moneys disbursed" under section 326(a), and held that in the context of 326(a), "disbursements means something more than monies." Turning to section 543(a), which prohibits a custodian from making certain disbursements, including the disbursement of "offspring," the court held that "disbursement" under section 543 "is broader than the disbursement of money."

The court considered opinions from across the country—including from the bankruptcy courts for the Western District of Tennessee, the District of South Dakota, the Eastern District of North Carolina, the Western District of Virginia, the Western District of Texas, the Southern District of New York, and the Ninth Circuit—all of which broadly construed the term "disbursements" under section 1930(a)(6) to include all payments, whether made directly by the debtor or made by a third party. The court concluded that "[t]he congressional purpose underlying the United States Trustee Program and quarterly fees lent additional support to a broad reading of the term 'disbursements' in § 1930(a)(6)," because that section was established as a "revenue-generating mechanism" to impose costs "on 'the users of the bankruptcy system, not the taxpayer.'"

Citing Supreme Court precedent from *RadLax Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2070 n.2 (2012) and other courts around the country, the court held that credit bidding protects a creditor "against the risk that its collateral will be sold at a depressed price," without requiring that the creditor put up additional cash or collateral to protect its interests. Thus, under section 363(k), a credit bid by the secured creditor is treated as the equivalent of

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DELAWARE CHANCERY COURT EVALUATES 'PUBLIC, COMMERCIALLY REASONABLE' FORECLOSURE SALE UNDER UCC

Edgewater Growth Capital Partners LP v. H.I.G. Capital, Inc., 68 A.3d 197 (2013)

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CASE SNAPSHOT

Edgewater Growth Capital Partners LP created the debtor and guaranteed its indebtedness. After several attempts to restructure the debtor, the company's assets were sold at foreclosure. Edgewater sued when the secured lender's affiliate purchased the assets, claiming the foreclosure sale violated the UCC. The court ruled that the foreclosure sale was public, commercially reasonable, and did not violate the UCC provisions governing post-default disposition of collateral. The court also ruled that Edgewater was responsible for repayment of the limited guaranteed amount, plus interest, attorney fees and costs incurred by the lender in the litigation brought by Edgewater.

FACTUAL BACKGROUND

Edgewater purchased and aggregated companies providing ATM services into one organization named Pendum. In the restructuring, Edgewater capitalized Pendum with little equity and burdened it with more than $70 million in senior secured debt. Edgewater's inability to effectively create and manage an integrated business plan for the enterprise resulted in multiple financial covenant defaults, a series of forbearances, and ultimately, the demand by Pendum's creditors for a permanent and strategic restructuring of Pendum. Edgewater failed to produce a restructuring plan. Further, the investment banker hired to sell Pendum as a going concern was unable to obtain an unqualified going concern opinion from Pendum's auditor. Without that certification, it became clear that no investor would purchase the company as a going concern.

Following this sequence of events, the senior lenders became fed up and refused to further fund the company's liquidity shortfall. The lenders chose, instead, to sell a majority of their senior debt position to an affiliate of H.I.G. Capital, Inc. (HIG). At this point, Edgewater had two choices: infuse the company with additional capital, or cede control of the company. Edgewater decided to cede control. The Edgewater-designated board members resigned and were replaced with restructuring professionals appointed by the lenders. When a last-ditch effort to restructure the company failed, all parties, including Edgewater, agreed that a bankruptcy filing would not provide the best result. Instead, the board of directors negotiated a foreclosure sale agreement with HIG under Article 9 of the UCC that required Pendum's assets to be marketed and auctioned. Edgewater and the subordinated lender opposed the Article 9 sale in favor of an out-of-court reorganization, but neither entity was willing to fund the costs of reorganization. In fact, neither party was willing to fund the costs of an orderly Article 9 foreclosure sale.

HIG advanced the costs and expenses of hiring the financial advisor to market the assets, and covered the operational shortfalls stemming from Pendum's continued operations during the two-month marketing period. When no buyer came forward in the market, Pendum's assets were auctioned. Pendum Acquisition, Inc., an affiliate of HIG, was the only bidder, and purchased the company's assets for the minimum bid amount set forth in the foreclosure sale agreement. Attempting to alleviate its obligation under a $4 million guaranty, Edgewater sued HIG and the purchaser, arguing that the foreclosure sale violated the Uniform Commercial Code because it was a private disposition and was not conducted in a commercially reasonable manner.

COURT ANALYSIS

The Delaware Chancery Court ruled that Pendum Acquisition purchased Pendum's assets in a commercially reasonable sale and that Edgewater had to make good on its guaranty. According to the UCC, every aspect of a post-default disposition of collateral by a secured party must be done in a commercially reasonable manner. It's a fact-intensive inquiry and a case-by-case determination. Here, the court identified several factors supporting its conclusion that the sale was commercially reasonable: the debtor's operations hemorrhaged cash; the assets had been aggressively marketed by a financial advisor; sophisticated entities, including other creditors and Edgewater itself, made no attempt to acquire the assets at a higher value; Edgewater's own internal correspondence stated that it did not believe the assets were worth more than what Pendum Acquisition paid at auction; and, no one else bid at the open, properly noticed, auction.

Edgewater argued that a sale pursuant to a foreclosure sale agreement between a secured party and the company board was necessarily a private sale. The court disagreed. The court considered the commentary to the UCC on what constitutes a public versus a private disposition of collateral. Per the commentary, a public disposition is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. Meaningful opportunity is construed to mean that some form of advertisement or public notice precedes the sale date. Thus, the court concluded that a sale is a public sale when it is advertised and potential buyers have an opportunity to bid for the assets. The court held that the foreclosure sale agreement provided a meaningful opportunity for the public to bid on Pendum's assets at auction. It was the means by which HIG was willing to infuse money into Pendum in order to fund an orderly liquidation by marketing the assets for sale to strategic and financial buyers, and then opening the sale process up to public auction. The court concluded that the agreement had a manifestly positive effect on the sale outcome. The fact that the minimum bid set forth in the foreclosure sale agreement was also the winning bid happened only after the opportunity for higher bids had come and gone and there were no other takers. The court reasoned that to accept Edgewater's argument that a foreclosure sale agreement is *per se* a private sale would create counter-productive incentives for secured parties to fire-sell assets to the detriment of debtors.

Edgewater also argued that a two-month sale period was an artificial deadline that adversely affected the sale price. The court held that what constitutes a reasonable timeframe for the sale must be analyzed in the context of the debtor's operational circumstances. By the time the foreclosure sale agreement

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PARENT OBLIGOR CAN PLEDGE SUBSIDIARY'S COLLATERAL WITH SUBSIDIARY'S KNOWLEDGE AND CONSENT

In re WL Holmes LLC, ___ Fed. Appx. ___, 2013 WL 4019397 (3rd Cir 2013)

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CASE SNAPSHOT

The Third Circuit held that a parent obligor could effectively pledge as collateral the deposit account of its subsidiary, with the subsidiary's knowledge and consent, and that the lender's security interest in the deposit account could be perfected even though the pledgor did not technically have legal title to the collateral being pledged.

FACTUAL BACKGROUND

Wachovia Bank (now Wells Fargo) extended a $20 million line of credit to WL Homes in 2007. To secure the loan, WL Holmes pledged to Wachovia its interests in the $10 million deposit account of its wholly owned subsidiary, JLH Insurance Company. JLH was a captive insurance company operating for WL Holmes' benefit, without significant assets other than the $10 million deposit account it was required to maintain under state law. The loan was negotiated and executed by WL Holmes' CFO, Wayne Stelmar, who also served as JLH's president. As JLH's president, Mr. Stelmar was given general charge of the business. Critically, however, Mr. Stelmar executed the loan agreement and collateral pledge in his capacity as WL Holmes' CFO, not as JLH's president.

WL Holmes filed for chapter 11 bankruptcy protection in February 2009, and the case was converted to chapter 7. Wachovia filed an action in the bankruptcy court seeking a declaration that it had a valid and perfected security interest in JLH's deposit account, and WL Holmes' chapter 7 trustee sought to invalidate Wachovia's security interest on the grounds that WL Holmes was unable to pledge as collateral a deposit account that was actually owned by JLH.

On summary judgment, the bankruptcy court ruled that Wachovia had a validly perfected security interest on the grounds that WL Holmes had "use and control" of the JLH account, and, alternatively, that JLH consented to the use of its account as collateral. On appeal, the District Court reversed on the "use and control" issue, but upheld Wachovia's security interest on the grounds of JLH's knowledge and consent. The rulings were further appealed to the Third Circuit.

COURT ANALYSIS

The Third Circuit analyzed the validity of the security interest under the California UCC. Under UCC section 9203(a), a security interest in a deposit account is enforceable when: (1) value has been given, (2) the debtor has rights in the collateral or the power to transfer rights to a secured party, and (3) the secured party has control over the deposit account. The critical issue in this case was the second element: whether WL Holmes had sufficient rights to pledge the deposit account of its subsidiary, JLH.

The Third Circuit ruled that the deposit account could be pledged so long as it was done with the knowledge and consent of the subsidiary. Mr. Stelmar negotiated the loan and executed the pledge as CFO of WL Holmes. At the time of execution, Mr. Stelmar was also serving as president of the account owner, JLH, and had broad powers to make decisions for JLH, including the power to pledge JLH's assets as collateral. Because Mr. Stelmar had personal knowledge of the pledge (and in fact, negotiated the pledge), his knowledge as JLH's president could be imputed to JLH regardless of whether Mr. Stelmar signed the agreement in the name of JLH. The Third Circuit ruled that JLH knew of the pledge through Mr. Stelmar, and JLH's knowledge manifested its consent to the pledge. Accordingly, the Third Circuit ruled that Wachovia's security interest in the deposit accounts was properly perfected. The Third Circuit declined to rule on the issue of "use and control."

PRACTICAL CONSIDERATIONS

When perfecting security interests, the details matter, including the legal capacity of the signatories of a pledge to actually pledge the collateral. Creditors should carefully analyze what title a pledgor has in the collateral being pledged, and if title is held by another entity – even a wholly owned subsidiary – creditors should be sure to obtain the express written consent of the owner of the collateral. While consent may be implied under the facts and circumstances, as it was in this case, it is better to not leave the issue to chance.

Amount of Credit Bid Must Be Included in Calculation of Quarterly Fee—continued from page 3

a cash purchase. As further support for its conclusion that credit bids are "disbursements" under section 1930(a)(6), the court cited instances where the substitution of a new loan for an existing debt and the satisfaction of an old debt through the sale of real property securing that debt were held to be "disbursements"—even though there was no benefit to the estate in either instance.

The court found that the debtor's quarterly payment was $30,000—not $975—because the creditor's $31 million credit bid was a "disbursement" under section 1930(a)(6).

PRACTICAL CONSIDERATIONS

The Bankruptcy Court for the Eastern District of North Carolina has joined courts from across the nation in holding that "disbursements" for purposes of determining the quarterly fee owed to the U.S. Trustee under section 1930(a)(6) is to be broadly construed. In this case, credit bids by secured parties pursuant to section 363(k) are considered disbursements and must be included as such in debtors' quarterly reports. The fact that the funds are paid by a third party and that the estate receives no benefit is not dispositive.

LENDER'S USE OF DEBTOR'S VALUATION JUDICIALLY ESTOPS LENDER FROM MAKING VALUE OBJECTION

In re Investors Lending Group, LLC, 489 B.R. 307 (Bankr. S.D. Ga. 2013)

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CASE SNAPSHOT

The secured lender was judicially estopped from objecting to the valuation of parcels of land that the debtor proposed to surrender to the secured creditor through its plan of reorganization because the debtor used the valuations provided by the secured lender's appraiser.

FACTUAL BACKGROUND

The debtor made loans that were secured by non-owner occupied and commercial real estate. On the petition date, the debtor listed approximately 75 separate parcels of property to which it either acted as lender or landlord. Twelve of the properties secured loans made by the Bank of Ozarks. The debtor filed a plan of reorganization that allowed the debtor to retain all of the property pledged to Bank of Ozarks, and Bank of Ozarks would retain its lien on the properties. Bank of Ozarks objected to the debtor's plan of reorganization, arguing that because the debtor intended to maintain possession of the properties, the replacement, or fair market value of the properties, should be used to calculate the value of the collateral. By using the fair market value, Bank of Ozarks argued that its claim would be oversecured and some of the property should be released to it. The debtor and the unsecured creditors' committee then filed a joint plan of reorganization that altered the debtor's prior plan because the joint plan proposed to surrender five of the 12 properties to Bank of Ozarks to satisfy the bank's claim. Bank of Ozarks objected to the joint plan, arguing that the debtor and creditors' committee overvalued the properties, and the debtor was not surrendering enough value to satisfy Bank of Ozark's claim. To settle this objection, the debtor agreed to surrender seven of the 12 properties.

COURT ANALYSIS

Section 1129(b)(2)(a) allows the debtor to confirm a plan of reorganization over a creditor's objection if the debtor provides the secured creditor the "indubitable equivalent" of its claim. The court found that when a debtor proposes to surrender collateral in satisfaction of the creditor's claim, it is proper to use the foreclosure or liquidation value, not the fair market value. However, because Bank of Ozarks had agreed to the debtor's proposed release of certain collateral in exchange for full satisfaction of its claim, Bank of Ozarks was judicially estopped from challenging the debtor's valuation method. Bank of Ozarks proposed the fair market values, and the debtor used those values when calculating the value of the properties surrendered. Accordingly, the court held that Bank of Ozarks was estopped from challenging the values. The court, however, also noted that the value surrendered by the debtor should account for incidental costs associated with achieving the fair market values in the open market. To achieve the fair market values, the court determined that the parties would incur 6 percent in broker commissions and 2 percent in closing costs. Thus, the debtor would have to surrender additional property (or money) to provide Bank of Ozarks with the indubitable equivalent of its claim.

PRACTICAL CONSIDERATIONS

A secured creditor that will, on account of its claim, be receiving a partial return of its collateral should be certain to supply the debtor with foreclosure or liquidation values of the collateral. A secured creditor that sits on the sidelines and is not actively involved in the collateral valuation process can be judicially estopped from objecting to the valuation at confirmation and forced to accept the value used by the debtor. Improper valuation may result in the diminution of the collateral value.

UK Supreme Court Finds Certain Pension Liabilities Are Not Entitled to Priority Treatment, in *Nortel* and *Lehman* Decisions —continued from page 2

In both an administration and liquidation (and similar to what is provided under the U.S. Bankruptcy Code), the unsecured debts (referred to as provable debts) of a company are payable *pari passu* to the relevant creditors, who must provide proof of their claim. Rule 12.3 of the Insolvency Rules states that "all claims by creditors are provable as debts against the company…whether they are present or future, certain or contingent, ascertained or sounding only in damages." Rule 13.12 further provides that a "Debt" is "any debt or liability to which the company is subject…at the date on which the company went into liquidation." The cut-off date to determine the creditors entitled to a distribution is the date the administration began, regardless of whether the administration is followed by a liquidation. If the insolvency event is a liquidation (and no administration preceded the liquidation), the relevant date is the date the liquidation began.

Additionally (and, again, similar to U.S. bankruptcy law), there is an order of priority for distributions, with expenses of the administration or liquidation being paid out prior to unsecured debts.

Nortel and Lehman

Lehman

Contemporaneously with U.S. Lehman entities filing for chapter 11 in 2008, the main London-based Lehman group companies were placed into administration on 15 September 2008. The principal Lehman employer company in the UK was Lehman Brothers Limited (LBL), who provided employees on secondment for most of the group's European activities. At the time of the administration, LBL crystallised a section 75 debt of approximate £120 million in relation to the Lehman Brothers Pension Scheme. Following the administration, the Pensions Regulator began investigating LBL and certain other Lehman Companies and, on the basis that LBL was a service company, determined that FSDs should be made to six target Lehman companies.

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BONDHOLDERS BOUND BY 'NO ACTION' CLAUSE IN UNITRANCHE FINANCING DOCUMENTS

In re American Roads LLC, et al., 496 B.R. 727 (S.D.N.Y. 2013

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CASE SUMMARY

An ad hoc committee of bondholders who executed an agreement with a monoline insurer securing claims under an insured unitranche containing a "no action" clause, bargained away their right to appear in the debtor's bankruptcy case and, therefore, lacked standing to object to the debtor's chapter 11 plan.

FACTUAL BACKGROUND

The bondholders, who held $162.5 million of senior secured bonds, were participants in a financing structure known as an "insured unitranche." Essentially, all of the creditors' claims were secured by the same lien, through the same trustee and collateral agent, on terms set forth in pre-petition contracts. Those contracts curtailed the rights and interests of the creditors, and at issue here, the "no action" clauses in the agreements with the monoline insurer contained provisions appointing the monoline insurer as "sole holder" and "sole representative" for all purposes, and granted the monoline insurer exclusive rights to enforce the financing documents and institute proceedings thereunder.

COURT ANALYSIS

Applying New York law, the court held that the bondholders bargained away their right to appear in the debtor's bankruptcy case. In so holding, the court noted that "no action" clauses are enforceable under New York law and must be strictly construed. Analyzing the provisions of the agreements between the bondholders and the monoline insurer, the court noted that although the "no action" provisions at issue in this case did not specifically reference bankruptcy rights of the creditors, the waiver of the ability to enforce individual rights, remedies and actions encompasses the ability to appear in a bankruptcy case. Accordingly, the court found that the right to appear was prohibited by the express and enforceable terms of the agreements. In addition, the court noted that bankruptcy courts have upheld pre-petition intercreditor agreements waiving a creditor's rights to appear in a bankruptcy case where the creditors are sophisticated parties aware of the implications of such a waiver. Finding that all parties to the relevant agreements were sophisticated parties who acknowledged as much on the record before the court, the court held that the bondholders lacked standing to appear in the debtor's bankruptcy case and object to confirmation of the debtor's plan of reorganization.

PRACTICAL CONSIDERATIONS

Creditors should be cognizant that, at least under New York law, broad "no action" provisions will be strictly construed and enforced, and may preclude the creditor from appearing in the event of a bankruptcy of the debtor. If the creditor entering into an intercreditor agreement wishes to retain such rights, the rights should be expressly reserved in the agreement.

UK Supreme Court Finds Certain Pension Liabilities Are Not Entitled to Priority Treatment, in *Nortel* and *Lehman* Decisions —continued from page 6

Nortel

In January 2009, Nortel companies in Canada, the United States and England each sought protection under the respective insolvency laws, with the English entities being placed into administration. Nortel's principal operating company in the UK was Nortel Networks UK Limited (NNUK), which was also the principal employer in the Nortel Networks UK Pension Plan. NNUK had a number of subsidiaries with operations in various European countries. At the time of its administration, NNUK's section 75 debt crystallised in an amount of approximately £2.1 billion. Following the commencement of the administration, the Pensions Regulator began its investigation of NNUK and ultimately determined that FSDs should be issued to a number of Nortel companies.

COURT ANALYSIS

The Lower Courts

For both Lehman and Nortel, the lower courts held, based on existing case law, that a target company's potential liability under an FSD when the FSD is not issued until after the target has gone into administration was an expense of the insolvency proceeding and, therefore, took priority over unsecured creditors.

The Supreme Court

Upon review, the UKSC unanimously held that the liability arising under an FSD made after an insolvency event was not an expense entitled to priority treatment, but instead was a provable debt that would be treated *pari passu* with other unsecured creditors.

This decision was based largely on the UKSC's reading of Rules 12.3 and 13.12 of the Insolvency Rules 1986, that the liability arising from an FSD made after an insolvency date still constituted a "debt" of the insolvent company. One of the limbs of the definition of debt provides that a "debt" includes "any debt or liability to which the company may become subject after [the insolvency date] by reason of any obligation incurred before [the insolvency date]" (Rule 13.12(1)). The UKSC noted that prior to the insolvency date, the insolvent entity was a member of a particular group of companies and held that this was sufficient to find that the obligation was incurred prior to the insolvency event, as required under Rule 13.12(1)(b).

Additionally, the UKSC held that for a company to have incurred an obligation, it must normally have taken (or be subject to) some step or combination of steps that (i) had some legal effect, and (ii) resulted in it being vulnerable to the specific liability in question, such that there was a real prospect of liability being incurred. The UKSC held that this was satisfied (i) by virtue of the target being part of the

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Delaware Chancery Court Evaluates 'Public, Commercially Reasonable' Foreclosure Sale Under UCC

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was executed in December 2007, Edgewater ceded control of Pendum and the company was an insolvent, operational mess, unattractive to any purchaser. It had been operating at significant losses since its inception and had sought nine covenant default waivers, extensions, modifications or forbearances from its creditors. HIG acquired its first round of senior debt at 76 cents on the dollar in September 2007. A few months later it acquired additional senior debt at 72 cents on the dollar. The subordinated secured lender had written down its investment by 50 percent in June 2007 and wrote down its entire investment by September 2007. Additionally, Edgewater itself refused to infuse additional capital to extend the sale period. All of these factors established that the two-month sale period was commercially reasonable.

The court also extensively detailed the marketing process the financial advisor undertook, noting that he utilized the same zeal and strategy in his attempts to find a buyer for Pendum's assets as he employed for marketing going-concern entities. The court accepted the testimony from HIG's expert witness that not one potential buyer was overlooked. Each of the 44 parties that expressed an interest in the company as part of the marketing campaign received notice of the time and place of the auction. Additionally, notice of the auction was advertised twice in the *Wall Street Journal*. Accordingly, the court found the sale process to be commercially reasonable. Finally, the court concluded that the purchase price was commercially reasonable because it was the product of a commercially reasonable public sale in which no one else bid at the sale, and because Edgewater's internal communications stated it was unwilling to purchase the assets for a higher price.

Edgewater's aggressive litigation tactics substantially backfired on it. When entering judgment against Edgewater on the limited guaranty, the court interpreted the guaranty to cap the maximum indebtedness on the principal, only, and that HIG was entitled to recover principal, plus interest, and attorney fees and costs. The court cited to prior rulings holding that "a court of equity has broad discretion, subject to principles of fairness in fixing the [interest] rate to be applied." Finding that Edgewater was utilizing litigation tactics not to ensure a better sale price, but to get out of its obligations under the guaranty and, in Edgewater's words, "to gum up" the foreclosure process, the court used its powers of equity to award HIG principal in the amount of $1.8 million, plus interest compounded quarterly from June 25, 2008. The final blow to Edgewater was imposition of the attorney fees and costs. The fee-shifting language in the guaranty was broad and covered any fees and costs incurred by HIG arising out of or consequential to the protection, assertion, or enforcement of the guaranteed obligations. The broad language covered all fees and costs incurred by HIG in five years of litigation. It did not, however, cover the obligations HIG incurred indemnifying the Pendum board of directors.

PRACTICAL CONSIDERATIONS

The UCC's requirement for commercial reasonableness in every aspect of the sale process is a fact-driven inquiry that will depend on the parties' particular circumstances. This case highlights the benefits of using a foreclosure sale agreement to provide a structure that ensures a debtor's assets are fairly marketed and that requires the public be given a meaningful opportunity to bid at an open, advertised auction. The case also highlights the detriment that can befall an aggressive and improperly motivated litigant. The possibility of compounding interest quarterly on $1.8 million in principal for five years, plus paying all of the secured party's fees and costs incurred in litigation, should give a party pause before pursuing litigation where the real motivation is to evade contractual obligations rather than assert what the party truly finds to be a commercially unreasonable sale yielding an unfair purchase price.

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relevant group of companies, and (ii) because the group of companies met the key criteria for the imposition of an FSD. Finally, consideration should be given to the fact that it would be consistent with the type of liability being imposed to conclude that it would be a "debt" under the Insolvency Rules. Upon review of the facts, the UKSC was satisfied that the FSDs against Nortel and Lehman were properly viewed as a "debt" that should be treated on par with the other unsecured debts of each.

PRACTICAL CONSIDERATIONS

Prior to these cases, the law was clear that if a CN was issued to a target company prior to an insolvency event, it would be treated as a general unsecured claim, and if a CN was issued any time after an insolvency event, it would still be considered a general unsecured claim if it was based on an FSD issued before the insolvency event. The question the Supreme Court was faced with was if an FSD based on events that occurred prior to an insolvency event is issued after the insolvency event, is it then treated as an expense of the administration, and therefore entitled to higher priority treatment? In its judgment, the UKSC ruled that the sensible and fair answer was for such claims to be treated as general unsecured claims.

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