

Is It Time to Think About SARE?

by Andrew D. Gottfried and Karen Gartenberg

After more than a decade of rising real estate values, the tide has turned against commercial and development real estate, prompting major builders and developers to commence Chapter 11 bankruptcy proceedings. As a result of the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) in 2005, many Chapter 11 cases that revolve around real estate will fall within the Bankruptcy Code's definition of single asset real estate (SARE) cases and are thus subject to special provisions in the Bankruptcy Code.¹ As a result, it is now time to think about SARE.

What Constitutes a SARE Case

The term "SARE Case" is a well-known and often used colloquialism "which essentially refer[s] to real estate entities attempting to cling to ownership of real property in a depressed market . . . rather than businesses involving manufacturing, sales or services."² Section 101(51)(B) of the Bankruptcy Code defines "single asset real estate" as

real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental.³

Thus, to qualify as a SARE case, the real property must first consist of a single property or project "operated under a common design or plan."⁴ Second, the real property must generate



substantially all of the gross income of the debtor and can include undeveloped real property that generates no income.⁵ Finally, the debtor must not be involved in any substantial business other than the business of operating the real property and activities incidental thereto. The last criterion is interpreted according to an active-versus-passive test that inquires into the nature of revenue generation on and by the property, "that is, whether the revenue is the product of entrepreneurial, active labor and effort—and thus is not single asset real estate—or is simply and passively received as investment income by the debtor as the property's owner—and thus is single asset real estate."⁶

SARE Case in Chapter 11

Section 362(d)(3) of the Bankruptcy Code

The typical Chapter 11 case for a SARE entity "is about raising new capital, renegotiating loan terms, or, if that cannot be done, attempting to 'cram down' a plan on the secured creditors, or selling the asset."⁷ Despite their similarity in goals to other Chapter 11 cases, SARE cases were viewed harshly by courts as cases intended solely to postpone foreclosure, and, accordingly, Congress enacted special provisions in the Bankruptcy Code intended to expedite the Chapter 11 process and potentially constrain the debtor's strategic options in its efforts to reorganize.⁸

These provisions, set forth in Section 362(d)(3) of the Bankruptcy Code, provide that within the

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in this issue

1 Is It Time to Think About SARE?

5 Champerty – New York Banishes the Specter of an Ancient Doctrine from Modern Debt Acquisitions

8 Out-of-Court Settlement in France "The Conciliation"

12 Recent Noteworthy Decisions

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Is It Time to Think About SARE?

continued from page 1

later of 90 days after the commencement of a SARE case and 30 days after the court finds the debtor subject to the SARE provisions, the SARE debtor must file “a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time,”⁹ or begin making monthly payments “to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured

under the circumstances and enabling courts to extend the aforementioned deadlines for “cause.” With respect to the latter, at least one court has held that:

Cause . . . would consist of something extraordinary in the circumstances, something that tips the equities of a case outside the balance that Congress envisioned and then reinforced by

Section 362(c)(2) of the Bankruptcy Code, a debtor may not use, sell, or lease cash collateral unless “each entity that has an interest in such cash collateral consents,” or “the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.”¹⁸ To avoid protracted litigation in court and to obviate the lender’s concern that the cash collateral not be spent haphazardly or wastefully, the SARE debtor and the lender often reach consensual resolution on the use of cash collateral, usually by agreeing to a mutually acceptable, reasonable budget under which the debtor will operate.¹⁹

Provisions Impacting Confirmation of a Plan of Reorganization

In addition, the SARE debtor will eventually have to confirm a plan of reorganization that satisfies the general requirements in the Bankruptcy Code applicable to all Chapter 11 cases and is “to be afforded no special consideration in formulating a confirmable plan.”²⁰ Generally, a debtor can either confirm a plan of reorganization consensually under Section 1129(a) of the Bankruptcy Code or impose a plan on a dissenting class by judicial “cramdown” under Section 1129(b) of the Bankruptcy Code.²¹

There are two conditions for cramdown. First, all of the requirements under Bankruptcy Code Section 1129(a) must be satisfied, except for the plan’s acceptance by each impaired class of claims or interests under Section 1129(a)(8).²² Critical among these requirements are the conditions that the plan be accepted by at least one class of impaired creditors under Section 1129(a)(10) and satisfy the “best interest of creditors” test under Section 1129(a)(7).²³ Second, “the objection of an impaired creditor class may be overridden only if ‘the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan.’”²⁴ As to a dissenting class of impaired unsecured creditors, such a plan may be found to be “fair and equitable” only if the allowed value of the claim is paid in full, or, in the alternative, if “the holder of any claim or interest that is junior to the claims of such [impaired unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property.”²⁵ This latter condition is the core of what is known as the absolute priority rule.²⁶

The SARE debtor will eventually have to confirm a plan of reorganization that satisfies the general requirements in the Bankruptcy Code.

statutory lien)” in an amount “equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor’s interest in the real estate.” Once a creditor has made a showing that the creditor holds a claim secured by the debtor’s single asset real estate, the debtor has the burden of proving compliance with the foregoing.¹⁰

The SARE provisions are noteworthy for a few reasons. First, unlike any other kind of Chapter 11 case, where no time requirement for the filing of a plan exists, these provisions set a time for filing a plan “in this species of Chapter 11 case.”¹¹ Second, by waiting 90 days after the petition date before seeking relief against a SARE debtor, a secured creditor can seek relief from the automatic stay while avoiding the costs and risks of litigating issues usually attendant to stay relief motions, including whether the debtor has equity in the property or whether cause otherwise exists to grant relief.¹² Third, the consequence of failing to satisfy these provisions is that the automatic stay of Bankruptcy Code Section 362 may be lifted “without further ado,”¹³ thereby expediting even further the already expedited scheme for dealing with relief from the stay matters under the Bankruptcy Code.¹⁴

The seeming hard-stop imposed by Section 362(d)(3) of the Bankruptcy Code, however, is somewhat tempered by additional language in Section 362(d)(3) itself, granting courts the ability to fashion the relief they deem appropriate

establishing the underlying requirement. If the requirement on its face protects a specific constituency, the cause should incorporate a viable alternative to address the constituency’s specified entitlement.¹⁵

For example, a prospective sale of single asset real estate will constitute “cause” only if the debtor meets its heavy burden as to the “likelihood that a sale will close promptly, and that there would be enough proceeds to serve the needs honored by the statute.”¹⁶ Only then “could a court feel assured that the protected mortgagee would receive a substantial equivalent of its expectancy under § 362(d)(3), so as to merit holding it off from foreclosing after the first 90 days of the case.” Nonetheless, because the latitude provided to courts not to enforce the expedited time frame is stringent, it is unlikely that courts will employ such provisions to provide debtors much relief from the rigid parameters set forth by Section 362(d)(3).

Provisions Allowing SARE Debtor to Operate under Chapter 11

Once a SARE debtor meets its burden for purposes of Section 362(d)(3), the SARE debtor must navigate its way through Chapter 11 in the same manner as other Chapter 11 debtors. To that end, for a SARE debtor to have any hope of reorganizing, the debtor must seek authority to use cash collateral to maintain its business or the lender may ask the court to approve the debtor’s use of cash collateral on restricted terms. Under

To satisfy the first condition of cramdown, it is typical for a SARE debtor to bifurcate the claim of its undersecured creditor into secured and unsecured claims and to attempt to classify the unsecured claim separately from other general unsecured claims.²⁷ The ability of the SARE debtor to engage in such a practice arises through Section 506(a)(1) of the Bankruptcy Code, which instructs bankruptcy courts to determine the value of the collateral, set the amount of the allowed secured claim at that value, and treat the remainder of the allowed claim as unsecured,²⁸ and Section 1111(b) of the Bankruptcy Code, which entitles an undersecured creditor to treat the deficiency claim arising out of a secured interest in property as secured.²⁹ Separate classification of the undersecured creditor's claim from the remaining general unsecured claims is often vital to the debtor's ability to confirm a plan, because it is likely that the undersecured creditor will vote to reject the debtor's plan, whereas the debtor usually "will have a bunch of friendly trade creditors who will go along with the plan because they have nothing to lose or because their claims are small and the debtor offers them substantial repayment."³⁰ If the claims are thus not separately classified, the debtor will not have an assenting impaired class, whereas if the claims are separately classified, the debtor is almost assured of its plan being accepted by the impaired general unsecured class and subsequently confirmed.

The attempt to separately classify the undersecured creditor's deficiency claim from other unsecured claims has met with mixed results.³¹ Some courts have held that the undersecured creditor's right to elect treatment of its entire claim as secured under Section 1111(b) of the Bankruptcy Code renders the undersecured creditor's deficiency claim to be of a different legal character than other general unsecured claims, and thus have permitted the separate classification of the unsecured claim.³² Other courts, however, have held that such separate classification is blatant gerrymandering of the plan vote and is impermissible under Section 1122 of the Bankruptcy Code, which requires that all creditors of equal rank with claims against the same property be placed in the same class.³³

Despite the divergence in caselaw, it appears that most courts that have ruled on the issue, as well as the legislative history underlying Section 1122 of the Bankruptcy Code, find that the separate classification of claims would render a secured creditor's election under Section 1111(b) meaningless because debtors could "carve the creditor out of the unsecured class and force confirmation over the creditor's objection."³⁴ It is thus unlikely that a SARE debtor will be able to proceed in such a manner against its lender, and thus will have to find a different manner by which to confirm its plan of reorganization.

A SARE debtor may have a less difficult time in satisfying the second condition of cramdown, namely compliance with the "fair and equitable" standard and the absolute priority rule. In SARE cases, it is common for a plan of reorganization to permit the debtor to retain ownership of the real estate in question in exchange for a new capital contribution to the reorganized debtor, even if classes senior to the debtor are not paid in full as required by Bankruptcy Code Section 1129(b)(2).³⁵ Confirmation of such plans is sought under a "new value" exception to the absolute priority rule, which mandates that the capital contribution by the former equity owners be (i) new, (ii) substantial, (iii) in cash or a cash equivalent, (iv) necessary for a successful reorganization, and (v) reasonably equivalent to the value or interest received. Because Section 1129(b) of the Bankruptcy Code does not permit the holder of any claim or interest that is junior to the claims of an impaired unsecured class to receive or retain any property under the plan *on account of* such junior claim or interest, the theory of a new value exception is that "former equity owners retain property in exchange for the new contribution, and not on account of their prior equity interest."³⁷

The circuit courts of appeal have split on whether a new value exception to the absolute priority rule exists or may be relied upon in confirming such plans. This split has yet to be resolved, as the U.S. Supreme Court declined to decide whether the statute includes a new value exception in *Bank of America Nat'l Trust and Savs. Assoc. v. 203 N. LaSalle St. P'ship*.³⁹ Nonetheless, the Court did hold that assuming that the new value exception to the absolute priority rule did, in fact, exist, a debtor's equity holders could not,

over the objection of a senior class of impaired creditors, contribute new capital and receive ownership interests in the reorganized debtor without allowing others to compete for that equity or propose a competing plan of reorganization.⁴⁰ The Court stated that the exclusiveness of the opportunity for existing equity owners to retain ownership of the property in exchange for new capital, with "protection against the market's scrutiny of the purchase price by means of competing bids or even competing plan proposals," is what renders the existing equity owners' right "a property interest extended 'on account of' the old equity position and therefore subject to an unpaid senior creditor class's objection."⁴¹

Thus, SARE debtors may satisfy the absolute priority rule in certain jurisdictions by permitting former equity to provide new capital to the reorganized debtor, so long as other constituencies are free to do the same in exchange for ownership of the underlying real estate. SARE debtors, however, may also run afoul of the absolute priority rule in jurisdictions that do not recognize a new value exception if they seek to confirm plans of reorganization under which the former equity owners retain ownership of the underlying real estate in exchange for capital.

In light of the foregoing issues, even if a SARE debtor satisfies the special provisions of the Bankruptcy Code contained in Section 362(d)(3), it may have insurmountable problems confirming its plan of reorganization via cramdown.

Conclusion

Given the enactment of BAPCPA and the current economic climate, the SARE provisions, once considered in large measure to be irrelevant, are now the focal point in real estate bankruptcy cases. Indeed, with courts going so far as to determine that affiliated Chapter 11 debtors can each qualify as SARE cases that are to be procedurally, and not substantively, consolidated,⁴² both debtors and lenders are left to ponder the virtually nonexistent authority addressing the manner in which, and the extent to which, courts will choose to apply the SARE provisions to these mega-bankruptcy cases.

Is It Time to Think About SARE?

continued from page 3

endnotes

- 1 The SARE provisions were enacted as part of the Bankruptcy Reform Act of 1994. Prior to the enactment of BAPCPA in 2005, these provisions only applied in cases involving less than \$4 million of debt secured by the debtor's single asset real estate. The 2005 BAPCPA Amendments to the Bankruptcy Code eliminated the debt cap, thus bringing more cases that revolve around real estate within the aegis of the SARE provisions in the Bankruptcy Code. See 11 U.S.C. § 101(51)(B).
- 2 *In re Philmont Dev. Co.*, 181 B.R. 220, 223 (Bankr. E.D. Pa. 1995).
- 3 11 U.S.C. § 101(51)(B).
- 4 *In re Philmont Dev. Co.*, 181 B.R. at 223 (subjecting debtors to SARE rules where each of the debtors owned multiple semidetached houses "operated under a common design or plan" as a "single project"); see also *In re Rear Still Hill Road, LLC*, 2007 WL 2935483, at *5 (Bankr. D. Conn. Oct. 5, 2007) (applying SARE rules to two legal parcels constituting a single project consisting of the debtor's plan to develop land for single-family homes); *In re Kkemko, Inc.*, 181 B.R. 47, 50 (Bankr. S.D. Ohio 1995) ("[R]esidential projects are within the scope of [Section 101(51)(B) of the Bankruptcy Code].").
- 5 *In re Oceanside Mission Assocs.*, 192 B.R. 232, 236 (Bankr. S.D. Cal. 1996).
- 6 *In re Golf Club Partners, L.P.*, 2007 WL 1176010, at *4 (E.D. Tex. Feb. 15, 2007); see, e.g., *In re Scotia Pacific Co., LLC*, 508 F.3d 214, 224-25 (5th Cir. 2007) (holding that sophisticated operations such as planning, growing, and maintaining timber on the timberland, as well as building and maintenance of roads on the real estate constituted substantial business other than the operation of the real property and activities incidental thereto); *In re Kkemko*, 181 B.R. at 51 (holding that debtor's marina did not come within the definition of SARE because "the business of the marina is something more than simply rental of moorings" as it stores, repairs, and winterizes boats, provides showers and activities for those using the marina, and sells gas and other amenities").
- 7 *In re Eagle Point Ltd. Dividend Ass'n Ltd. P'ship*, 350 B.R. 84, 89 (Bankr. N.D. Ind. 2006).
- 8 See *In re Kkemko*, 181 B.R. at 49, 50 (The purpose of the SARE provisions is "to impose an expedited time frame for filing a plan."); see also *In re Heather Apartments Ltd. P'ship*, 366 B.R. 45, 49-50 (Bankr. D. Minn. 2007) ("[T]he terse extant history and the statute's own structure suggest that Congress was concerned about the relative unfairness of lengthy delay in Chapter 11 cases involving single-asset real estate projects . . . that one of its goals aims to expedite the proposal of meritorious plans of reorganization in such cases." (internal citations omitted)).
- 9 In proving a "reasonable possibility" of plan confirmation, "the stage of the proceeding assists in the showing a debtor must make: At a minimum the debtor must show that (1) it is a proceeding to propose a plan of reorganization, (2) the proposed or contemplated plan has a realistic chance of being confirmed and (3) the proposed or contemplated plan is not patently unconfirmable." *In re Windwood Heights, Inc.*, 385 B.R. 832, 838 (Bankr. N.D. W. Va. 2008) (internal citations and quotations omitted).
- 10 Kimberly S. Winick and Stuart M. Rozen, SARE: *New Rules for the Current Downturn*, Norton Bankruptcy Law Adviser 13 (Thomson/Reuters West 2008).
- 11 *In re Kkemko*, 181 B.R. at 49.
- 12 See 11 U.S.C. § 362(d)(1)-(2).
- 13 *In re Kkemko*, 181 B.R. at 49; accord *In re Oceanside Mission Assocs.*, 192 B.R. at 235 ("The consequence of not acting quickly is that the automatic stay may be lifted without further ado."); see also *Centofante v. CBJ Dev., Inc. (In re CBJ Dev., Inc.)*, 202 B.R. 467 (9th Cir. BAP 1996) ("relief under § 362(d)(3) is mandatory where its provisions are not strictly complied with" (quoting *NationsBank, N.A. v. LDN Corp. (In re LDN Corp.)*, 191 B.R. 320, 327 (Bankr. E.D. Va. 1996)).
- 14 *In re Kkemko*, 181 B.R. at 49.
- 15 *In re Heather Apartments Ltd. P'ship*, 366 B.R. at 47-48 (As concerns Section 362(d)(3)(B), "any proffer of cause for excusing a debtor's compliance must include a concrete substitute for the creditor's statutorily-fixed expectation of payment, if the debtor is to be excused.").
- 16 *Id.* at 50 ("At minimum, it seems, there should be a binding purchase agreement executed before the presentation of the motion under § 362(d)(3); a binding lending commitment in favor of the prospective purchaser; and demonstrated substantial progress in satisfying the ministerial minutiae for closing.").
- 17 *Id.*
- 18 11 U.S.C. § 363(c)(2).
- 19 See, e.g., *In re Euro-American Lodging Corp.*, Case No. 06-11325 (SMB), Interim Order (I) Restricting Use of Cash Collateral and (II) Providing Adequate Protection (Docket No. 98) and Order Amending Interim Cash Collateral Order (Docket No. 150).
- 20 *In re Nat'l/Northway Ltd. P'ship*, 279 B.R. 17, 29 (Bankr. D. Mass. 2002).
- 21 See *Bank of America Nat'l Trust and Savs. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441 (1999).
- 22 *Id.* at 441.
- 23 *Id.* Section 1129(a)(7) of the Bankruptcy Code provides that if the holder of a claim impaired under a plan of reorganization has not accepted the plan, then such holder must "receive . . . on account of such claim . . . property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive . . . if the debtor were liquidated under chapter 7 . . . on such date." The "best interests" test applies to individual creditors holding impaired claims, even if the class as a whole votes to accept the plan. *Id.*
- 24 *Id.* (citing 11 U.S.C. § 1129(b)(1)).
- 25 *Id.* at 441-42 (citing 11 U.S.C. § 1129(b)(2)(B)(i)-(ii)).
- 26 *Id.* at 442.
- 27 See *In re L.G. Salem Ltd. P'ship*, 140 B.R. 932, 935 (Bankr. D. Mass. 1992) ("Congress was also aware that a debtor may attempt to contrive an accepting class of impaired claims by classifying the mortgagee's unsecured deficiency claim in one class and all other unsecured claims in another class." (internal citations and quotations omitted)).
- 28 *Airadigm Commc'ns, Inc. v. Fed. Commc'ns Comm'n*, 372 B.R. 894, 909 (Bankr. W.D. Wis. 2006).
- 29 See *In re Waterways Barge P'ship*, 104 B.R. 776, 784 (Bankr. N.D. Miss. 1989).
- 30 *In re L.G. Salem Ltd. P'ship*, 140 B.R. at 935 ("Usually, the debtor will have a bunch of friendly trade creditors who will go along with the plan because they have nothing to lose or because their claims are small and the debtor offers them substantial repayment." (internal citations and quotations omitted)).
- 31 See *In re Nat'l/Northway Ltd. P'ship*, 279 B.R. at 25 (comparing cases).
- 32 *Id.* at 25 (citing *In re Bjolmes Realty Trust*, 134 B.R. 1000 (Bankr. D. Mass. 1991), and *In re Gato Realty Trust Corp.*, 183 B.R. 15, 21 (Bankr. D. Mass. 1995)).
- 33 See, e.g., *In re Nat'l/Northway Ltd. P'ship*, 279 B.R. at 25 (holding that deficiency claim of nonrecourse undersecured creditor that was eligible to make Section 111(b) election was not of different legal character than other general unsecured claims and could not be separately classified); *In re L.G. Salem Ltd. P'ship*, 140 B.R. at 935 ("Congress provided . . . that if any class rejects a plan, such as the class containing the mortgagee's unsecured deficiency claim, then the plan may not unfairly discriminate. Accordingly, the debtor would not be allowed to provide one treatment for the class of unsecured trade claims and a less favorable treatment to the class containing the mortgagee's unsecured deficiency claim." (internal quotations

and citations omitted)); *In re 266 Washington Assocs.*, 141 B.R. 275, 287 (Bankr. E.D.N.Y. 1992) (holding that mortgagee's unsecured deficiency claim could not be classified separately from unsecured claims of trade creditors).

³⁴ *In re Nat'l/Northway Ltd. P'ship*, 279 B.R. at 28 (citing *In re Greystone III Joint Venture*, 995 F.2d 1274, 1279–80 (5th Cir. 1991), cert. denied sub nom. *Greystone III Joint Venture v. Phoenix Mut. Life Ins. Co.*, 506 U.S. 821 (1992)).

³⁵ See *In re Dollar Assocs.*, 172 B.R. 945, 948–49 (Bankr. N.D. Cal. 1994).

³⁶ *Id.* at 949.

³⁷ *Id.*; see also *Bank of America Nat'l Trust and Savs. Ass'n*, 526 U.S. at 449–54.

³⁸ See *Bank of America Nat'l Trust and Savs. Ass'n*, 526 U.S. at 443 (noting the circuit split among the Seventh and Ninth Circuit Courts of Appeals, which have upheld the new value exception, and the Second and Fourth Circuit Courts of Appeals, which, while not expressly rejecting the exception, have disapproved plans of such type).

³⁹ *Id.* at 443

⁴⁰ *Id.* at 454–58.

⁴¹ *Id.* at 456.

⁴² See *Kara Homes Inc. v. Nat'l City Bank (In re Kara Homes, Inc.)*, 363 B.R. 399, 406 (Bankr. D.N.J. 2007) (holding that affiliated Chapter 11 debtors, each of which owned a tract of real property for development and each of which derived substantially all of its income from the sale of homes located in the tract, were qualified as SARE cases).



Champerty

New York Banishes the Specter of an Ancient Doctrine from Modern Debt Acquisitions

by Menachem O. Zelmanovitz with assistance from Alexis L. Allen and Lynda Madera Vaillant

Introduction

In our increasingly litigious society, the development of a secondary debt trading market has increased the importance of evaluating litigation claims in connection with investment opportunities in various debt instruments. Especially where the borrower is accused of some financial fraud or misconduct, potential claims of conspiracy, aiding and abetting, and breach of fiduciary duty, among others, against third parties, such as the borrower's initial or agent lender, have become an important element in the strategy of many hedge funds and other investment vehicles for acquiring debt at exceedingly sharp discounts.

As lenders have increasingly come under attack by subsequent purchasers of the debt who seek windfall profits based on such claims, they have turned to various protective devices including, on occasion, the ancient doctrine of champerty and maintenance. In New York, however, the champerty statute generally has not been applied to secondary transactions in debt instruments despite the acquirer's clear intent to enforce the obligation through litigation. Now, in *Trust for the Certificate Holders of the Merrill Lynch Mortgage*

Investors Inc. v. Love Funding Corp., No. 123 (N.Y. Oct. 15, 2009) (*Merrill Lynch v. Love Funding*), the New York Court of Appeals may have finally eliminated any ability to utilize the old doctrine against purchasers of debt that acquire the debt with the intent of collecting through litigation.

Definitions

Maintenance is defined as the support, promotion, or assistance provided to a litigant by one who has no bona fide interest in the case.¹ Champerty, a subset of maintenance, is defined as undertaking to further another's interest in a suit in exchange for an interest in the claim should a favorable result ensue.² As explained by the U.S. Supreme Court, "[p]ut simply, maintenance is helping another prosecute a suit; champerty is maintaining a suit in return for a financial interest in the outcome."³ As discussed below, champerty includes the purchase of a claim for the purpose of bringing suit.

History and Policy

The doctrines of champerty and maintenance are ancient, reaching as far back as ancient Greek and Roman law and the doctrines of *sykophanteia* and *calumnia*.⁴ "Commentators have traced the doctrine of champerty, and its doctrinal near-

cousins of maintenance and barratry, back to Greek and Roman law, through the English law of the Middle Ages, and into the statutory or common law of many of the states."⁵ An early champerty statute was enacted by Edward I in the thirteenth century.⁶ It provided that "[n]o officer of the King by themselves, nor by other, shall maintain pleas, suits, or matters hanging in the King's courts, for land, tenements, or other things, for to have part or profit thereof by covenant made between them; and he that doth, shall be punished at the King's pleasure."⁷

Under early English common law, assignments of a cause of action, giving the assignee the right to bring suit in his own name, generally were forbidden.⁸ To avoid such impediments, wealthy individuals acquired interests in legal claims by agreeing to pay the litigant's expenses in exchange for a share of the results if successful,⁹ thus often financing claims against those upon whom the champertors sought to inflict financial or political injury.¹⁰

Legal historians view champerty as a final "flaring up" of the feudal era, a last-ditch effort of feudal lords to combat the limits and framework of the monarchy and the capitalistic forces that had begun to take

root across Europe in the eleventh and twelfth centuries.¹¹ Efforts to prevent champerty and maintenance were grounded in several concerns: the king's desire to prevent litigation involving his own interests or those of his supporters; clerical opposition to litigation generally, especially in secular courts; a general dislike of usury, or the practice of loaning money at interest; and the belief that litigation was, in itself, an undesirable and distasteful affair, regardless of the merits of a lawsuit.¹²

Although much of the common law of champerty has eroded to near obsolescence,¹³ the core of the doctrine—the public policy against profiteering and speculation in litigation—still survives in many states. The contemporary justification for such laws is far from obvious,¹⁴ as many of the policies underlying their development are now gone.¹⁵

In fact, courts have increasingly rejected champerty claims and defenses, recognizing that the alleged champertor has a legitimate interest in the action.¹⁶

New York Champerty Statute

The doctrine of champerty has been incorporated into Section 489 of the New York Judiciary Law, which prohibits the purchase of a claim with the intent and purpose of bringing suit on the claim.¹⁷ Specifically, Section 489 provides:

As a criminal statute, whose violation is a misdemeanor, Section 489 is narrowly construed.¹⁹

In the past, in assessing whether the champerty statute applied, many New York courts focused on whether the claim was acquired for the sole or primary purpose of bringing suit.²⁰ Thus, in *Elliott Associates, L.P. v. Banco de la Nacion*, the Second Circuit, in predicting what the New York Court of Appeals would do, concluded that despite its apparent applicability, the statute was not intended to prohibit the acquisition of debt where the primary purpose was collection of the debt, even if litigation was a necessary step in the collection process.²¹

A year later, in *Bluebird Partners v. First Fidelity Bank*, the New York Court of Appeals, in an action by investors who acquired certain debt instruments at steep discounts, cautioned that the “conventional notion of champerty,” rooted in medieval land tenure practices, may prove archaic “in the modern setting of sophisticated financial transactions and complicated investment strategies.”²² Thus, when interpreting the statute, the court must follow a “prudent approach” that is “consistent with the limited scope of the champerty doctrine as it originally appeared and developed in the Anglo-American legal system.”²³ The court found the key question to be “whether it was [plaintiff's] asserted business purpose or the admitted

Love Funding Corporation (Love) originated mortgage loans for which UBS Real Estate Securities, Inc.'s (UBS's) predecessor-in-interest provided financing and was ultimately assigned the loans for securitization.²⁶ One such loan was made to Cyrus II Partnership (Cyrus), secured by a mortgage on an apartment complex.²⁷

The Cyrus loan was sold to Merrill Lynch Mortgage Investors, Inc., which loan was then securitized with others under a pooling and servicing agreement pursuant to which a trust (the *Trust*) was created to hold the loans and mortgages.²⁸ Thereafter, the Cyrus loan was declared in default, and Cyrus's principals were determined to have committed fraud in obtaining the loans.²⁹ The Trust sued UBS and, after significant litigation, UBS assigned its rights under its agreement with Love to the Trust in exchange for a release.³⁰ In the ensuing litigation by the Trust against Love, U.S. District Judge Shira A. Scheindlin of the Southern District of New York concluded that the Trust's primary purpose in obtaining an assignment of UBS's rights was to sue Love.³¹ Accordingly, Judge Scheindlin held that the assignment was void for champerty and dismissed the action.³² On appeal, the Second Circuit determined that resolution of the appeal depended on significant and unsettled questions of New York law and, therefore, certified the following questions to the New York Court of Appeals:

1. Is it sufficient as a matter of law to find that a party accepted a challenged assignment with the “primary” intent proscribed by New York Judiciary Law §489(1), or must there be a finding of “sole” intent?
2. As a matter of law, does a party commit champerty when it “buys a lawsuit” that it could not otherwise have pursued if its purpose is thereby to collect damages for losses on a debt instrument in which it holds a pre-existing proprietary interest?
3. (a) As a matter of law, does a party commit champerty when, as the holder of a defaulted debt obligation, it acquires the right to pursue a lawsuit against a third party in order to collect more damages through that litigation than it had demanded in settlement from the assignor?

(b) Is the answer to question 3(a) affected by the fact that the challenged assignment enabled the assignee to exercise the

The doctrines of champerty and maintenance are ancient, reaching as far back as ancient Greek and Roman law and the doctrines of *sykophanteia* and *calumnia*.

No person or co-partnership . . . and no corporation or association . . . shall solicit, buy or take an assignment of, or be in any manner interested in buying or taking an assignment of a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon.¹⁸

consideration of the lawsuit that constituted the primary purpose for the purchases of the second series certificates.²⁴

Merrill Lynch v. Love Funding

On October 15, 2009, in *Merrill Lynch v. Love Funding*, at the request of the Second Circuit, the New York Court of Appeals once again addressed the applicability of the champerty statute to modern investment practice.²⁵

assignor's indemnification rights for reasonable costs and attorneys' fees?³³

In its decision, the Court of Appeals answered the second question and both parts of the third question in the negative, and the court determined that it was unnecessary to answer the first question because champerty does not depend on whether the acquirer's intent to bring suit was his primary or sole intent in obtaining the right.³⁴ Rather, the purpose behind the acquisition is the determining factor.³⁵ In describing the history of the champerty doctrine, the court noted that it had always been "limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs."³⁶ The court emphasized "the difference between one who acquires a right to make money from litigating it and one who

acquires a right in order to enforce it,"³⁷ stating that "the champerty statute does not apply when the purpose of an assignment is the collection of a legitimate claim."³⁸

The court concluded that the Trust, as the holder of the loan and the party that would directly suffer from a default on the loan, *had a pre-existing proprietary interest in the loan*.³⁹ Therefore, if the Trust's purpose in taking the assignment was to enforce its rights with respect to the loan, "then, as a matter of law, *given that the Trust had a pre-existing proprietary interest in the loan*, it did not violate Judiciary Law § 489(1)," even where the Trust sought to recover more than it had demanded in settlement from UBS including recovery of additional interest and recovery on UBS's rights of indemnification for reasonable costs and attorneys' fees.⁴⁰

In short, even though the Trust acquired the assignment of UBS's rights specifically to institute suit against Love, its interest in the loan, which predated the assignment, cleared the transaction of any champerty taint.

Conclusion

The doctrines of champerty and maintenance have a long history, originating in medieval times. Today, however, these terms have different meanings and different applications in various states. In New York, it appears clear that where an investor acquires the right to sue a third party with respect to a debt, if that investor also owns an interest in that debt, its separate acquisition of the right to sue will not be subject to a defense of champerty.

endnotes

¹ See 14 C.J.S. *Champerty* § 2b (1991).

² See *id.* § 2a; BLACK'S LAW DICTIONARY 231 (8th ed. 2004) (citing William R. Anson, *Principles of the Law of Contract* 294 n.2 (Arthur L. Corbin ed., 3d Am. ed. 1919)).

³ *In re Primus*, 436 U.S. 412, 424 n.15 (1978).

⁴ See Max Radin, *Maintenance by Champerty*, 24 CAL. L. REV. 48, 49, 53–54 (1935). *Sykophanteia* and *calumnia* are doctrines against sycophants and calumniators, people who institute baseless litigation for their own gain. See *id.* at 49, 53.

⁵ *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.3d 363, 372 (2d Cir. 1999).

⁶ See Percy H. Winfield, *The History of Maintenance and Champerty*, 35 LAW Q. R. 50, 59–60 (1919).

⁷ *Id.* at 59.

⁸ See *Noland v. Law*, 170 S.E. 439, 442 (S.C. 1933).

⁹ See *Osprey, Inc. v. Cabana Ltd. P'ship*, 532 S.E.2d 269, 273 (S.C. 2000).

¹⁰ See *id.* at 273–74.

¹¹ See Radin, *supra* note 4, at 64–66.

¹² See *id.* at 60–67.

¹³ See 14 AM. JUR. 2d *Champerty & Maintenance* § 1 (2000) ("[T]he doctrines are no longer recognized in any American jurisdiction to the extent they were recognized at English common law."); *id.* n.6 ("[I]n no state are these doctrines and the laws relating to them preserved with their original vigor").

¹⁴ See Radin, *supra* note 4, at 71 ("If we dealt with this as a matter of abstract logic, it would be hard to justify the objection to champerty either in the case of law champertors or lawyers.")

¹⁵ See *Brown v. Bigne*, 28 P. 11, 12 (Or. 1891) ("[T]he doctrine of champerty and maintenance . . . arose from causes peculiar to the state of society in which it was established."); Radin, *supra* note 4, at 66 ("[T]he background against which the law of champerty and maintenance grew up . . . has disappeared.")

¹⁶ See *Temeron, Inc. v. Ferraro Energy Corp.*, 861 P.2d 319, 325–26 (Okla. Civ. App. 1930) (stating that alleged champertor has the right, under a consulting contract it signed, to bring suit on supplier's behalf and retain percentage of proceeds); *Giambattista v. Nat'l Bank of Commerce of Seattle*, 586 P.2d 1180, 1186–88 (Wash. Ct. App. 1978) (reversing grant of summary judgment for defendant on grounds of champerty and recognizing that the alleged champertor, a money broker who agreed to pay litigation expenses for its client depositors, had a legitimate interest in the matter).

¹⁷ See N.Y. Judiciary Law § 489 (McKinney 2005).

¹⁸ *Id.*

¹⁹ See *Elliott Assocs., L.P. v. Republic of Peru*, 12 F. Supp. 2d 328, 356 (S.D.N.Y. 1998).

²⁰ See *Elliott Assocs., L.P. v. Republic of Peru*, 961 F. Supp. 83, 85 (S.D.N.Y. 1997); see also *CIBC Bank & Trust Co. (Cayman) Ltd. v. Banco Cent. do Brasil*, 886 F. Supp. 1105, 1111 (S.D.N.Y. 1995); *Aubrey Equities, Inc. v. SMZH 73rd Assocs.*, 622 N.Y.S.2d 276, 277–78 (N.Y. App. Div. 1995) (noting that if commencement of suit was primary purpose of assignment, corporation may not take assignment); *Wainco Funding v. Logiudice*, 606 N.Y.S.2d 86, 88 (N.Y. App. Div. 1993). As discussed below, the New York Court of Appeals has now stated that the critical issue is not the "primary" or "sole" intent, but the purpose behind the acquisition. See *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Inc. v. Love Funding Corp.*, No. 123, slip op. at 6–7 (N.Y. Oct. 15, 2009).

²¹ 194 F.3d 363, 372 (2d Cir. 1999).

²² 731 N.E.2d 581, 586 (N.Y. 2000).

²³ *Id.*; see also *Elliott Assocs. v. Panama*, 975 F. Supp. 332, 340 (S.D.N.Y. 1997) (observing that Section 489 is a criminal statute that must be narrowly construed).

²⁴ *Bluebird Partners*, 731 N.E.2d at 589.

²⁵ See *Merrill Lynch v. Love Funding*, No. 123, slip op. at 4–5.

²⁶ See *id.* at 1–3.

²⁷ See *id.* at 2.

²⁸ See *id.*

²⁹ See *id.* at 2–3.

³⁰ See *id.* at 3.

³¹ See *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Inc. v. Love Funding Corp.*, 499 F. Supp. 2d 314, 325 (S.D.N.Y. 2007).

³² See *id.*

³³ *Trust for the Certificate Holders of the Merrill Lynch Mortgage Investors Inc. v. Love Funding Corp.*, 556 F.3d 100, 114 (2d Cir. 2009).

³⁴ See *Merrill Lynch v. Love Funding*, No. 123, slip op. at 4–5.

³⁵ See *id.* at 6–7.

³⁶ *Id.* at 5 (citing *Bluebird Partners*, 731 N.E.2d at 586).

³⁷ *Id.* at 6.

³⁸ *Id.* at 7.

³⁹ *Id.*

⁴⁰ *Id.* (emphasis added).



Out-of-Court Settlement in France “The Conciliation”

by Roland Montfort

Article L 611-4 to L 611-15 of the French Commerce Code.

Act n° 2005-845 of 26 July 2005, as completed and amended, has created a new out-of-court settlement process known under French law as “Conciliation,” replacing the former amicable settlement or “*règlement amiable*.”

Both the Conciliation and the *mandat ad hoc*, a second type of out-of-court settlement scheme under French law, are viewed as preventive schemes, that is, schemes aimed at preventing debtors’ actual insolvency or bankruptcy. The goal is to induce debtors to face their financial difficulties as early as possible by encouraging their negotiation of an appropriate rescue package with creditors.

Elements of the Conciliation

Conciliation is (i) a purely national scheme, applicable to natural (self-employed) or legal persons. The purpose of the Conciliation is to facilitate, (ii) over a limited time period, (iii) negotiation of a compromise agreement (iv) with key creditors, (v) on a confidential basis (vi) at an early stage in the debtor’s financial difficulties. To that end, (vii) a professional third party, a Conciliator, is appointed by the Commercial Court (the Court). French law provides for (viii) various tools and (ix) incentives that encourage participating creditors to compromise and support a fresh start. The opening of negotiations (x) does not trigger an automatic stay, and the debtor remains in possession of its property. Once a compromise is reached, the agreement is either (xi) validated or endorsed by the Court. A failure of negotiations or breach of the agreement (xii) can lead to insolvency. Certain (xiii) practical considerations are helpful in assessing the actual merits and effectiveness of Conciliation. These 13 characteristics of the Conciliation are described within.

(i) A National Scheme

The Conciliation scheme does not appear in either Annex A or Annex B of EC Regulation n° 1346/2000 of 29 May 2000 on insolvency proceedings (the Regulation). In particular, the Conciliation does not entail partial or total divestment of a debtor nor the appointment of a liquidator as required by Article 1 (scope) and Annex C of the Regulation. The amicable and confidential nature of the Conciliation is also incompatible with the automatic recognition and publication requirements under the Regulation. Consequently, the commencement of a Conciliation will, in principle, have no official effect outside of France.

(ii) A Confidential Scheme

Only the debtor’s management is empowered

want to have their compromise agreement endorsed by the Court (see section xi below). Nevertheless, leaks are a reality. However, since there is no obligation to include all creditors, the debtor’s selection of the creditors with whom to negotiate can be based, at least in part, on confidentiality considerations.

(iii) Early Stage

Eligible debtors must experience legal, economic, or financial difficulties, whether existing or foreseeable. However, debtors are no longer eligible to benefit from Conciliation if they have already attained a “state of insolvency” (*cessation de paiements*) for more than 45 days. State of insolvency is defined by French case law as the stage where the debtor can no longer pay its obligations as

The Conciliation is designed to remain confidential unless and until contracting parties want to have their compromise agreement endorsed by the Court.

to file for the opening of a Conciliation scheme with the President of the Court, and to terminate the Conciliation at any time. Public prosecutors, creditors, or employees do not have such right. In principle, the debtor’s executive officer may exercise that right without the prior approval of his or her board of directors or shareholders. There is no obligation to inform either the works council (at least until the compromise agreement is finalized) or outside auditors. Notice of the opening of the Conciliation is given to certain third parties, such as the public prosecutor, outside auditors, applicable professional bodies, or supervising authorities for self-employed persons.

The Conciliation is designed to remain confidential unless and until contracting parties

they become due and payable in cash or cash equivalents.

Until the state of insolvency is reached, debtors may also commence safeguard proceedings (*procédure sauvegarde*).¹ However, once that stage is reached, debtors have no choice but to file for Conciliation, receivership (*redressement judiciaire*), or judicial liquidation.

Commencement of the Conciliation requires the filing of detailed information regarding the debtor with the President of the Court (e.g., list of principal creditors, summary of all indebtedness, cash and cash equivalent assets). To the extent necessary, the President may collect additional information through an expert appointed for such purpose. All such

information is made available by the President to the Conciliator.

(iv) Limited Time Period

The maximum term of a Conciliation is four months, subject to a one-month extension upon request of the Conciliator (i.e. thus a maximum of five months), excluding any time taken by the Court to issue its endorsement. To avoid an abusive use of successive Conciliation proceedings in circumstances where other insolvency proceedings would be more appropriate, no new Conciliation may be opened within three months of the close of the preceding Conciliation.

In practice, if it appears that negotiations with creditors will last more than four to five months, the debtor may precede the Conciliation with a *mandat ad hoc* scheme, which is not regulated, has no specific time limit, and is extremely flexible. In certain circumstances, the Conciliation may be a necessary preparatory step to a prepackaged plan, which is agreed on during a subsequent safeguard scheme.²

(v) Negotiations with Key Creditors

The Conciliator's mission is to promote a compromise agreement among the debtor, key creditors, and, as the case may be, regular business partners (not necessarily creditors) that will remedy the debtor's financial difficulties. The Conciliator's role is not to assist management or otherwise represent the debtor. He may formulate any proposal for the debtor's rescue, the continuity of business operations, and the preservation of jobs. The compromise agreement does not require the consent of all creditors. The process is contractual, confidential, optional, and simple.

In practice, once a recovery plan is drafted by the debtor's management and the Conciliator, certain categories of creditors (e.g., tax and social security, banks, trade suppliers) may be selected for further negotiation, based on criteria such as the debtor's business sector. Not all creditors need be party to the negotiations. In addition, there is no requirement of equal treatment among the participating creditors. The compromise agreement will only be binding upon its

signatories and, in principle, will not affect third parties.

(vi) Reaching a Contractual Compromise

As indicated above, the objective of Conciliation is to negotiate amicably, outside of any judicial constraint, a reduction of the debtor's total outstanding debt and a rescheduling of maturity dates to reflect the debtor's financial capacity. The agreement may also include other measures, such as a capital increase, restructuring, issuance of new securities, and the like. Ever present is the threat of a possible conversion to a receivership or liquidation proceeding should negotiations fail or should the measures proposed in the compromise agreement be insufficient to ensure the continuity of business operations, in which case the prospects for creditors will be much less favorable.

The compromise must resolve the debtor's financial difficulties.

(vii) Professional Third Party

For the Conciliation to have any chance of success, there must be a relationship of trust between the debtor and the Conciliator. A conciliator is usually appointed in each case from among the list of receivers (*administrateurs judiciaires*) existing with each Commercial Court, but may also be a turnaround professional, accountant, or other expert or attorney who is recognized as competent in the field. The debtor is free to propose his choice or to oppose the selection made by the President of the Court.

(viii) Incentives for Participating Creditors

Provided that the compromise agreement is endorsed by the Court, "Qualified Creditors" benefit from a "new money privilege" in case of a subsequent safeguard proceeding, receivership or judicial liquidation. Qualified Creditors are those providing new cash advances (but not contributions to capital) and/or new supplies of goods or services that ensure the continuity of business operations as set forth in the compromise agreement. Neither cash advances or credit granted before the opening of the Conciliation, nor the mere postponement of the maturity of an obligation, will qualify under the privilege.

The new money privilege consists of a seniority in ranking of the claim, coming immediately after judicial costs and wages, that is applicable upon conversion of the Conciliation to a safeguard, receivership, or judicial liquidation.

Further, should the Conciliation be converted subsequently into a receivership or judicial liquidation, providers of new money during the Conciliation (to which the new money privilege attaches if the compromise agreement is judicially endorsed) are shielded from potential liability for abusive lending except in the following limited circumstances:

- a) Fraud
- b) Participation in the debtor's management
- c) Unbalanced guarantees, i.e., guarantees of debt that exceed the amount of the new cash contribution obtained in consideration for the guarantees

(ix) Supporting Tools

- (a) Cancellation of indebtedness by certain public creditors

As is also the case in a safeguard or receivership proceeding, public creditors

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Out-of-Court Settlement in France – “The Conciliation”

continued from page 9

(tax and social security authorities), represented by an ad hoc commission, may, as a condition to a compromise agreement under the Conciliation, consent to cancellation of certain indebtedness upon receipt of detailed information from the debtor or the Conciliator. For cancellation of public debt, the following conditions must be satisfied:

- 1) Simultaneous cancellation of debt by private creditors

period decided by the Court. The Court can condition its decision on certain acts by the debtor’s management in order to facilitate or guarantee the payment of its debt.

(c) Other

Payment of the claims of creditors signatory to the compromise agreement is automatically stayed during the term of the agreement. However, the time limitation applicable to their claims is suspended during

- c) The interests of nonparticipating creditors may not be adversely affected as a result of the compromise agreement

Only the debtor’s management may request judicial endorsement. No time period is set forth for the Court to process a request for endorsement and issue its endorsement decision. In practice, this time period can be quite long due to the need to hear various stakeholders, including the debtor’s works council.

With both endorsement and validation, the automatic stay applies to all signatory creditors for the entire term of the compromise agreement, and co-obligors and guarantors enjoy benefits from the agreement similar to the debtor’s benefits. However, only upon endorsement will Qualified Creditors benefit from a new money privilege in case of a subsequent safeguard, receivership, or judicial liquidation.

Validation does not result in publication. In contrast, endorsement judgments are published. Such publication, however, will not disclose the terms and conditions of the compromise agreement generally, but only information as to any contractual guarantees and the amount of new money privilege. The published information should provide sufficient sensitive information for nonparticipating parties (e.g., trade creditors, credit insurers) to assess the magnitude of the financial support granted to the debtor pursuant to the compromise agreement. A copy of the compromise endorsement agreement is also communicated to the outside auditors, if any.

(xii) Failure or Breach

If the parties fail to reach agreement, the Conciliator will issue a report to the Court, terminating the Conciliation. Whether the compromise agreement is simply validated or endorsed by the Court, nonperformance by the debtor will trigger the cancellation of the compromise agreement.

In itself, cancellation of the compromise agreement does not lead to the opening of another insolvency proceeding. However, the

The Conciliation is designed to remain confidential unless and until contracting parties want to have their compromise agreement endorsed by the Court.

- 2) Satisfaction of a certain proportionality test as between concessions by private and public creditors

- 3) Cancellation is applied in the following priority: judicial enforcement costs, surcharges, penalties, interest, fines, and lastly, principal debt

Several types of tax and social security indebtedness are eligible for this scheme. However, cancellation of indirect tax (such as VAT), is limited to late penalties, other penalties, surcharges, interest, and fines.

(b) “Grace period”

At the debtor’s request, while the Conciliation is in progress, the Court in summary proceedings may impose a moratorium with respect to individual proceedings brought by existing creditors against the debtor, including those initiated before the commencement of the Conciliation, pursuant to articles 1244-1 to 1244-3 of the French Civil Code. Essentially, the Court, after consultation with the Conciliator, in consideration of the debtor’s financial difficulties and the actual needs of creditors, can stretch out installment payments or postpone debt maturity by up to two years, effectively staying individual enforcement actions and freezing any late penalty or interest rate increases during the time

the term. Creditors may prosecute judicial actions other than those for the payment of the debt (cancellation of a contract, recovery of tools, ownership/consignment stock, etc.).

Personal liability of the debtor’s management is limited. For example, the filing for Conciliation freezes the obligation of the debtor to file for receivership or judicial liquidation within 45 days of the date it reaches the stage of insolvency.

(x) During the Negotiation Period

The Conciliation does not trigger an automatic stay. A stay of an individual proceeding can be ordered by the Court on a case-by-case basis as indicated in section ix above. The debtor remains in possession of its properties.

(xi) Validation versus Endorsement

The choice between the simple validation and the judicial endorsement of the compromise agreement will depend on several factors and circumstances.

For an endorsement (*homologation*), the following three conditions must be satisfied:

- a) The debtor has not reached the state of insolvency or, if it has, the compromise agreement will end that stage
- b) The continuity of the debtor’s business operations are assured

recent debtor representations

Conciliation can be converted into a receivership during the term of the compromise agreement if the conditions for receivership are met.

(xiii) Practical Considerations

By allowing debtors who have been in a state of insolvency for fewer than 45 days to seek the benefit of the Conciliation procedure instead of filing for receivership, French law has tempered the traditional finality of that stage, which otherwise triggers a receivership or judicial liquidation proceeding.

Debtors are clearly in the driver's seat during the Conciliation proceeding (by deciding to commence that proceeding, selecting the creditors invited to the negotiations, etc.). At the close of the Conciliation, debtors further control whether to seek judicial endorsement of the compromise agreement or simply its validation by the Court. That choice will depend on several factors, including the fact that publication of the endorsement judgment might negatively impact trade creditors.

Finally, the intervention of a third-party professional, the Conciliator, in addition to that of other specialized professionals alongside the debtor's management, is a powerful tool in reaching a compromise agreement. In practice, the success of the proceeding will depend largely on the credibility, competence, and qualities (diplomatic or negotiating skills) of the Conciliator and on the trust established between the Conciliator and the debtor's management.

endnotes

¹ By contrast, the threshold to open a safeguard procedure is "difficulties that debtors are not capable of overcoming." See section L 620-1 of the French Commerce Code.

² The safeguard is the French equivalent of Chapter 11.

Linens 'N Things: Co-counsel in Chapter 11 filing in Delaware; largest retail bankruptcy filing in 2008.

Mervyn LLC: Lead debtors' counsel in Chapter 11 filing in Delaware. At time of filing, client had 177 stores in California and the Southwest; for fiscal year ending February 2008, Mervyn's net sales reached nearly \$2.5 billion.

Powermate Corporation and affiliates: Represented largest manufacturer of power generators in Chapter 11 cases in Delaware. Successfully led client through bankruptcy sales of five U.S. divisions and numerous foreign affiliates.

Fluid Routing Solutions: Represented auto parts manufacturer in Chapter 11 filing in Delaware. Aided successful sale of power-steering business after bankruptcy auction; sold remaining fluid-handling business. Unique DIP loan provided to the company by the "Big 3" U.S. automakers.

Century/ML Cable Venture: One of Adelphia's affiliated debtors in Chapter 11 proceedings in New York; successful reorganization plan included \$520 million sale of company, full payment of creditors, and large distribution to owners.

Riverstone Networks, Inc.: Represented this public company in Chapter 11 case and successful sale to Lucent for \$207 million; reorganization paid creditors 100%, provided substantial distribution to shareholders.

One Price Clothing Stores, Inc.: Represented this public company with 600 stores and 4,000 employees in Chapter 11 case in Delaware. Company liquidated via package sale of 60 stores in Puerto Rico and Virgin Islands to 5.7.9 stores and a package sale of remaining U.S. stores to Rainbow stores.

- 1** *In re TOUSA, Inc.*, 408 B.R. 913 (Bankr. S.D. Fla. 2009). Prepetition lenders could not assert third-party claims against the debtors for breach of contract based on loan document representation that debtor borrowers, on a consolidated basis, would be solvent after the financing transaction because such claims did not depend on the outcome of the fraudulent transfer claims of the creditors, which asserted that individual debtor subsidiaries were insolvent.
- 2** *In re Metaldyne Corp.*, 409 B.R. 671 (Bankr. S.D.N.Y. 2009). Credit agreement provisions requiring unanimous consent of lenders to any modifications or amendments did not apply to collateral agent's ability to credit bid the amount of the collateral at an auction sale of the debtors' assets.
- 3** *In re MarchFIRST, Inc.*, 573 F.3d 414 (7th Cir. 2009). A proof of claim could not be submitted by fax where the notice of claims bar date precluded such submissions. Bankruptcy Rule 5005(c) applied only where a paper was declined to the wrong party and could not be invoked by the creditor to excuse its failure to use a proper method in submitting its proof of claim.
- 4** *Wachovia Corp. v. Citigroup, Inc.*, 634 F. Supp. 2d 445 (S.D.N.Y. 2009). Where a financial institution entered into a nonbinding agreement-in-principle to acquire a troubled bank with FDIC assistance and an exclusivity agreement barring the bank from soliciting or negotiating acquisition proposals with third parties, and the bank thereafter received an unsolicited greater offer and entered into a major agreement with another financial institution that did not require FDIC assistance, Section 126(c) of the Emergency Economic Stabilization Act rendered the exclusivity agreement unenforceable. "Transaction," as that term was used in the statute, referred generally to a competitive sale of the bank, rather than a sale to a specific buyer.
- 5** *In re Ames Dept. Stores, Inc.*, 582 F.3d 422 (2d Cir. 2009). In a matter of first impression, the Second Circuit held that, unlike other claims, Section 502(d) does not bar allowance of postpetition administrative claims until the creditor's return of any preferential transfers.
- 6** *In re Manchester, Inc.*, No. 08-03163-BJH, 2009 WL 1533614 (Bankr. N.D. Tex. June 1, 2009). Given the trustee's failure to show that enforcement of a forum selection clause, requiring that any litigation be brought in New York, was unreasonable, the clause must be enforced in an adversary proceeding for breach of contract and avoidance of preferential transfers.
- 7** *In re SNTL Corp.*, 571 F.3d 826 (9th Cir. 2009). Unsecured creditors may assert claim for attorneys' fees incurred postpetition based on a prepetition contract, and such claim was not subject to disallowance under Section 506.
- 8** *In re DBSI, Inc.*, 407 B.R. 159 (Bankr. D. Del. 2009). Disagreeing with other bankruptcy courts, the court held that the appropriate remedy for a debtor's failure to perform under a lease prior to assumption or rejection, as required by Section 365(d)(3), was to cause rejection of the lease in a timely fashion and not necessarily to award an administrative claim for unperformed obligations.
- 9** *LaSalle Nat. Bank Ass'n v. Paloian*, 406 B.R. 299 (N.D. Ill. 2009). An asset securitization trust was the initial transferee for the purpose of liability upon avoidance of lease payments as fraudulent transfers because it had both legal title and dominion over the funds. Carte blanche authority to use the funds however one sees fit is not necessary.
- 10** *In re Winstar Communications, Inc.*, 554 F.3d 382 (3d Cir. 2009). Where an equipment supplier that entered into a \$2 billion prepetition financing agreement to provide the debtor with construction funding also forced the debtor to purchase equipment before it was needed and delayed issuing a refinancing notice so as to induce other creditors to invest in the debtor and inflate its own earnings, the supplier's conduct warranted equitable subordination of its claim.