ROUNDTABLE

Bankruptcy litigation

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ROUNDTABLE

BANKRUPTCY LITIGATION

Bankruptcy matters come intertwined with complex issues, and the past few years have seen significant developments. There remains a fair amount of conflicting case law, and lower courts are expected to grapple with many issues in the years ahead. Although there are fewer large, complex filings at present, there seems to more litigation attached to the cases that are filed, compared with years gone by. But debtors, creditors and stakeholders are also taking more creative approaches to find workable solutions.

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FW: Could you provide an insight into some of the key trends and developments you have seen in bankruptcy litigation in recent months?

Chatz: Bankruptcy litigation had been severely impacted by the US Supreme Court's 2011 decision in *Stern v. Marshall*. The decision issued by the US Supreme Court on 9 June 2014 in the *Executive Benefits Insurance Agency v. Arkinson, Chapter 7 Trustee of Estate of Bellingham Insurance Agency, Inc*., has clarified the jurisdictional basis for bankruptcy courts to act in many pending actions. There have been significant delays prior to the issuance of *Bellingham*. Bankruptcy courts nationwide appear to be in a position to act in cases pending before it. Whether the bankruptcy courts will be able to issue final orders or just findings of fact and conclusions of law for the purpose of *de novo* review by the United States District Courts will be determined on a case-by-case basis.

Barefoot: The key trends in bankruptcy litigation in recent months involve the application of the safe harbours in avoidance litigation, whether bankruptcy courts have the power to decide certain disputes because they are Article I courts, and the use of settlement procedures unique to bankruptcy, such as Bankruptcy Rule 9019, to settle claims that a debtor has against its affiliates or insiders. There is a fair amount of conflicting case law in these areas, and we expect lower courts to grapple with many legal issues over the next year or two until definitive rulings from appellate courts on certain key legal issues are handed down.

Zahralddin: Fraudulent transfer causes of action allow creditors to unwind transactions that unfairly deplete a debtor's assets. These claims can be based either on actual fraud or constructive fraud – the debtor not receiving reasonably equivalent value in exchange for what it transferred. Section 546(e) prevents a bankruptcy trustee from avoiding settlement payments made by a debtor in a securities transaction. Section 546(e) does not, however, provide a safe harbour for such settlement payments if they are shown to be an intentionally fraudulent transfer. The district court in *In re Tribune* held that, by its plain language, the Section 546(e) safe harbour for securities transaction settlement payments applies only to protect such payments against fraudulent transfer avoidance actions brought by a bankruptcy trustee and does not preclude state law constructive fraudulent conveyance claims asserted by individual creditors.

Uhland: Two recent trends are, first, the litigation of central issues necessary to structure a plan of reorganisation prior to plan negotiations and second, the deferral of resolutions of all avoidance actions until after confirmation. While the timing of addressing these issues is arguably mandated by the bankruptcy process itself, the fact that these issues are being litigated as opposed to resolved through a negotiated plan of reorganisation is a developing trend. Some years ago, the parties worked to reach a consensual reorganisation from the outset of the case, and failing an ability to reach agreement among all classes, would litigate these issues in connection with plan confirmation. We are now seeing declaratory relief actions and other litigation to determine the extent of claims and collateral prior to the formulation of a plan, and avoidance actions almost always brought through post-confirmation by litigation trusts.

From what I have seen, much of this litigation could be greatly truncated, or avoided altogether, if the parties and their professionals took a more pragmatic, and less confrontational, approach from the outset of their bankruptcy cases.

ANTHONY W. CLARK

Hayek: On the one hand, it appears to us that in complex bankruptcy cases the period between the declaration of bankruptcy and the issuing of the schedule of claims is longer than it used to be. Since the publication of the schedule of claims is the starting point for Swiss bankruptcy litigation, this has an impact on the overall duration of the proceedings. On the other hand, under the new unified Swiss Code of Civil Proceedings – in force since 1 January 2011 – contesting the schedule of claims may take a little less time, because deadlines are generally shorter.

Clark: One trend that I have noticed in recent times is that while the larger complex Chapter 11 case filings are down, largely due to the continued availability of relatively cheap credit, there seems to be more litigation in the cases that do get filed these days as compared with years past. I have no empirical data to support this observation, just my own anecdotal experience. And I have no explanation for it beyond, perhaps, the law of nature that applies as much to restructuring professionals as to anyone else – the work they do tends to fill the time they have to do it. From what I have seen, much of this litigation could be greatly truncated, or avoided altogether, if the parties and their professionals took a more pragmatic, and less confrontational, approach from the outset of their bankruptcy cases.

Sherrill: The *Grede/FCStone* decision out of the Seventh Circuit is compelling because it continues a developing trend of recent years. Lower courts have consistently refused to apply the Bankruptcy Code's safe harbour statutes as written. In the *Grede* litigation, which arose out of a failed commodity broker, the district court stated that applying the statutory language according to its terms "would fly in the face of justice and do nothing to advance any plausible Congressional purpose". The Seventh Circuit disagreed, concluding that "[Section] 546(e) reflects a policy judgment by Congress that allowing some otherwise avoidable pre-petition transfers in the securities industry to stand would probably be a lesser evil than the uncertainty and potential lack of liquidity that would be caused by putting every recipient of settlement payments... at risk of having its transactions unwound in bankruptcy court". The appellate courts' consistent reliance on strict construction is refreshing for those who favour interpreting ▸▸

statutes by their terms.

Schonholtz: The US Supreme Court continued to upend decades of bankruptcy court practice in its 9 June 2014 ruling in *Executive Benefits Insurance Agency v. Peter H. Atkinson (Bellingham)*. Clarifying its landmark decision in *Stern v. Marshall*, the Supreme Court ruled that even when the Bankruptcy Courts are authorised by statute to enter a final judgment in "core matters", the US Constitution prohibits them from fully adjudicating certain core matters that arise in many bankruptcy cases – commonly referred to as 'Stern Claims'. The Supreme Court made it clear that the proper course of action for Stern Claims is for the Bankruptcy Court to issue proposed findings of fact and conclusions of law to be reviewed *de novo* by US district courts. This ruling creates significant challenges for bankruptcy judges and practitioners.

FW: In what ways does the bankruptcy litigation process differ from other types of litigation? How do the issues of cost and speed shape the process?

Barefoot: Much more frequently than in traditional two-party commercial litigation, the commercial realities of the debtor's circumstances force resolutions that are both expedited and often negotiated. In most cases, the debtor has insufficient resources to satisfy its creditors, and by remaining in Chapter 11 proceedings – or even protracted litigation outside or after a bankruptcy – the debtor only depletes the pie available for distribution. This is particularly the case where its adversaries – whether secured lenders or official committees – are also being funded by the estate. On the flip side, bankruptcy litigation can be more complex both because there are often multiple individual disputes and multiple parties involved with each one. For example, when a company becomes subject to Chapter 11, many of its business decisions become subject to approval by the court and, in turn, review and objection by creditors.

Zahralddin: The Federal Rules of Bankruptcy Procedure separate matters that can be handled under motion practice from those disputes that have to be handled as 'adversaries', which resembles civil litigation conducted under the Federal Rules of Civil Procedure – including the costs associated with discovery and trial. The distinction allows for the *possibility* of abbreviated procedures in many instances, even though some matters under motion practice can become 'contested matters' and will require an evidentiary hearing, which means an increase in costs similar to civil litigation and adversaries. Bankruptcy courts, to stem the tide of mass filings of preference cases, have accelerated deadlines through model scheduling orders in an attempt to encourage settlement or manage their busy dockets. However, if you are a party that doesn't have access to information, if there is an 'asymmetry' in who has the information, abbreviated schedules and processes can put a party at a grave disadvantage in a fundamentally unjust manner.

Cost and speed are an issue in any type of litigation, but since no monetary interest accrues on debts after bankruptcy has been declared, the time value of money is more of a concern than in regular litigation.

DANIEL HAYEK

Uhland: Bankruptcy litigation is certainly faster than other types of litigation. Much of this is due to the general availability of the bankruptcy courts and their willingness to hear matters on shortened time. This can particularly speed up the discovery phase of litigation. In ordinary litigation, a discovery process may go on for many months with objections, productions and motions to compel. In bankruptcy, litigators are more likely to go to the court and have the court rule on the scope of discovery at the outset of the discovery process. This difference alone dramatically shortens the time necessary for bankruptcy litigation.

Hayek: A major difference between bankruptcy litigation and regular litigation is that a creditor who wants to contest the schedule of claims needs to file a statement of claim within the 20 days statutory – and non-extendable – deadline after the schedule of claims is published. In regular proceedings the plaintiffs have, subject to limitation of actions, the option to bring an action whenever they want. It goes without saying that this needs a higher level of preparation by both the creditors and their lawyers. Cost and speed are an issue in any type of litigation, but since no monetary interest accrues on debts after bankruptcy has been declared, the time value of money is more of a concern than in regular litigation.

Clark: For the most part, litigation in bankruptcy cases is far more expedited than in other courts. There is a statutory bias to getting companies in and out of Chapter 11 cases more quickly, as well as a financial incentive – the less time spent in bankruptcy, the less that has to be paid to the lawyers and other restructuring professionals who are necessary to administer the bankruptcy process. But, ironically, the incentive to move more quickly in bankruptcy in order to minimise administrative expense often translates into higher litigation costs in the near term, since the normal litigation tasks – preparing pleadings and briefs, taking and defending discovery and, of course, conducting hearings and trials – still have to be done, but they are compressed into a much shorter period than the normal course outside of bankruptcy. The speed of the process can be an eye-opener for clients unfamiliar with bankruptcy, because they are forced to make strategic litigation decisions, and to focus on settlement, a lot quicker than they may be used to.

Sherrill: Bankruptcy litigation usually proceeds on a tighter timeframe than other types of litigation. For most adversary proceedings in bankruptcy, there is no reason for a longer timeframe because the issues may not be especially novel. For the more complex forms of litigation, most bankruptcy courts are flexible in allowing more time or other alternatives. Cost and speed are clearly a determinant. Bankruptcy estates ▸▸

or post-confirmation trusts operating on extraordinarily tight budgets may need to proceed to litigation – or near enough to litigation to foster settlement – quickly. The cost can have unfortunate consequences as well, however. Many cases get passed from larger firms to small bankruptcy boutiques after plan confirmation. There are many great bankruptcy boutique firms around the country, but there are others that survive only because of the volume of their case loads. When smaller firms take on a mass-filed adversary proceedings, it can result in great frustration and delay for the defendants.

Schonholtz: Bankruptcy litigation often involves discrete but critical and time-sensitive issues that must be resolved before the bankruptcy case can be resolved. Practitioners and judges often operate under severe time constraints. The discovery process has to be more focused or condensed. Motion practice is frequently replaced by conferences with the bankruptcy court. Bankruptcy Judges are the triers of fact, so attorneys argue to sophisticated factfinders who will be considering the specific issue before them against the backdrop of their views on the entire bankruptcy case and how it should proceed. Multiple parties in interest participate, which complicates and can delay the proceedings. Debtors often pay expenses of many of these parties, which have their own counsel and financial advisers, so the bankruptcy estate's litigation costs can skyrocket.

Chatz: Litigation in the bankruptcy courts can provide for a fair, expedited litigation process with respect to causes of actions enumerated in Chapter 5 of the Bankruptcy Code. Specifically, the trustee or debtor-in-possession's ability to require turnover of property, and avoidance and recovery of preferential and fraudulent transfers are actions bankruptcy courts are well-situated to expeditiously handle. The bankruptcy litigation process allows parties – who think the best way to assure litigation results is through trial rather than settlement – the ability to obtain a fair, expedited trial on those causes of action. The bankruptcy courts' less-encumbered trial calendars – and often the narrower range of issues at hand – allow for more efficient litigation processes.

FW: Are you seeing any common issues arising in bankruptcy processes in today's market? How frequently do related disputes proceed to litigation?

Zahralddin: Make whole provisions have played a big part in recent bankruptcy litigation. Corporate bond instruments contain no-call provisions, make-whole or yield maintenance premiums which are designed to keep interest payments flowing by prohibiting early repayment or requiring the borrower seeking to replay early to pay the bondholder a premium to cover the loss of interest. Low interest rates allow a debtor to use Chapter 11 to refinance high-yield notes with lower interest debt while seeking to avoid paying any a mark-up on the debt that is being refinanced. This has caused a lot of litigation as disputes come up focused mostly on contract language and disputes over whether the premiums are unmatured interest and subject to disallowance under section 502(b)(2) of the US Bankruptcy Code.

Uhland: I am seeing issues relating to the determination of the extent of the value of a secured creditor's claim popping up as key issues to be litigated much earlier in a bankruptcy case. These issues were previously often settled or litigated in connection with the plan of reorganisation later on down the road, and now I see them arising prior to the negotiation of a plan of reorganisation.

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SUZZANNE UHLAND

Hayek: In connection with the bankruptcy of the Swiss Lehman Brothers entity Lehman Brothers Finance S.A., we have seen issues in connection with the valuation of claims. The Swiss liquidator approached creditors informally with an indication of the range in which they intended to allow a claim thereby trying to reach an agreement before issuing the schedule of claims. While Lehman Brothers is a particular case where the valuation of claims based on derivatives was rather difficult, we are of the opinion that this approach may be a viable solution to reduce the risk of litigation. However, it seems to us that the liquidator's valuation of claims with low amounts were rather at the top end of the range. A frequent issue that indirectly affects the recovery by creditors are disputes related to intercompany claims. In the context of a group, Swiss companies are often used as a 'financial hub' – so too in the case of Lehman Brothers. Additionally, after a group's default, information and knowledge in connection with intercompany debts may no longer be easily available to the Swiss liquidator. Therefore, solving intercompany issues often proves to be a rather difficult task for the liquidators and they usually try to find an amicable solution instead of litigating. However, the duration of negotiations should only go so far as it would take to obtain a final verdict by the Swiss Federal Supreme Court. Otherwise, it makes more sense to litigate.

Clark: Despite the decrease in larger complex corporate bankruptcy filings, the cases that are being brought seem to generate significantly more disputes – between debtors and creditors, and among competing creditor groups – than in the past, which all too frequently lead to full-blown, and expensive, litigation. As a litigator, I appreciate the work, but as an economic observer of the bankruptcy process, I cannot help but think that too much value that could otherwise help to make creditors whole – or, rather, more whole – is wasted by too much litigation.

Sherrill: Discovery disputes are always commonplace. With them, there is almost always the tension between trying to pre- ▸▸

serve a client's rights and trying not to irritate a judge – who inevitably does not want to address discovery disputes. For that reason, those disputes seldom advance to full litigation. One airing in a status conference – and the attendant disapproving looks – will usually quash any appetite for litigation. We are also seeing an increase in disputes concerning whether documents should be sealed by the court. Historically, bankruptcy courts have shown considerable willingness to grant requests to seal. Recently, more parties seem to be pushing back, and the pendulum may be swinging in the opposite direction.

Schonholtz: A common theme in today's market is to 'litigate for leverage'. Creditors seize every opportunity to improve their ultimate recoveries by commencing litigation or otherwise impeding the progress of the case. Since bellicose creditors often obtain enhanced recoveries and reimbursement of their legal – and other adviser – fees as part of their ultimate settlements, this type of litigation is essentially an all upside strategy.

Chatz: Given that lenders, debtors and other parties prefer out of court or other types of remedies – due to its costs and public nature – the bankruptcy process is not a well-received means of debt resolution in these times. A major area of litigation in bankruptcy process resolution appears generally within cases involving Ponzi-scheme fraudsters as well as legal service providers. The bankruptcy process is well-situated to timely resolve avoidance and recovery litigation. In the Ponzi-scheme and legal provider cases, significant and widespread litigation is often commenced in order to facilitate recovery for creditors. Some of these avoidance and recovery cases proceed to trial; however, many are settled due to the very public nature of, as well as the wide public interest in, these cases.

Barefoot: Given today's low interest-rate environment, relaxed monetary policy and the simple cost and expense of in-court reorganisation, many borrowers and lenders are choosing out-of-court solutions to the extent possible. For example, Chapter 11 filings are at historical lows, and inexpensive credit in the capital markets makes in-court reorganisation less attractive than at any time in recent years. However, to the extent debtors file for Chapter 11, the recent trend seems to suggest that more and more debtors are walking into court on the first day already having reached an agreement with a material group of their creditors, either in the form of prepetition settlement agreements, plan support agreements or similar arrangements.

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MARGOT B. SCHONHOLTZ

FW: Could you comment on any recent, significant court rulings that will have repercussions for bankruptcy proceedings going forward?

Uhland: A couple of key recent decisions will be important for bankruptcy cases going forward. First, Judge Glenn's decision in Rescap, *Official Comm. of Unsecured Creditors v. UMB Bank, N.A.,* addressed important issues regarding the extent of a creditor's collateral, including the ability to obtain a lien on the goodwill of an entity. Second, in Bankruptcy Code section 363 cases, the recent decisions in *In re Fisker Automotive Holdings, Inc.* and *In re Free Lance-Star Publishing Co. of Fredericksburg*, regarding credit bidding, will likely inject a litigation element in the Bankruptcy Code section 363 sale process as debtors and other constituents seek to limit the secured creditor's ability to credit bid its claim. This could slow down what has been an increasingly faster pace for 363 sales.

Hayek: On 8 May 2014, the Swiss Federal Supreme Court made a noteworthy decision regarding the potential impact of foreign judgments on Swiss bankruptcy proceedings. The *Belgian Masse en faillite ancillaire de Sabena SA* is the former Belgian national airline's bankruptcy estate. A Belgian court ruled that the insolvent Swiss entities SAirGroup and SAirLines were responsible for Sabena's bankruptcy and awarded damages to the Belgian airline. Sabena requested that the judgment be recognised and enforced in Switzerland according to the provisions of the Lugano Convention. However, the Swiss Federal Supreme Court decided that the Lugano Convention did not apply to the Belgian judgment and made it clear that after the bankruptcy of a Swiss entity the Swiss courts have sole jurisdiction in connection with insolvency related disputes. Consequently, foreign judgments against the Swiss bankruptcy estate are not recognisable decisions and have generally no impact on the bankruptcy proceedings of Swiss entities. However, it is not yet completely clear whether a Swiss bankrupt entity may bring an action before a foreign court and how this would affect the Swiss bankruptcy proceedings of such entity.

Clark: Earlier this year, in *Fisker Automotive*, a bankruptcy court, in a section 363 asset sale auction, limited the credit bidding rights of a holder of the secured debt, which it had purchased from the US government at a steep discount – $25m paid for $168m face amount of debt – to the amount paid for the debt. The court's ruling was a complete game-changer – without it, the secured creditor, a strategic bidder for the assets, would have won the auction, but as a result of the ruling, other bidders came in and someone else prevailed. Decisions like *Fisker* cannot help but encourage more litigation in bankruptcy cases between unsecured and secured creditors, and not necessarily just in the asset sale context. There is no reason why the fundamental argument that prevailed in *Fisker* – that the value to be received by the estate would be maximised by curtailing the secured creditor's rights – could not be made in other contexts. And I have no doubt that creative lawyers representing unsecured creditors' committees and other stakeholders will find plenty of opportunities to do so.

Sherrill: The *Tronox/Kerr-McGee* opinion stands out as a very significant decision in recent months. So often, we deal with fraudulent transfer issues only in the abstract. But the *Tronox* case is a great illustration of many aspects of fraudulent transfer law, from the long-arm powers in the Bankruptcy Code to whether to collapse a transaction to the 'badges of fraud'. It's a very impressive opinion, and that doesn't even get into the dollar amount at stake. Also significant was the *Fisker* ruling on credit bids. In that case, the Delaware bankruptcy court limited the ability of a secured lender to credit bid when its collateral is sold. In *Fisker*, the court used a 'for cause' provision in the statute to cap the secured lender's credit bidding rights at the amount paid for the claim on the secondary market. Already, one other court has followed the same analysis, and more will likely follow.

Schonholtz: In addition to the *Bellingham* decision, recent decisions with respect to the ability of a secured lender to credit bid in a bankruptcy auction will have repercussions going forward. In *In Re Fisker Automotive Holdings and In Re Free Lance-Star Publishing Co*., the courts limited the ability of distressed secured debt purchasers to credit bid the full value of their claims where their liens were contested by other parties in the case and the court determined that capping the amount of the bid may be necessary "to foster a competitive bidding environment". In addition, the courts ruled that the decision to cap a credit bid amount was not immediately appealable, thus effectively leaving the credit bidders without an effective remedy during the auction process.

Chatz: The issuance of *Bellingham* by the US Supreme Court on 9 June 2014 appears to provide practitioners with the comfort that they can act for the benefit of their clients within the context of the bankruptcy courts and, ultimately, obtain final relief. Whether bankruptcy courts have jurisdiction to enter a final order or instead are limited to entering findings of fact and conclusions of law that are subject to *de novo* review of the US District Court, will depend upon the nature of the case. Whether the parties will consent to jurisdiction of a bankruptcy court, when they are locked into a circumstance wherein the bankruptcy court is limited to only making findings of fact, will depend upon the parties' willingness to accept the delay caused by the *de novo* review of the District Court and the still unsettled issue of whether parties can consent to jurisdiction for cases that fall in what is now called the '*Stern* Gap'.

Barefoot: Perhaps the most important area of bankruptcy litigation in recent years involves the scope of the power of the bankruptcy court to hear and finally determine certain types of disputes before it. This topic of litigation spawns from the Supreme Court's decision in *Stern v. Marshall* where the court held that bankruptcy courts, as Article I courts, lack the constitutional power to finally adjudicate certain types claims even though Congress had bestowed upon them such power by statute. A significant amount of litigation has ensued from this case, and bankruptcy practitioners have sought much needed clarity from the Supreme Court regarding the extent to which *Stern v. Marshall* precludes a bankruptcy court from entering a final order even in the most basic type of bankruptcy dispute. Unfortunately, practitioners will need to wait for another day because the Supreme Court on 9 June 2014 expressly declined to decide whether bankruptcy courts have the constitutional power to finally decide certain types of routine claims, including fraudulent transfer claims.

One of the only remaining assets for the bankruptcy estate is litigation against the former directors and officers (D&Os) of a corporation in an attempt to recover from the D&O insurance policy of the debtor.

RAFAEL X. ZAHRALDDIN

Zahralddin: One of the only remaining assets for the bankruptcy estate is litigation against the former directors and officers (D&Os) of a corporation in an attempt to recover from the D&O insurance policy of the debtor. Sometimes, the insurance held by the debtors is insufficient or has been exhausted. Often, in addition to pursuing the D&Os, the plaintiff in bankruptcy litigation will also pursue claims against the professionals that advised the debtor. Recently, the Delaware Chancery Court in the *In re Rural Metro Corp. Stockholders Litigation* breathed new life into the claim against a corporation's advisers of aiding and abetting breaches of fiduciary duty by a board. A financial adviser was held liable for aiding and abetting in the case even though the board and an alternative financial adviser had settled its own liability, there was no breach of loyalty found against the board, and the company's articles of incorporation included a waiver of liability for the breach of the duty of care. Because many bankruptcy litigation disputes involve rights governed by the underlying state laws or applicable non-bankruptcy law, and because Delaware is the corporate home of more than half of the US's publicly traded companies and 63 percent of Fortune 500 firms, chancery court rulings resonate beyond the state's borders, and will impact bankruptcy litigation significantly.

FW: How would you describe the evolving dynamic between various creditor committees and creditor classes in a modern bankruptcy process? To what extent are you seeing increased collaboration among multiple parties to reach a viable solution?

Hayek: In Switzerland, the creditors' committee is established before the schedule of claims is published. Consequently, it is not clear if, or in what class, the creditors will be admitted in the schedule of claims. In addition, the creditor committees' area of responsibility may vary, but it usually only supervises the liquidator's work and approves settlements and does not represent the bankrupt's estate. Consequently, discussions take place between creditors – or third parties – and the liquidator. Whether or not collaboration is possible depends mainly on the liquidator. We found that in well-conducted insolvency proceedings the liquidators are open to discussion ▸▸

and attempts to finding solutions which are beneficial to all creditors of the Swiss bankrupt's estate.

Clark: In recent years there has been a very positive trend among the more sophisticated players in the market for control of troubled companies to try to do more out-of-court restructurings or, if necessary, pre-packaged or pre-arranged bankruptcies. These deals can significantly expedite the change-in-control process and greatly mitigate the transactional and administrative costs that otherwise would be incurred if the restructuring were to occur in a traditional or free-fall bankruptcy. These kinds of win-win collaborative efforts among competing economic interests are to be encouraged. By contrast, I also have seen an emerging trend in internecine creditor disputes in which structurally senior, but later maturing noteholders seek to judicially block troubled issuers from making principal payments to earlier maturing, structurally subordinated noteholders. In effect, the senior noteholders try to force the issuer into a premature bankruptcy filing, which would be triggered by a default on the junior notes that would result if a court were to enjoin the issuer from paying them, because the senior notes think they will recover more and sooner in Chapter 11 than outside of bankruptcy.

Sherrill: The committee issues in the *Energy Future Holdings* case are going to be very interesting to watch. The *EFH* case involves a very large leveraged buyout, and, as a result, many different creditor constituencies who will be willing to act aggressively in the bankruptcy proceedings. The debtors appear to have performed Herculean tasks in getting many of those constituencies in line prior to the bankruptcy filing, but unsurprisingly, other constituencies are still at odds with the debtors. The intra-committee dynamic may be provocative, especially early in the case. It is common to see increased collaboration among various parties, but that typically does not materialise immediately. Bankruptcy almost always features some – or all – parties taking aggressive negotiating postures, and then an eventual resolution somewhere in the middle. I expect that *EFH* will eventually follow that same script – although the identity of some of the parties and the dollar amounts involved may complicate matters in the interim.

Schonholtz: Excessive leverage and the complex capital structure of many debtors has resulted in decreased collaboration, and more litigation, among the creditors. In numerous large cases, sizable multiple tranches of secured debt jockey for position to soak up as much reorganisation value as possible. They wrangle over issues like what constitutes the fulcrum security and whether second lien creditors can 'cram' a plan of reorganisation up on first lien creditors. Unsecured creditors often watch from the sidelines and frequently recover nothing more than the right to pursue proceeds, if any, of post-bankruptcy avoidance actions.

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MARK SHERRILL

Chatz: The relative stakes for the parties in bankruptcy cases have increased over the last few years. Parties are less able to incur losses and their willingness to fight to preserve their claims has increased. Collaboration therefore often takes longer to occur or is often unfeasible as livelihoods are at stake.

Barefoot: The most interesting dynamic in modern bankruptcy involves the presence of distressed investors who invest in all levels of a debtor's capital structure at the same time or at different times before, after, and during the life of a case. Because distressed investors are usually sophisticated and well financed, they often view litigation – typically litigation against other creditor constituencies, but not necessarily – as a means to create leverage and drive a higher recovery. Such investors are generally not afraid to take novel, risky and sometimes frivolous positions where the potential upside is material. Against this backdrop, however, courts and practitioners have increased the use of mediation and other forms of dispute resolution in bankruptcy as a way to increase collaboration and consensus, and distressed investors and hedge funds play a vital role in that process to the extent they are willing to participate.

Zahralddin: Everyone has to row together to get an exit out of the bankruptcy, whether it is a sale or exit financing, and that will help unify different constituencies, but there is a lot of jockeying for position and often there will be some party that wants to threaten capsizing the boat in order to get a concession from the estate. I have even seen cases where the more successful the bankruptcy is, the more bitter some creditors are towards others because now there are assets over which to fight. So the dynamic that used to be the hallmark of a reorganisation, which is that we are unified by our shared misery – we are all going to take a loss – and hope, that used to bind us together, doesn't materialise, if at all, until after the dust has settled from hard fought litigation.

Uhland: The current dynamic in Chapter 11 cases is being driven by the increase in secured debt in the capital structure and the effective replacement of senior subordinated debt with second lien debt. As companies have various priorities of secured debt, valuation becomes a critical issue, as does the extent of the secured party's collateral and whether there are any gaps in the secured creditor's collateral package. Given that these threshold issues must be resolved to structure a plan, I think we are seeing less rather than more collaboration until these issues can be resolved through litigation or mediation.

FW: Are mediators and arbitrators playing a more active and meaningful role in the bankruptcy process?

Clark: Yes and no. The use of mediators in bankruptcy cases appears to be on the rise and can be very helpful and effective ▸▸

– especially where the presiding bankruptcy judge enlists another member of the bankruptcy bench to handle the mediation. As for arbitration, bankruptcy courts have for some time generally enforced arbitration clauses in debtors' prepetition contracts. But I think there is a consensus that, at least in the US, arbitration has not turned out to be materially quicker or less expensive than traditional litigation in most cases – though it does offer the benefit of confidentiality. So I have not seen any particular increase in the role that arbitration plays in bankruptcy cases.

Sherrill: In my experience, mediators are playing a more active role across the board. Whether they play a meaningful role depends largely on the individual mediator. Said another way, your mediation session is going to be only as productive as your mediator. We have had tremendous experiences with some mediators – often retired lawyers who had very accomplished practices and now act as mediators solely for the intellectual challenge. In other scenarios, however, we have been very disappointed by unprepared mediators who seem to be interested only in getting paid. A proactive judge can play a very productive role in this process, but because the mediation is away from the courtroom, it may be difficult for a judge to know what issues to guard against. We also see a fair amount of arbitration, but my sense is that is localised to certain industries.

Schonholtz: More and more bankruptcy judges are sending parties to other sitting judges in the same court for mediation. These mediations can occur at any point in a case on a variety of issues. Many judges like to mediate so they are happy to assist their colleagues in resolving cases in a cost effective way. In addition, judges believe that mediation by another judge incentivises the parties to be constructive in mediation.

Chatz: Frankly, I am not a fan of mediators or arbitrators in the bankruptcy process. I think an additional layer of administrative expenses is created when, in fact, it may just be easier and quicker for parties to go to trial on bankruptcy and bankruptcy-related issues. When jurisdiction is clear, trial lawyers are happy to try cases. What in fact may be occurring in the marketplace is that bankruptcy practitioners are fearful or not capable of trying cases, or do not have the history or talent to undertake trials. They would seemingly rather impose a protocol which may force an otherwise unnecessary settlement upon their clients. For those with weak cases, mediation or arbitration may be beneficial. For those with strong cases, the ability of the bankruptcy courts to expeditiously try cases is an invaluable advantage.

Barefoot: As with many other types of litigation, mediators and arbitrators are indeed playing a more active role in bankruptcy proceedings across the board. At one end of the spectrum, in large complex Chapter 11 reorganisations, both practitioners and judges have become more open to employing mediators to drive consensus on the terms of plans of reorganisation. This can be particularly valuable in multi-party disputes where resolution with one constituency only foments a new bone of contention with another. Mediation can also be particularly effective where all constituents stand to lose from protracted litigation that only serves to deplete estate resources and reduce the resources available for distribution to creditors. At the other end of the spectrum, bankruptcy courts are becoming more receptive to mediation or consensual arbitration even in smaller matters, such as claims allowance disputes or, in the case of individual debtors, procedures to help ensure an open dialogue among the parties.

For those with strong cases, the ability of the bankruptcy courts to expeditiously try cases is an invaluable advantage.

BARRY A. CHATZ

Zahralddin: Mediators have become essential in not only settling litigation but framing litigation so it is more cost effective and doesn't waste judicial resources. In a recent case, our mediation involved the debtor, equity and creditors' committees, class action securities lawyers, SEC, auditors, directors and officers of the debtor, and a stack of insurance companies. The only party that didn't profit from attending was the party that didn't show up, as they are now one of the litigation targets for the fulcrum security. That doesn't mean mediation will replace litigation, but at its worst, in my experience, it clears the runway for the important disputes in the case or the ones that are truly irresolvable without judicial help.

Uhland: Mediation has taken on a central role in the bankruptcy process. As parties have moved to litigation to determine key issues that are central to the plan of reorganisation instead of consensually resolving them through negotiation, they are having difficulty facing the reality of the cost and time needed to litigate complex commercial issues. As a result, the initiation of litigation in these matters and the subsequent appointment of a mediator has become a key path for the resolution of the issues and negotiation of a plan. An example of this is the *Dynegy* case.

Hayek: The court at the place of incorporation of a Swiss bankrupt entity has the sole jurisdiction in connection with bankruptcy litigation. Therefore, arbitration plays virtually no role in Swiss bankruptcy proceedings. Mediation is also not common, but parties frequently try to settle disputes by way of informal settlement negotiations. In addition, if a settlement seems to be possible, it is mostly reached under the guidance of the court after the schedule of claims was contested and one or two briefs were exchanged.

FW: Not everyone can emerge satisfied from a bankruptcy dispute. In your experience, what factors are required to reach a positive resolution for the benefit of most interested parties?

Sherrill: The most important factors that the attorney can control are to learn the case well and to develop a close, cooperative relationship with an experienced client representative. When the client truly understands its strengths and weaknesses, seldom will the results be a major surprise. That understanding level requires that the client rep has litigation experience, and that the attorney is working in a collaborative manner to explain the nuances fully. Among factors that we cannot control, an engaged, proactive judge is certainly helpful. I am frequently impressed with the many ways that a smart judge can move parties toward settlement. And settlement almost always leaves both sides somewhat satisfied – otherwise they wouldn't reach the agreement. Finally, conservative estimates by the client's treasury department in establishing litigation reserves can go a long way toward leaving the client satisfied with the resolution.

Schonholtz: One of my mentors lived by the following credo: "Prepare a case for trial and you will settle it well; prepare a case for settlement and you will try it badly". Preparing a case well for trial requires thinking creatively about litigation options and strategies while staying 'within the lines'. Do not give the judge any reason to criticise the conduct of you or your client. It could affect the outcome. Prepare thoroughly with careful attention to detail, even under compressed timeframes. View mediation as an opportunity to learn about the weaknesses in your case and the strength in your adversary's case. Although you need to be ready to fight hard, be prepared to compromise at appropriate times. Attorneys and their clients can become so enamoured of their position in cases that they miss great opportunities to move the case forward or settle it well.

Chatz: Litigation does not always lead to happy clients. Determining the agenda of the client is critical to ensure that the client understands, with their counsel, how to drive the process. A loss in court may not be a loss for a client, depending upon how the matter was handled and the timeline required for resolution. Winning, of course, is always best. Utilising procedures to ensure that parties have the ability to prove up their claims is a necessary component for assuring that clients attain the outcome they are seeking. Sometimes, less than competent lawyers, who would prefer to mediate or settle, are forced to attempt to prove up claims and are incapable of doing so. The perception of lawyers' value in the bankruptcy process seems to have been slightly diminished over the last 10 years. For the purpose of disputes, work-out professionals and other non-attorneys who claim to understand processes, do not always provide the best advice. Counselling by counsellors in the context of litigation is the best way to ensure that clients are well cared for.

Where a debtor's resources are generally insufficient, and a prolonged restructuring proceeding itself can destroy value for the business and its constituents, forging reasonable compromise and driving consensus often provide the best approach.

LUKE A. BAREFOOT

Barefoot: A commercial and practical approach is key. Resorting to every available appeal, or insisting on burdensome document discovery, for example, are alone unlikely to create and preserve value for any party. Where a debtor's resources are generally insufficient, and a prolonged restructuring proceeding itself can destroy value for the business and its constituents, forging reasonable compromise and driving consensus often provide the best approach.

Zahralddin: In bankruptcy there are classes of creditors that are only partially 'in the money'. If the secured debt will be paid in full, but unsecured creditors will receive 7 percent on the dollar, the unsecured debt is the fulcrum security. The fulcrum security is the creditor class that should have the most significant input in how the estate is handled as they will be taking the hardest hit economically. As they will not be paid in full, they also have the strongest influence over any plan of reorganisation. In tandem and balanced with the fiduciary duties that the debtor owes the estate and that official committees owe their constituencies, collaboration between the fulcrum security and the debtor are key to moving forward and getting the result that works out the best for the estate. That holds true whether the fulcrum is the secured lenders, unsecured creditors or equity.

Uhland: It is often said that the best resolution of a bankruptcy dispute leaves each party both satisfied and dissatisfied in equal measure. That said, to minimise dissatisfaction it is critical to understand the goals and motivations of the parties, which may differ. For example, vendors or other trade creditors may be as interested in a going forward commercial relationship as the realisation of their pre-bankruptcy claim – perhaps even more so. A secured creditor may be interested in a new debt instrument that will trade so it has liquidity, or, alternatively, more interested in an ownership role in the debtor. Only by sorting through these goals or motivations can an optimum resolution be achieved.

Hayek: In our jurisdiction, the liquidators are the key to a successful and beneficial settlement. They have to safeguard the rights of all creditors of the bankrupt entity and they have to treat all creditors equally – subject to the ranking of their claims. Therefore, it is not possible to have a multi-party settlement that is beneficial only to, for example, a certain class of creditors. However, in case there is a chance to find an amicable solution that is to the benefit of all creditors, it helps a lot if the liquidators specify the issues and cooperate with the creditors who are willing to do so. It goes without saying that the creditors would have to share information and support the liquidator.

Clark: In my experience, frequently no one emerges entirely satisfied from bankruptcy litigation disputes, even the 'winners' who prevail in a court judgment – the process itself is just too costly, monetarily, temporally and emotionally. So the best ▸▸

path to a satisfactory resolution of most bankruptcy disputes is to approach them from the beginning with a willingness to consider reasonable compromise and to avoid the temptation to fight to the death 'as a matter of principle' or over every last disputed dollar of value. Because those fights cost money, and those costs, once sunk, cannot be recovered. The avoidance or mitigation of these kinds of transactional costs, which can be very material, is why, in my view, the preferred priority of process for restructuring situations should be: out of court restructuring; pre-packaged bankruptcy; pre-arranged bankruptcy; Chapter 11 reorganisation or liquidation; and Chapter 7 liquidation.

FW: How do you expect the bankruptcy arena to unfold through the remainder of 2014 and beyond? What issues will remain in the spotlight, and are there any new sources of interest on the horizon?

Schonholtz: Because of the continued confusion created by the *Bellingham* decision, much effort will be devoted to figuring out what litigated issues in a bankruptcy case require district court review and how to prevent delay and value erosion that will be caused by two levels of judicial decision making. *Bellingham* left open the question as to whether parties can consent to a final adjudication on core matters by the bankruptcy judge. Until that question is answered, many bankruptcy judges will be reluctant to enter final judgments even though they want the underlying bankruptcy cases to proceed expeditiously for the benefit of all stakeholders.

Chatz: With the jurisdictional issues resolved by *Bellingham*, the utilisation of the bankruptcy process may become a more favoured forum for the resolution of issues with respect to distress. Fair cost and fee quoting is critical for clients. Those who quote low in order to get business in the door are not doing a service to their clients. Constituent parties are entitled to their day in court. The debtor is entitled to undertake its vision of what the company can be in the future. Litigation may ensue. Certitude appears to now exist as to how and where a case can be litigated and bankruptcy courts have always provided expedited review. Whether parties will be willing to use bankruptcy courts in the future will depend on the nature of the proceeding, the competency of the jurist and the agendas of the parties.

Barefoot: By and large, consistent with pundits' predictions, large restructuring cases have not returned to the levels seen in prior years, both because of the continued availability of credit even to distressed enterprises, and companies' lack of appetite for 'free-fall' reorganisation proceedings. Two particular focuses of US bankruptcy proceedings over the coming year may include cross-border restructurings – including ancillary proceedings for recognition of foreign proceedings – and pre-packaged proceedings or asset sales. These latter proceedings have been used increasingly to reduce costs and uncertainty while effectively repositioning the business.

Zahralddin: Large bankruptcy cases requiring business reorganisations or liquidation of a lot of physical assets have been replaced with litigation asset based bankruptcy cases with litigation claims against creditors or third parties being the main assets. Professional malpractice – and other forms of negligence – insurance bad faith, alter ego, breach of fiduciary duty, fraud in the inducement, breach of contract, and fraudulent conveyances predominate over preference litigation. Cases involving reverse mergers with inside investors and companies from jurisdictions like China, which are emerging markets with tremendous opportunity that is used to entice unsuspecting US investors, and the resulting fraud in which that some foreign entities and managers have engaged, will continue to play out in 2014.

Uhland: Through the remainder of 2014 I expect that bankruptcy will continue its sluggish pace unless there is a rise in interest rates. Certain legal issues will remain in the spotlight including credit bidding, prepayment penalties and the ability of secured creditors to obtain liens on assets such as goodwill. As far as new sources of interest on the horizon, one issue I am watching with interest is the ability of educational institutions to file for bankruptcy. There could be serious implications for student loan funding if an educational institution files bankruptcy. The cases that have addressed this issue to date have not provided assistance to the educational institutions, but, with the potential on the horizon for some larger cases being filed, I am curious to see what other courts may conclude.

Hayek: In the course of the Swissair insolvency, the market participants first became aware of Switzerland as an interesting source for distressed debt claims. In the current major Swiss insolvency cases, for instance Petroplus and Lehman brothers, more and more institutional investors are strategically buying claims. Those investors have the resources to analyse not only their own claims, but also the claims of other parties and, whether or not there is a chance for success, to challenge the admission of other creditors' claims to the schedule of claims. We therefore expect that in the future such creditors will increasingly contest the admission of their fellow creditors.

Clark: I think the near-term future – the next year or two – will look a lot like the recent past: smaller, more contentious or litigious bankruptcy cases and more intercreditor squabbles blowing up into litigations. The larger cases that have been rare for the past few years are likely to remain so until interest rates rise and refinancing cash becomes more restricted. I do expect the *Fisker Automotive* credit bidding issue to be relitigated in other cases and, ultimately, to make it up to one or more of the Courts of Appeals, perhaps even the US Supreme Court. It seems to me that the issue is simply too important to distressed debt traders and strategic buyers to leave where it presently stands.

Sherrill: Overall, I suspect the balance of 2014 will continue to see relatively little bankruptcy activity, while central banks maintain their low interest rates. From boutiques to larger firms, bankruptcy groups have been slow for some time and many have been trimming their ranks. When the next bankruptcy boom does hit, many firms will be unprepared and under-resourced, particularly at the junior associate levels. Junior associates can always be re-tasked, but there may be quite a scramble at the outset. In recent years, the US has seen an oil and gas boom, with a great number of smaller exploration companies diving into the shale patch. At some point, there will likely be a shakeout in that industry. At that time, the interplay with state-law royalty trust issues – as explored in *SemGroup* – may be again at the forefront. ■