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BANKRUPTCY & REORGANIZATION REPORT

The Evolving Landscape of Midstream Gathering Agreements

A decision in the Sabine Oil & Gas Corp. bankruptcy cases set a precedent that allows oil and gas exploration and production ("E&P") debtors to reject their midstream gathering agreements—agreements that were previously considered to be immune from rejection because they contained covenants that "run with the land." While the rejection of gathering agreements has subsequently played out in numerous E&P cases, is it possible that the paradigm may shift again in the near future? *Read more on page 2.*

The Impact of the Presumption Against Extraterritoriality on Avoidance Actions

There is a long-standing principle of American law which holds that unless a contrary intent is evident, congressional legislation, including the Bankruptcy Code, is meant to apply only within the territorial jurisdiction of the United States. This "presumption against extraterritoriality" has been used by defendants to limit their liability based on federal law in the context of wholly foreign transactions—including defendants in avoidance actions. However, in the age of international bankruptcy cases, is a defense premised on the "presumption against extraterritoriality" still viable? *Read more on page 4.*

Drafters Beware: Broad Remedies Provisions May Have Unintended Consequences

Two recent New York cases illustrate how "standard" bond indenture remedies provisions may be interpreted broadly enough to allow indenture trustees to pursue fraudulent conveyance actions or to force borrowers to provide holders with "make-whole" fees upon non-monetary covenant defaults. These cases serve as a reminder that all parties must carefully consider all contractual language to avoid unintended consequences.
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The Evolving Landscape of Midstream Gathering Agreements

By Robert J. Gayda

A recent decision in an oil and gas exploration and production ("E&P") bankruptcy case has had a significant impact on billions of dollars of infrastructure investments. The Sabine Oil & Gas Corp. ("Sabine") cases set a precedent, allowing the rejection of midstream gathering agreements in bankruptcy. Gathering agreements were commonly considered to be protected from rejection because they were drafted to contain covenants that "run with the land," or to grant the contract counterparty real property rights, which would not be subject to rejection or would continue to be effective regardless of rejection. This precedent provided leverage to subsequent E&P debtors, many of which sought to reject their own midstream gathering agreements. Generally, these debtors were able to extract more advantageous terms under their contract through a settlement. While this scenario has played out in numerous cases, which are discussed below, it is possible that the paradigm may shift again in the near future. The Sabine decision remains subject to an appeal, and other courts are grappling with the issue, with one court suggesting that it could arrive at a different result if presented with an opportunity to do so.

Midstream Agreements

E&P companies generally rely on "midstream" operators to provide transportation (via pipeline, rail, or tanker, for example), storage, and treatment services for hydrocarbons which the E&P companies have extracted from the ground. The relationship between the E&P company and the midstream operator is governed by a "gathering" agreement. Such agreements typically "dedicate" all of the oil and gas produced from a certain acreage to be serviced by the midstream operator, with the E&P company obligated to pay for these services. The agreements also generally provide that either the agreements themselves, or the obligations under the agreements, constitute a "covenant" that "runs with the land." In layman's terms, this generally means that the rights under the contract relate to the land, or the real property, and not solely to the contract counterparty. These gathering agreements often require a minimum volume of oil and gas to be transported under the agreement, with a deficiency payment to be made by the E&P company if the minimum is not met. If these contracts are over market, or the E&P company is not producing the required amount of oil or gas to be transported, they can be a significant burden on a debtor and the debtor's bankruptcy estate. Conversely, midstream gathering companies often make significant expenditures in establishing the infrastructure required to perform under the agreement, so stakes are high for both counterparties.

Sabine Decision

Sabine had contracts with several midstream companies, include Nordheim Eagle Ford Gathering, LLC ("Nordheim") and HPIP Gonzalez Holdings, LLC ("HPIP"), which were governed by Texas law. Both agreements had minimum delivery requirements that were not being met, and provided for deficiency payments. Accordingly, the debtors sought to reject the contracts under Bankruptcy Code section 365. Rejection serves as a breach of a contract by a debtor as of the bankruptcy filing, and allows the contract counterparty a damages claim. Such claim is generally afforded only unsecured status, which means the creditor will often receive cents on the dollar. Nordheim and HPIP opposed the rejection, arguing that either the contracts could not be rejected or that rejection was of no real consequence because Sabine's obligations were covenants that ran with the land. If this were the case, the obligations would burden the land itself, not merely the debtor, and thus any successor to the debtor would remain obligated under the contract.

Judge Shelley Chapman of the U.S. Bankruptcy Court for the Southern District of New York examined the contracts under Texas law and determined that the agreements did not run with the land, and approved rejection. Judge Chapman reasoned that the only interests addressed in the contract were in minerals extracted from the ground rather than minerals in the ground, and that the agreements thus did not touch and concern the land nor create valid real covenants. Nordheim

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and HPIP appealed Judge Chapman's decision, which appeal was recently heard by the District Court for the Southern District of New York.

Implications of the Sabine Decision

It is important to note at the outset that Judge Chapman's decision is extremely fact-intensive, turning on the specific language contained in the Nordheim and HPIP contracts and how that language is interpreted under governing state law. While the majority of gathering agreements include similar language, minor differences could lead to a different result. Further, the state law of other states in which E&P companies typically reside, such as North Dakota, may also have a significant impact. Thus, every case must be examined on an individual basis.

That being said, the Sabine decision has altered the E&P restructuring landscape, tilting the playing field in favor of E&P debtors. In certain circumstances, such as when an E&P company has only one option when it comes to its gathering counterparty, that counterparty may still have some leverage over the debtor. However, even in that case, the counterparty must be careful in negotiating with the debtors. If the counterparty refuses to renegotiate a burdensome contract, it may force a liquidation of the debtor, which could still result in a loss of its infrastructure investment.

The archetypal post-Sabine case includes a debtor moving to reject its gathering agreements, while contemporaneously filing an adversary proceeding seeking a declaratory judgment that the covenants in the contract do not run with the land. This has generally resulted in the parties renegotiating the contract or otherwise arriving at a settlement of the issue. This scenario played out in a number of E&P bankruptcies, including Magnum Hunter Resources Corp., Quicksilver Resources Corp., Penn Virginia, Warren Resources, Swift Energy Co., SandRidge Energy, and, most recently, Emerald Oil Inc.

There are, however, interesting developments in two other cases, the Tristream Energy and the Triangle USA bankruptcies, which could have a Sabine-like impact on the industry. Tristream is a midstream company that sought to reject its gathering agreements. Judge David Jones of the Bankruptcy Court for the Southern District of Texas approved the rejection, but expressly preserved the parties' rights to challenge whether the agreements' covenants could not be rejected. The unsecured creditors committee has taken advantage of the preservation of rights, filing a complaint seeking a declaratory judgment that the covenants in question are real property interests under Texas law and are not subject to rejection. The creditors' committee does not want the midstream gathering parties' "massive" rejection damages claims to increase the pool of unsecured claims, diluting the potential recoveries of other unsecured creditors.

Perhaps the most interesting aspect of the Tristream cases is that Judge Jones has previously implied that he might disagree with the Sabine decision. Judge Jones, who also presided over the SandRidge bankruptcy cases (where, as noted above, the rejection issue was settled by the parties), stated during a June hearing in those cases that he was "looking for an opportunity to correct the state of New York." If the issue is fully litigated in the Tristream cases, and Judge Jones indeed finds that the midstream gathering contracts are not subject to rejection, it could recast the midstream agreement paradigm. While Tristream seems to have promise for midstream gathering companies, it is entirely possible that the issue is settled prior to being fully litigated. At a recent hearing Judge Jones allowed the debtors to proceed with a sale process in advance of hearing the rejection issue, and noted his concern over potential costs, as the cases do not have the funds to support all-out litigation.

Triangle USA is an E&P company that has followed the Sabine paradigm, seeking to reject its midstream agreement with several entities, which can generally be referred to as the "Caliber" parties, as well as filing a related adversary proceeding. In that case, however, the Caliber parties had filed a civil action in North Dakota state court (subsequently removed to North Dakota federal court) prior to the bankruptcy seeking a determination of the parties' respective rights under the applicable midstream agreement under North Dakota law, including whether the dedications of oil and gas interest were covenants running with the land. After Triangle USA had moved to reject postpetition, Caliber filed a motion to lift the stay to allow the North Dakota civil action to proceed, as well as a motion to dismiss the adversary proceeding. Both Caliber motions were recently granted, meaning the North Dakota federal court may decide the issue applying North Dakota law.

For the time being, until the case law is further developed, midstream gathering entities must adjust to the current landscape, and accept that their contracts may be subject to rejection if they are not willing to renegotiate. It is possible that future litigation over the issue yields a different result, which may shift leverage back to the gathering companies. As it stands, all parties must consider all of the applicable facts, including contractual language, governing law, and practical considerations, such as the availability of other parties to provide gathering services to an E&P debtor, when deciding what to do in a particular distressed situation. ◆

The Impact of the Presumption Against Extraterritoriality on Avoidance Actions

By Catherine V. LoTempio

Introduction

The presumption against the extraterritorial application of federal statutes, or "the presumption against extraterritoriality," is a long-standing principle of American law which holds that unless a contrary intent is evident, congressional legislation is meant to apply only within the territorial jurisdiction of the United States. Simply put, wholly foreign transactions cannot give rise to federal law claims without the specific authorization of Congress.

The presumption against extraterritoriality can have a significant impact in domestic bankruptcy cases with international scope, which are more common in today's global economy. For example, the presumption could limit the reach of the Bankruptcy Code's avoidance powers, which empower a trustee or debtor-in-possession to rescind certain transfers made by the debtor prior to the bankruptcy filing. These transfers can include payments made to unsecured creditors within 90 days of the bankruptcy filing, as "preferential" transfers, as well as transfers made by a debtor for less than reasonably equivalent value, which can be recovered as "constructively fraudulent" transfers. Distributions to shareholders, investment redemptions and commissions and fees received by brokers, banks and investment advisors are all transfers that may be at risk of "avoidance" once the transferor files for bankruptcy. However, if such transfers are effected entirely outside the U.S. — *i.e.*, wholly foreign transactions, the presumption against extraterritoriality could restrict a debtor's ability to avoid them. Therefore, avoidance action defendants should always consider whether the presumption might apply to their facts.

Framework for Application of the Presumption

The Supreme Court established a framework for application of the presumption against extraterritoriality in its 2010 decision in *Morrison v. National Australia Bank Ltd.*[1]

The framework consists of two parts. First, a court must determine if the action in question seeks to apply federal law to a foreign transaction. According to the Supreme Court, under this step a court must identify the conduct that the statute proscribes or regulates and then consider where that conduct occurred. If the court determines that the conduct occurred in the United States, the presumption against extraterritoriality is not implicated. If, however, the regulated

[1] 561 U.S. 247 (2010).

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conduct occurred outside of the United States, the presumption against extraterritoriality is implicated, and the court then proceeds to the second step.

The second step requires the court to consider whether Congress intended foreign application of the statute. The court should look to the statute's text, context and legislative history to make this determination. If the court determines that there is no clear indication of an extraterritorial application, the statute has none, and the federal law will not impact the foreign transaction at issue.

Application to Avoidance Actions

Several courts have applied the *Morrison* two-step analysis to the avoidance provisions of the Bankruptcy Code, providing avoidance action defendants with another defense to consider. Below, we examine the application of the first and second steps in turn, and then synthesize the various judicial findings.

Step One: Was the transaction a foreign transaction?

When a debtor pursues a claim to avoid a transfer, the first consideration for a defendant attempting to utilize the presumption against extraterritoriality is whether the transaction in question was a foreign transaction. This is largely a question of fact. Generally, courts have held that foreign transfers from one foreign entity to another are foreign transactions, despite connections to the United States. A few cases provide insight into what courts have considered in making this determination.

One of the first bankruptcy decisions to consider the presumption was in *In re Maxwell*,[2] which involved an international company that filed a bankruptcy petition in the United States contemporaneously with an insolvency proceeding in the United Kingdom. Shortly before its bankruptcy filing, the company sold U.S. assets and used a portion of the sale proceeds to pay off overdraft balances on its London bank accounts. The U.S. bankruptcy estate sought to avoid these transfers as preferences.

In considering whether these transactions were foreign transactions, the District Court for the Southern District of New York looked at the location of the transfers as well as the component events of the transactions. The court found that the transfers were "clearly foreign transactions" because the allegedly preferential payments occurred in the U.K. between two U.K. bank accounts, and the debts underlying the transfers arose from accounts maintained in the U.K. that were governed by English law. While the court found the fact that the transferred funds were proceeds of a U.S. asset sale was relevant, it determined that this fact alone was insufficient to characterize the transfers as transactions occurring within the United States.

In a more recent case, the Bankruptcy Court for the Southern District of New York also determined that transfers between two foreign entities occurred extraterritorially rather than domestically. In *In re Lyondell*,[3] a Luxembourg company made a distribution to its foreign shareholders two weeks before closing a merger with a U.S. company in a leveraged buyout. Within 13 months of the merger, the resulting company filed for bankruptcy in the United States. Subsequently, the *Lyondell* litigation trustee filed adversary complaints against the shareholders that received the pre-merger distributions alleging that the distributions were fraudulent transfers subject to claw-back. The shareholder defendants sought dismissal of the adversary complaints, arguing that avoidance of the shareholder distributions would require an improper extraterritorial application of the Bankruptcy Code.

The *Lyondell* court determined that because the shareholder distributions were made from one Luxembourg entity to another, and there were insufficient connections to the United States to overcome the substantially foreign nature of the distributions, the transfers were foreign transactions.

While the first *Morrison* step is usually an analysis of fact, it can, in certain circumstances, be slightly more complicated. Several decisions issued in the context of the liquidation of the infamous Madoff Ponzi scheme (the "*Madoff* bankruptcy cases") highlight this. As many readers are likely aware given the high-profile nature of these cases, foreign investment in the Bernard L. Madoff Investment Securities LLC fund

[2] *Maxwell Commun. Corp. PLC by Homan v. Societe Generale PLC (In re Maxwell Commun. Corp. PLC),* 186 B.R. 807 (S.D.N.Y. 1995).
[3] *Weisfelner v. Blavatnik (In re Lyondell)*, 543 B.R. 127 (Bankr. S.D.N.Y. 2016).

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("BLMIS") was largely made through offshore investment vehicles, or "feeder funds." Accordingly, redemption payments from BLMIS flowed first from BLMIS, a U.S. entity, to the relevant feeder fund, a foreign entity, and then subsequently to foreign investors. After the initiation of liquidation proceedings for BLMIS, the Madoff trustee sought to use the bankruptcy avoidance powers to recover any "profits" made by foreign investors who withdrew more than their principal investment in these redemption transactions. Certain of these investor-defendants moved to dismiss the trustee's actions, alleging the recovery of the transfers was an improper extraterritorial application of the Bankruptcy Code.

One issue faced in the *Madoff* bankruptcy cases was whether the initial or the subsequent transfer is the relevant transfer for purposes of the presumption against extraterritoriality. Two courts considering the issue in separate actions arrived at different conclusions because they disagreed on what conduct the avoidance provisions of the Bankruptcy Code intend to regulate. The *Madoff* bankruptcy court reasoned that the conduct at issue was the improper depletion of the bankruptcy estate, and thus, the relevant transfer for purposes of the extraterritoriality analysis was the initial transfer.[4] Therefore, the bankruptcy court ruled that because the initial transfer to the feeder funds originated from the accounts of BLMIS in the United States, the transfers were domestic and the trustee's actions were not seeking an extraterritorial application of the Bankruptcy Code.

Subsequently, the *Madoff* district court in several different actions found that the focus of the Bankruptcy Code's avoidance provisions was on the "property transferred," and that the relevant transaction was the transfer to the defendant foreign transferee.[5] Accordingly, the district court held that where the transfers from the foreign feeder funds to their foreign investors were predominantly foreign, the trustee's actions would require an extraterritorial application of the Bankruptcy Code.

Very recently, another decision in the *Madoff* bankruptcy cases addressed the issue of when a transfer between two foreign entities might be considered a domestic transaction.[6] In these actions, the bankruptcy court was applying the *Madoff* district court's analysis to determine whether the subsequent transfers to the foreign investors were in fact foreign transfers. The bankruptcy court determined that the "single most important factor" in this analysis is the location of the exchange of cash. Thus, according to the bankruptcy court, if a subsequent transfer occurred domestically — from one U.S. bank account to another — it is a domestic transfer, even if the transfer is between two foreign entities. In addition, the bankruptcy court concluded that a transfer from a U.S. bank account by a foreign entity that "resides" in the United States, even to a foreign transferee, is sufficiently domestic to rebut the presumption against extraterritoriality.

With respect to step one of the *Morrison* analysis, courts have for the most part been in agreement and taken a holistic view of the transactions at issue in determining whether they implicate the presumption against extraterritoriality. Both the *Maxwell* and *Lyondell* courts found that mostly foreign transactions were extraterritorial in nature despite certain U.S. connections. The bankruptcy and district courts considering the transfers in the *Madoff* bankruptcy cases largely conducted a similar analysis despite disagreeing on which transfer (initial or subsequent) was relevant to the analysis. Furthermore, the *Madoff* bankruptcy cases have recently added clarity to the question of when transfers between foreign entities may be held to have occurred domestically. Accordingly, precedent provides a relatively coherent framework to apply with respect to step one. Unfortunately, the same is not true for step two.

Step Two: Did Congress intend the foreign application of the avoidance powers?

Once a court determines that the presumption against extraterritoriality is implicated and a cause of action seeks an extraterritorial application of a federal statute, the second *Morrison* step is for the court to determine whether Congress intended extraterritorial application. In contrast to step one, which is chiefly a factual issue, this is a question of statutory interpretation. While courts making this determination

[4] *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff),* 480 B.R. 501 (Bankr. S.D.N.Y. 2012).
[5] *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC*, 513 B.R. 222 (S.D.N.Y. 2014).
[6] *Sec. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (In re Madoff),* Case Nos. 08-01789, 11-02732, 2016 Bankr. LEXIS 4067 (Bankr. S.D.N.Y. Nov. 21, 2016).

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will necessarily interpret the same federal statute, they have often come to different decisions.

The *Maxwell* court, in one of the earliest decisions, determined that there was nothing in the language and the legislative history of the Bankruptcy Code that demonstrated that Congress "unmistakably intended" that the avoidance powers apply extraterritorially. Embracing some of the same reasoning as the *Maxwell* court, the *Madoff* district court also determined that there was no clear indication that Congress intended that the Bankruptcy Code's avoidance powers should apply to foreign transactions.

Notably, other courts have reached the opposite conclusion. For example, the Fourth Circuit, in *In re French*,[7] was persuaded that the Bankruptcy Code's broad definition of "property of the estate," which includes property "wherever located," was incorporated into the Bankruptcy Code's avoidance and recovery provisions and adequately demonstrated Congress' intent that the avoidance powers have a global reach. This same logic of congressional intent through "interweaving terminology and cross-references to relevant code provisions" was also adopted by the *Madoff* bankruptcy court, albeit in dicta.

Recently, the *Lyondell* bankruptcy court, which sits within the Second Circuit with the *Maxwell* and *Madoff* courts, adopted the reasoning in French, parting ways from the *Maxwell* and *Madoff* district court decisions. Having first concluded that the prepetition distribution to the Luxembourg company's shareholders was a foreign transfer, the *Lyondell* court next found that the express language of the Bankruptcy Code supports a finding that Congress intended the avoidance and recovery provisions to apply extraterritorially to such foreign transfers. Indeed, the court found that it would be inconsistent that property located anywhere in the world could be property of the estate once recovered, but that a trustee was prohibited from reaching extraterritorially to recover the property in the first place.

As the foregoing discussion highlights, the conclusion of the *Morrison* second step has not been uniform, even within the same circuit. However, the recent decision from the *Lyondell* bankruptcy court, relying on the Fourth Circuit's analysis, may indicate a shift in the courts to a finding that Congress intended that the Bankruptcy Code's avoidance powers apply extraterritorially. Yet, until other circuit courts weigh-in, the outcome will remain uncertain.

Conclusion

As the development of the case law indicates, mostly foreign transactions that occur are likely to be considered extraterritorial. Moreover, until there is further guidance, there remains a colorable argument that Congress did not intend the Bankruptcy Code to apply to such transactions. Accordingly, despite the inconsistencies and uncertainties highlighted in this article, defendants in avoidance actions should consider whether they could maintain a defense based on the presumption against extraterritoriality. ◆

[7] *French v. Liebmann (In re French)*, 440 F.3d 145, 154 (4th Cir. 2006).

Drafters Beware: Broad Remedies Provisions May Have Unintended Consequences

By Laurie R. Binder

Two recent New York cases have interpreted similar "standard" remedies provisions under indentures to permit indenture trustees to pursue remedies on behalf of noteholders under New York law, although to quite different ends. One decision read an indenture's remedies clause to allow a trustee to pursue a fraudulent conveyance action on behalf of the holders, which appeared to be in keeping with the spirit of the indenture. The other decision, however, allowed the use of the indenture's remedies clause to force the borrower to provide holders with a pre-payment, or "make-whole," fee based solely on a non-monetary covenant default, a result arguably not intended. These decisions illustrate the value of careful drafting, as minor differences can lead to widely disparate, and perhaps unintended, results.

Cortlandt

In *Cortlandt Street Recovery Corp v. Hellas Telecommunications, S.a.r.l.*,[8] the relevant indenture provision provided: "If an event of default occurs and is continuing, the Trustee may pursue any available remedy to collect the payment of principal, premium, if any, and interest on the Notes." Examining the language of the remedies provision, the appellate court overruled a lower court decision and held that such provision granted the trustee standing to pursue not only breach of contract claims but also fraudulent conveyances and other claims. The trustee could pursue these claims on behalf of all noteholders as a remedy for an injury suffered ratably by all noteholders, so long as the recovery is limited to the principal, premium and interest on the notes. Although this is the first New York state court to reach this conclusion with respect to the remedies provision, the court cites to precedent from Delaware courts interpreting New York law to allow fraudulent conveyance and similar actions in connection with certain no-action clauses. Notably, the remedies provision before the court did not limit actions to those that are "under the indenture," a phrase that might have changed the holding of the *Cortlandt* court.

Wilmington

In *Wilmington Savings Fund Society FSB v. Cash America International, Inc.*[9] a New York federal court interpreted a similar remedies provision to allow the indenture trustee far greater latitude in exercising remedies, permitting the trustee to enforce a make-whole provision under the indenture based on a technical default. The remedies clause in *Wilmington* was practically identical to the clause in *Cortlandt*, except that it granted the trustee the right to pursue any remedy not only to collect the payment of principal and interest on the notes but also "to enforce the performance of any provision of the Notes or the Indenture." While this difference may seem innocuous, when read in conjunction with the acceleration and redemption provisions of the indenture, it may have inadvertently granted the trustee with significant power. The acceleration clause of the indenture provided that that upon an event of default that was not caused by bankruptcy, the trustee was permitted, but was not required, to accelerate the maturity of the notes (absent language to the contrary in an indenture, an acceleration advances the maturity date of a loan, arguably nullifying any required make-whole fee). The indenture also provided that the borrower could, at any time, redeem the notes, but would be required to pay a make-whole fee under those circumstances. Based on this, after the occurrence of a non-monetary (and non-bankruptcy) event of default, the court held that the indenture trustee could choose to waive its right to accelerate and enforce the performance of the redemption provision, triggering the make-whole requirement.

Takeaway

These two decisions highlight the importance of careful drafting. Parties entering into indentures must consider the potential unintended consequences of what would otherwise appear to be standard and uncontroversial provisions. If the parties are aware of the possibilities, indentures could be revised to ensure that the indenture is clear on the relief available under the remedies provisions, and that it is in accordance with the business terms of the deal. ◆

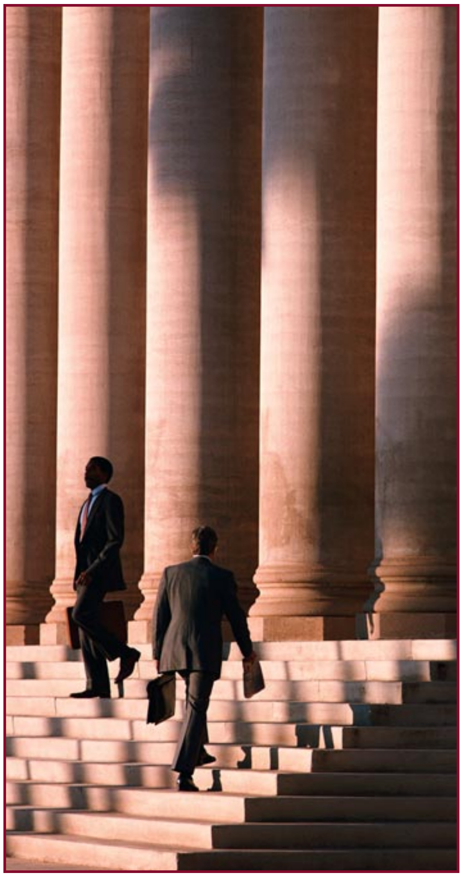
[8] 37 N.Y.S.3d 505 (N.Y. App. Div. 2016).
[9] Case No. 15- CV-5027 (JMF), 2016 U.S. Dist. LEXIS 127421 (S.D.N.Y. Sept. 19, 2016).

In Brief

All Sales Are Final

The Fourth Circuit, joining the Fifth, Sixth and Seventh Circuits, earlier this year held that a bankruptcy court sale order is a final order on the merits with res judicata effect. In the underlying bankruptcy case the Fourth Circuit considered, a Chapter 11 trustee had obtained court approval to sell certain of the debtor's properties in satisfaction of a secured lender's debts, and to distribute the proceeds directly to the lender. More than a year after the lender was paid and the debtor's bankruptcy case was dismissed, the debtor filed suit against the lender, alleging certain lender liability claims. The Fourth Circuit, affirming the lower court, held that the bankruptcy court's sale order was a final order on the merits because the sale motions in the bankruptcy court effectively conceded the validity of the obligations of the lender and the sales satisfied those obligations. The Fourth Circuit found that the purpose of res judicata, along with the goal of efficient and central administration of Chapter 11 bankruptcy cases, mandated the dismissal of the claims asserted in the subsequent lawsuit. The Fourth Circuit's decision can provide comfort to parties involved in bankruptcy sales, allowing them to rely on the fact that the bankruptcy court's sale order will be enforceable outside of the bankruptcy case.

Providence Hall Assocs. L.P. v. Wells Fargo Bank, N.A., 816 F.3d 273 (4th Cir. 2016).



Safe Harbor Protects Tribune Shareholders

The Second Circuit held that certain state law fraudulent conveyance claims against shareholders that received distributions in the Tribune LBO were preempted by Bankruptcy Code section 546(e), regardless of the party bringing the claim. Section 546(e) shields from avoidance as constructive fraudulent transfers payments made by and to financial intermediaries in the settlement of securities transactions or the execution of securities contracts based on a concern that unwinding settled securities transactions would undermine markets in which certainty, speed, finality and stability are necessary to attract capital. At the time, it was relatively clear that section 546(e) would protect the shareholders from claims brought by the bankruptcy estate or any party acting on its behalf. However, the Tribune plan provided that constructive fraudulent transfer claims would be abandoned by the estate such that individual creditors could bring them under state law. The Second Circuit held that the principles of conflict-preemption prohibited the state law causes of action because, if they were permitted to proceed, section 546(e)'s objective of preventing the unwinding of settled securities transactions would be undermined. Accordingly, practitioners should be aware that, at least within the Second Circuit, state law constructive fraudulent transfer claims brought by individual creditors are no longer actionable after a bankruptcy case is filed.

Deutsche Bank Tr. Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.), 818 F.3d 98 (2d Cir. 2016).

In Brief

Consignment Issues in Sports Authority Case

A dispute arising from the bankruptcy cases of Sports Authority Holdings Inc. highlights an issue that could be at the forefront of upcoming retail bankruptcies and should always be considered by parties with credit exposure to distressed retailers. The Sports Authority debtors, its term lenders, and 160 of its consignment vendors engaged in litigation that lasted the better part of five months over consigned goods. Consignment is an arrangement where goods are left in the possession of another party to sell and usually the consignor receives a percentage of the sale. If a consignment vendor does not properly perfect its interest in the goods, it may lose its priority, which was precisely the issue in Sports Authority. The debtors took the position that because the consignment vendors had failed to perfect their purported security interests, they were simply unsecured creditors. The term lenders agreed with this position, as the term lenders had a secured interest in the debtors' inventory, which could be junior to a perfected consignment vendor. The vendors generally asserted that either the goods were not property of the estate or that they were properly perfected in those goods because they adhered to perfection requirements. After a court ruling that favored the consignment vendors and significant further legal maneuvering, the parties agreed on a settlement. The settlement provided for each settling vendor generally to receive between 25 and 49 percent of the proceeds of the sale of "its" goods, with the balance being retained by the secured lenders. The case clearly illustrates the importance to consignment vendors of closely following the UCC's purchase-money security interest perfection requirements. It also demonstrates, however, that secured lenders must consider the potential leverage that consignment vendors may wield in a bankruptcy, even if their interests are legally unprotected.

In re Sports Authority Holdings Inc., Case No. 16-10527 (MFW) (Bankr. Dist. Del. July 7, 2016) (Docket No. 2434).

Statute of Limitation Issues for State-Law Fraudulent Transfer Causes of Action

There is often a misconception regarding state law statutes of limitations and their impact on bankruptcy cases, which can sometimes inure to the benefit of fraudulent transfer defendants. Bankruptcy trustees/debtors are empowered to bring state law fraudulent transfer actions as long as the state law statute of limitations had not run on the claims at the start of the bankruptcy case. This is true whether the state law limitations period extends one day or five years past the date of the bankruptcy filing. In either circumstance, the Bankruptcy Code dictates that the trustee/debtor generally has two years from the petition date to bring the state law claim (this period may be extended if a trustee is subsequently appointed during these two years). Confusion arises when the state law limitation period expires after the two year period provided by the Bankruptcy Code. It is sometimes assumed that the trustee/debtor would have the longer of the two limitations periods; however, this is not the case. While the Bankruptcy Code acts to extend a limitations period that barely passes the petition date, it also acts to cut off a longer period that extends beyond the two year period. If faced with a demand letter or complaint in a bankruptcy case for an avoidance action, it is best to consult with an attorney to understand if you may have a statute of limitations defense under the Bankruptcy Code's limitations period, even if the state-law limitations period has not expired.

In re Juliet Homes, LP, 2010 Bankr. LEXIS 4826 (Bankr. S.D. Tex. Dec. 16, 2010).

In the News

Partner **John Ashmead** led a panel at the 18th Annual Norway Ship & Offshore Finance Forum on restructuring the offshore sector.

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Counsel **Robert Gayda** was selected as a winner of the 7th Annual M&A Advisor Emerging Leaders Awards in the Legal Advisor category. He was chosen for his accomplishments and expertise from a pool of nominees by an independent judging panel of distinguished business leaders.

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Partners **John Ashmead** and **Bruce Paulsen** co-authored an article in the University of San Francisco Maritime Law Journal titled, "Culture Clash: The Intersection of Maritime Law and the United States Bankruptcy Code."

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Partners **John Ashmead** and **Mike Timpone** and Counsel **Robert Gayda** co-authored an article in the October/November 2016 edition of Marine Money Magazine titled, "Chapter 11: A Restructuring Tool for Foreign Shipping Companies."

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Partner **John Ashmead** and Counsel **Robert Gayda** co-authored an article in the October/November 2016 edition of Marine Money Magazine titled, "Chapter 11 'Prepacks' and the Restructuring of Offshore Industry Debt."

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Counsel **Robert Gayda** and Associate **Michael Tenenhaus** co-authored an article in the Journal of Corporate Renewal titled, "Retail Rivalry: Consignment Vendors, Secured Lenders Spar Over Priority."

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Partners **John Ashmead** and **Ronald Cohen** and Associate **Michael Tenenhaus** co-authored an article in the New York Law Journal titled, "Cases Warn Careful Drafting is Critical for Bankruptcy 'Make-Whole' Provisions."

Seward & Kissel LLP

Bankruptcy and Reorganization Practice Group

If you have any questions or comments about this Newsletter, please feel free to contact any of the attorneys in our Bankruptcy and Reorganization Group listed below via telephone at (212) 574-1200 or via e-mail generally by typing in the attorney's last name @sewkis.com.

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