

PRATT'S JOURNAL OF BANKRUPTCY LAW

VOLUME 7

NUMBER 7

OCTOBER 2011

HEADNOTE: FEEDER FUNDS AND BANKRUPTCY Steven A. Meyerowitz	581
BREAKING NEW GROUND (AGAIN) IN CHAPTER 15 Pedro A. Jimenez and Mark G. Douglas	583
A ROUTINE FORECLOSURE MAY BE A PREFERENTIAL TRANSFER Robert D. Albergotti, Robin E. Phelan, and John Middleton	595
THE EUROPEAN DEBT CRISIS: KEY ISSUES TO CONSIDER WHEN PURCHASING DISTRESSED EUROPEAN LOAN PORTFOLIOS Renee Eubanks and Jeremy Cape	601
SEVENTH CIRCUIT HOLDS THAT FREE AND CLEAR SALE PLAN CANNOT BE CONFIRMED WITHOUT PRESERVING SECURED CREDITOR'S CREDIT BIDDING RIGHTS: RULING CREATES CIRCUIT SPLIT Michael Goldstein, Matthew Gensburg, and Whitney Baron	609
ABN AMRO BANK NV v. MBIA INC. — NEW YORK COURT OF APPEALS ALLOWS POLICY HOLDERS' FRAUDULENT CONVEYANCE AND COMMON LAW CLAIMS AGAINST MBIA TO CONTINUE IN STATE COURT Kristopher M. Hansen, Kenneth Pasquale, and Erez E. Gilad	617
IN RE ENRON: SECOND CIRCUIT EXPANDS "SETTLEMENT PAYMENT" EXEMPTION TO THE REDEMPTION OF COMMERCIAL PAPER (AND BEYOND?) Andrew M. Leblanc, Sarah A. Sulkowski, and Nicole Vasquez	621
SEVENTH CIRCUIT AFFIRMS BANKRUPTCY COURT RULING THAT SALE OF ASSETS THROUGH PLAN MAY NOT USE "INDUBITABLE EQUIVALENT" STANDARD TO PREVENT SECURED CREDITORS FROM CREDIT BIDDING Abhilash M. Raval, Michael E. Comerford, and James C. Harris	627
DCF ANALYSIS: A "COMMERCIALLY REASONABLE DETERMINANT" OF VALUE FOR LIQUIDATION OF MORTGAGE LOANS IN REPO TRANSACTION Benjamin Rosenblum	635
THE SECOND CIRCUIT INTERPRETS THE BANKRUPTCY CODE'S SAFE HARBOR PROVISIONS MORE BROADLY THAN THE BANKRUPTCY COURT Jason H. Watson, Dennis J. Connolly, and David Wender	642
BAD BOYS GET SPANKED: NEW YORK COURTS UPHOLD RECOURSE GUARANTIES Michael J. Feinman and Joseph A. McFalls	648
FIFTH CIRCUIT SHOWS REORGANIZATION INVESTORS HOW TO GET AND KEEP AN EXPENSE REIMBURSEMENT ORDER Michael L. Cook and Lawrence V. Gelber	653
ARGENTINA'S CENTRAL BANK'S ASSETS IN FEDERAL RESERVE ACCOUNT ARE NOT SUBJECT TO ATTACHMENT UNDER THE FSIA, SECOND CIRCUIT RULES Steven A. Meyerowitz	658

EDITOR-IN-CHIEF

Steven A. Meyerowitz

President, Meyerowitz Communications Inc.

ASSISTANT EDITOR

Catherine Dillon

BOARD OF EDITORS

Scott L. Baena

*Bilzin Sumberg Baena Price &
Axelrod LLP*

Leslie A. Berkoff

Moritt Hock & Hamroff LLP

Andrew P. Brozman

Clifford Chance US LLP

Kevin H. Buraks

Portnoff Law Associates, Ltd.

Peter S. Clark II

Reed Smith LLP

Thomas W. Coffey

Tucker Ellis & West LLP

Mark G. Douglas

Jones Day

Timothy P. Duggan

Stark & Stark

Gregg M. Ficks

*Coblentz, Patch, Duffy & Bass
LLP*

Mark J. Friedman

*DLA Piper Rudnick Gray Cary
US LLP*

Robin E. Keller

Lovells

William I. Kohn

Schiff Hardin LLP

Matthew W. Levin

Alston & Bird LLP

Alec P. Ostrow

*Stevens & Lee P.C.
LLP*

Deryck A. Palmer

*Cadwalader, Wickersham &
Taft LLP*

N. Theodore Zink, Jr.

Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, Copyright © 2011 THOMPSON MEDIA GROUP LLC. All rights reserved. No part of this journal may be reproduced in any form — by microfilm, xerography, or otherwise — or incorporated into any information retrieval system without the written permission of the copyright owner. Requests to reproduce material contained in this publication should be addressed to A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, fax: 703-528-1736. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-572-2797. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed — articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

ISSN 1931-6992

Fifth Circuit Shows Reorganization Investors How to Get and Keep an Expense Reimbursement Order

MICHAEL L. COOK AND LAWRENCE V. GELBER

The U.S. Court of Appeals for the Fifth Circuit recently affirmed the lower court's decision authorizing reimbursement of expenses to qualified bidders for a reorganization debtor's assets. The authors of this article explain the case and note that prior court authorization for the expense reimbursement was essential to the result here.

The U.S. Court of Appeals for the Fifth Circuit, on Aug. 16, 2011, affirmed the lower court's decision authorizing reimbursement of expenses to qualified bidders for a reorganization debtor's assets.¹ In the court's view, the debtor provided "a compelling and sound business justification for the reimbursement authority."²

Michael L. Cook is a partner in the New York office of Schulte Roth & Zabel LLP, where he devotes his practice to corporate restructuring, workouts and creditors' rights litigation, including mediation and arbitration. Lawrence V. Gelber is a partner in the firm's New York office where he concentrates his practice in the areas of distressed mergers & acquisitions, debtor-in-possession financing, corporate restructuring, creditors' rights and prime brokerage insolvency/counterparty risk. The authors may be contacted at michael.cook@srz.com and lawrence.gelber@srz.com, respectively.

FACTS

The Chapter 11 debtor had invited investors to bid at an auction sale of its most valuable asset. It promptly sought, with advice from its professionals, authorization under Bankruptcy Code (“Code”) § 363(b) to reimburse expenses incurred by any selected bidders, explaining “that... it...would [give the bidders] the opportunity to conduct additional due diligence” entailing “highly sophisticated legal analysis” at “substantial” expense.”³ In the debtor’s view, it had to “provide bidders with an incentive to undertake this investment.”⁴

The bankruptcy court granted the debtor’s motion for the so-called expense “reimbursement order” after a hearing. Although the debtor’s corporate parent had objected, the bankruptcy court found that the debtor had shown “a compelling and sound business justification” for the relief requested.⁵ When the corporate parent appealed, the district court affirmed, but the parent appealed again to the Fifth Circuit.

ARGUMENTS MADE ON APPEAL

The debtor’s corporate parent argued that the bankruptcy court had applied the wrong legal standard for authorizing the reimbursement of expenses. In its view, the bankruptcy court should have relied on Code § 503(b), which applies to administrative expenses, a standard that is “more stringent” than the business judgment standard contained in Code § 363(b).⁶ Second, according to the parent, even if Code § 363(b) was the correct standard, the bankruptcy court erred in finding that the debtor’s “motion satisfied the business judgment” test.⁷ Finally, although the parent argued that the bankruptcy court abused its discretion in approving the reimbursement procedures “without notice” to it and “without sufficient judicial oversight,”⁸ it had not raised this issue in the lower courts, and the Court of Appeals refused to consider the argument, deeming it waived.⁹

LEGAL STANDARD: §§ 363(b) OR 503(b)

Business Judgment — § 363(b)

A Chapter 11 debtor-in-possession may, under Code § 363(b), “after notice and hearing...use, sell, or lease, *other than in the ordinary course of business*, property of the estate” (emphasis added). To satisfy the court in this context, the debtor-in-possession or trustee must articulate a “business justification....” for the use of cash — estate property.¹⁰ According to the Fifth Circuit, the business judgment standard in Section § 363(b) is “flexible and encourages discretion,” requiring the bankruptcy judge to “consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike.”¹¹

Administrative Expense — § 503(b)

Code § 503(b), pertaining to administrative expenses, provides a narrower standard for the use of the estate’s cash. It allows a party to recover, as an administrative expense, “the actual, necessary costs and expenses of preserving the estate.” As explained by the Fifth Circuit, “[t]he words ‘actual’ and ‘necessary’ have been construed narrowly: ‘the debt must benefit [the] estate and its creditors.’”¹²

The debtor’s parent argued here that “the reimbursement order was in error because the requested reimbursements were not actually necessary to preserve the value of the estate.”¹³ To support this argument, the parent cited “two Third Circuit Decisions where the lower court applied § 503(b) and not 363(b) to requests for break-up fees.”¹⁴

Resolution

The Fifth Circuit was “not persuaded that *Reliant* and *O’Brien*” applied here. First, the debtor only sought “authority to reimburse expense fees for second-round ‘qualified’ bidders in a multiple stage auction for a very unique and very valuable but possibly worthless asset.”¹⁵ Second, “prospective (and qualified) bidders could be reimbursed regardless of whether they were successful.”¹⁶ Finally, there was no bid-chilling here because the

debtor “sought to *increase* competition by providing bidders an incentive to undertake the costly but necessary due diligence.”¹⁷ In the court’s view, § 363(b) applied to the debtor’s advance request to use its funds “*before* any potential qualified bidders...had incurred due diligence and work fees.”¹⁸ In contrast, the “unsuccessful bidders in *O’Brien* and *Reliant Energy* sought payment for expenses incurred without the court’s pre-approval,” making § 503(b) “the proper channel for requesting payment.”¹⁹

The Court of Appeals also deferred to the bankruptcy court’s findings in *Asarco* that the “proposed reimbursement...was designed to maximize the value” of the debtor’s estate; “was fair, reasonable, and appropriate;” and was “in the best interests” of the debtor, “its estate, creditors, interest holders, stakeholders, and all other parties in interest.”²⁰ Moreover, there was “no evidence...of self-dealing or manipulation among the parties who negotiated the reimbursement procedures; the Reimbursement Order facilitated, not hindered, the auction process; and the approved maximum available size of the reimbursement fee was reasonable.”²¹

COMMENTS

The requested fees here were based on actual “due diligence” expenses. They were not merely the typical “break-up fee...paid by a seller to a prospective purchaser in the event that a contemplated transaction is not consummated.”²²

Prior court authorization for the expense reimbursement was essential to the result here. With the proper showing — reasonableness, arm’s length negotiations and tangible benefit to the estate — a court is more likely to pre-approve expense reimbursement if it learns of the fees at the earliest stage of the process. For the prospective acquiror, early court review also provides the certainty of reimbursement before incurring substantial expenses.

NOTES

¹ *In re Asarco, LLC*, 2011 BL 213002 (5th Cir. Aug. 16, 2011).

² *Id.* at *12.

³ *Id.* at *3-4.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *7-8.

⁷ *Id.* at *8.

⁸ *Id.* at *8.

⁹ *Id.*

¹⁰ *Id.* at *9.

¹¹ *Id.* (quoting *In re Cont'l Airlines*, 780 F.2d 1223, 1226 (5th Cir. 1986) and *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983)).

¹² *Id.* at *10 (quoting *In re Trans American Natural Gas Corp.*, 978 F.2d 1409, 1416 (5th Cir. 1992)).

¹³ *Id.*

¹⁴ *In re O'Brien Env't Energy, Inc.*, 181 F.3d 527, 529 (3d Cir. 1999) (*held*, no break-up fee to unsuccessful stalking horse bidder; § 503(b) governs unsuccessful bidder's request for break-up fee; applying administrative expense standard, unsuccessful bidder failed to make requisite showing that awarding its fee was actually necessary to preserve value of estate; fee to be paid if prospective bidder unsuccessful; court concerned that fee would "chill...the competitive bidding process."); *In re Reliant Energy Channelview LP*, 594 F.3d 200, 204 (3d Cir. 2010) (same).

¹⁵ 2011 BL 213002 at *11.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at *12.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at *12-13.

²² *Id.* (quoting *O'Brien*, 181 F.3d at 528).