AIRA Journal

News from the Association of Insolvency and Restructuring Advisors Volume 21, Number 5 December/January 2008

The Impact of China's New Bankruptcy Law & Opportunities for Strategic Operators and Financial Investors

Prof. Li Shuguang, China University of Politics and Law

China's new Bankruptcy Law passed its third review on August 27, 2006, at the 23rd session of the 10th National People's Congress with a high positive vote rate. It took effect on June 1, 2007. Implementation of the new Bankruptcy Law will bring about opportunity and effect to strategic investors and financial investors at least in the following aspects.

I. It Applies to All Domestic Legal Person Enterprises

Compared with the old bankruptcy law in trial application from 1986, the new Bankruptcy Law expands its legal application which is one of its innovations.

The old bankruptcy law only applied to state–owned enterprises and the new Bankruptcy Law, based on the market economy principal of equality, breaks through this limitation by including all the domestic legal person enterprises such as state–owned enterprises, private enterprises with legal entity of legal person, three types of foreign enterprises incorporated in China(joint ventures, joint cooperative enterprises, and foreign proprietary enterprises), listed corporations and non-listed corporations, and even financial institutions. Article 135 expands its application to other business associations, enabling other business associations such as partnerships and schools to have legal foundation in bankruptcy.

The new Bankruptcy Law for the first time covers transnational bankruptcy: "The bankruptcy proceeding filed under this law is effective on the debtor's assets located outside of the People's Republic of China."With the increase of global capital flow and transnational investment, related bankruptcy judgment will have significant influence on creditors or debtors in other countries. The new Bankruptcy Law, in consideration of this situation, stipulates that China's court shall rule to accept and execute a judgment of foreign bankruptcy courts on the condition of there existing mutual benefit, judicial assistance, or international conventions. This provision enables domestic enterprises going public abroad and foreign enterprises preparing to acquire finance in China's capital market to have legal support in case of bankruptcy.

II. It Stresses the Role of Bankruptcy Administrator and Court

The new Bankruptcy Law provides for a bankruptcy administrator system and creates a new profession which deals with bankruptcy affairs professionally. Under the new Bankruptcy Law, the liquidation, conciliation and reorganization procedure shall be managed and operated by professionals. In past practice, bankruptcy affairs were handled by non-professionals and government officials in a strong atmosphere of government intervention which caused creditor interests to lack effective protection. In accordance with article 13 of the new Bankruptcy Law the court will designate a bankruptcy administrator to take over the bankruptcy estate and deal with bankruptcy affairs upon acceptance of an application for bankruptcy. Article 24 provides that the post of bankruptcy administrator shall be filled by law firms, accounting firms,

Impact, Continued on Page 32

In this issue:

AIRA Scholar in Residence

Courts Send Mixed Messages to Debt Collectors Cases

Emerging Case Law Under Chapter 15

Taxation Cases

Comparative Provisions & Implications of U.S. & China Bankruptcy Codes: Moving Towards Common Ground?

Bankruptcy Cases

Club 10

In This Issue

The Impact of China's New Bankruptcy Law & Opportunities for Strategic Operators and Financial Investors
Prof. Li Shuguang 1

Executive Director's Column
Grant W. Newton, CIRA 4

AIRA Scholar in Residence
Professor Jack F. Williams, CIRA, CDBV 6

Courts Send Mixed Messages to Debt Collectors Cases
Kenneth E. Rubinstein and Alexander G. Rheaume 9

Emerging Case Law Under Chapter 15
William H. Schrag and William C. Heuer 11

Taxation Cases
Forrest Lewis 18

Comparative Provisions & Implications of U.S. & China Bankruptcy Codes: Moving Towards Common Ground?
John J. Rapisardi and James H.M. Sprayregen 20

Bankruptcy Cases
Baxter Dunaway 26

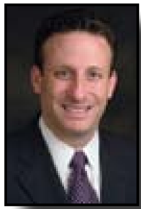
Members on the Move 35

Club 10 37

AIRA News is published six times a year by the Association of Insolvency and Restructuring Advisors, 221 Stewart Avenue, Suite 207, Medford, OR 97501.
Copyright 2007 by the Association of Insolvency and Restructuring Advisors. All rights reserved. No part of this newsletter may be reproduced in any form, by xerography or otherwise, or incorporated into any information retrieval systems, without written permission of the copyright owner.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal or accounting advice or other expert assistance is required, the services of a competent professional should be sought.

AIRA extends special thanks to these **AIRA News** contributors:
Peter Stenger - Editor
Baxter Dunaway - Section Editor
Jack Williams - Scholar in Residence
Forrest Lewis - Section Editor
Miles Stover - Section Editor
Stacey Schacter - Section Editor
Jennifer Ginzinger - General Editor



Letter from the President

Dear AIRA Members:

It's the beginning of a new year, and it will be another active one for the Association. The highlight will be our Annual Conference in Las Vegas on June 4 – 7, 2008, but there will be plenty of other opportunities to network, learn and have some fun all throughout the year.

You may or may not have made New Year's resolutions for 2008, but it's never too late to add a few more. Consider the following:

- Start the CDBV program to bolster my valuation skills and testifying qualifications and to have one less thing that my spouse doesn't understand about me
- Write an article for AIRA Journal and sent it out to all of my contacts to remind them about my expertise (and what I look like)
- Get current with my CPE requirements so I can continue to practice in [insert state name]
- Finish the CIRA exam, and add this meaningful credential to my resume (finally!)
- Visit Las Vegas with the hope that what happens in Vegas (learning at the Annual Conference) doesn't stay in Vegas

I wish all of our members a happy, healthy and prosperous new year, and look forward to your active participation in AIRA during 2008.

Warm regards,

Alan D. Holtz

Alan Holtz is a Managing Director with AlixPartners based in New York. He has spent close to 20 years as a corporate restructuring and reorganization specialist and has managed all aspects of the financial restructuring process. Alan has provided services to companies, management teams and boards of directors, as well as to financial institutions and creditors' committees, across a wide variety of industries. A frequent speaker on the subject of bankruptcy and reorganization, Alan holds a bachelor's degree in economics from the Wharton School of Business at the University of Pennsylvania and is a CPA and a CIRA, for which he received the 1992 silver medal from AIRA.

This would be difficult for us.

Bankruptcy cash management isn't.

Whether you are establishing new Debtor-in-Possession accounts in accordance with your First Day Orders or creating a Post Confirmation Trust, we strive to simplify your banking experience.

We understand the products and services you need from basic operating accounts to complex treasury solutions; we'll work with you to ensure that your cash management and investment requirements are met, while remaining in compliance with Section 345 of the Bankruptcy Code.

Approved Depository, customized solutions, safety of principal, knowledgeable client managers, we have everything you need at **JPMorgan Bankruptcy Deposit & Investment Services**.

Our bankruptcy cash management solutions include:

Nationally Approved Section 345 Depository

Collateralized accounts

Comprehensive cash management and investment products

Client managers with extensive bankruptcy experience

Department dedicated exclusively to bankruptcy

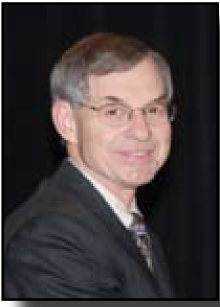
>> To learn more about our services, please contact:

Terri Steinbrenner
at 212-623-6080 or terri.a.steinbrenner@jpmorgan.com

jpmorgan.com/info/bankruptcy

©2007 JPMorgan Chase Bank, N.A. All rights reserved.

JPM07-BSSDIF-1-AIRAAUG



Executive Director's Column

Grant W. Newton, CIRA

PBGC Acknowledges AIRA Comments

On December 17, the PBGC issued a final rule[1] to amend PBGC's regulations on Premium Rates and Payment of Premiums to implement certain provisions of the Deficit Reduction Act of 2005 (Pub. L. 109–171) and the Pension Protection Act of 2006 (Pub. L. 109–280). The provisions implemented by this rule change the flat premium rate, cap the variable-rate premium in some cases, and create a new "termination premium" that is payable in connection with certain distress and involuntary plan terminations. The PBGC acknowledged the comment submitted by the AIRA Board based on the proposed rule. The AIRA Board expressed concern that "Congress may not have considered the financial ramifications of" the termination premium. The Board also requested that PBGC "adopt a facts-and circumstance approach in collecting the termination premium fee" and "consider limiting its recoveries of this termination premium to amounts that each company can afford to pay without jeopardizing its ability to stay in business."

While the PBGC rejected the AIRA recommendations, it acknowledged that the PBGC has accepted less than full payment on its claims for unfunded benefit liabilities, unpaid funding contributions, and unpaid flat- and variable-rate premiums in circumstances in which, like other creditors, it has been forced to compromise those claims. Additionally the PBGC acknowledged this practice will continue by making the following comment: "The PBGC recognizes that plan sponsors may face difficult financial choices because of the termination premium. Accordingly, PBGC encourages sponsors that may be facing termination premium liability to contact PBGC as early as possible to discuss."

The AIRA is grateful to Laura Rosenburg for assisting the Board in its response to the PBGC.

I wish all of you the best for 2008. As you plan your schedule for 2008, remember the following programs (others will be added during the year):

- Valcon Conference, Ft. Lauderdale, FL, January 14-15, 2008
- AIRA and NYIC Joint Luncheon, New York, NY, January 29, 2008
- 24th Annual Conference, Las Vegas, NV, June 4-7, 2008
- China Investing and Restructuring Conference, Shanghai, September 2008
- Advanced Restructuring and Plan of Reorganization Conference, New York, NY, October 21, 2008
- Los Angeles Plan of Reorganization and Restructuring Conference (Fall 2008, date TBD)

Best Regards,

Grant

---

1 **Federal Register** / Vol. 72, No. 241 / Monday, December 17, 2007 / Rules and Regulations, 71222.

Some tasks are difficult ...

... creditor distributions shouldn't be.

TrustWorks

TrustWorks is a dynamic software solution custom-designed for receivers, liquidating trustees, disbursing agents, and assignees for the benefit of creditors to effectively manage and distribute funds.

TrustWorks provides critical case and claims management functionality that no spreadsheet or accounting software can match.

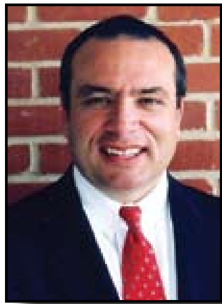
For more details, contact BMS at 800-634-7734, ext. 3.

TrustWorks automates:

- Complex distribution calculations
- Multiple customized claims reserves
- Check printing and claimant noticing
- Bank account reconciliations

TrustWorks provides:

- Free banking with a nationally approved depository
- Back-office support by dedicated and experienced bankruptcy account managers



AIRA Scholar in Residence

Professor Jack F. Williams, CIRA, CDBV

BANKRUPTCY RETAKES

The Myths of Going Concern Valuations

These days business valuations are occupying a lot of court time. From solvency determinations under avoidable preference or fraudulent transfer actions to enterprise valuations in contested cram down confirmation hearings, courts are confronting an array of valuation issues. Attorneys, financial advisors, turnaround managers, and business valuation experts are becoming more sophisticated in the developing sub-discipline of valuing distressed businesses.

Often, the threshold issue in a business valuation is the question of whether the target business is a going concern. Experts tend to assume a going concern or not, providing very little insight or analysis in their expert reports or testimony in resolving the issue. Courts are no more helpful, often concluding that a business is or is not a going concern without much analysis beyond embracing the colorful but unhelpful metaphor that a business is a going concern "unless it is on its deathbed." Really, what exactly does that phrase mean? As a test, the deathbed metaphor is undisciplined, awkward, and unhelpful. To paraphrase Justice Benjamin Cardozo, nothing fetters creative thought like a rhythmic refrain.

The determination of whether the target business is or is not a going concern will flavor assumptions, tools, and techniques employed throughout the business valuation. For example, if the target business is determined to be a going concern for insolvency calculation purposes as of the transfer date, then the appropriate fair valuation process would generally require an asset and liability value somewhere on a continuum approximating a fair market value to orderly liquidation value. Moreover, a going concern may have substantial value (or not) in both severable (intellectual property licensing rights owned by the target company, for example) and nonseverable goodwill (for example, the future earning potential of the assets in excess of total tangible asset value and intangible severable asset value discounted to present value). If the target business is determined not to be a going concern, then the appropriate fair valuation process would generally require an asset and liability value somewhere on a continuum approximating an orderly liquidation to straight liquidation value. In these circumstances, although severable goodwill like the right to license a tradename may have value, nonseverable goodwill may be severely impaired or even nonexistent.

As suggested above, so much in a valuation analysis turns on the resolution of the threshold issue of going concern status; however, little guidance can be gleaned from authorities. In fact, a perusal of cases that have addressed going concern determinations has uncovered several myths. In this column I seek to uncover and address those myths.

Myth 1: Going concern is a standard of business valuation

The concept of going concern is not technically a measure or standard of valuation at all. It is an expression of the current status of a business. For example, Certified Public Accountants express their opinion on a business's financial statements based on a going concern standard. A going concern is a business that will continue in operation for an indefinite period of time. In contrast, the longevity of a business may be in question if it has a negative net worth, liquidity or leverage problems, or performance or profitability problems.

Thus, the determination that a business is a going concern influences the assumptions an expert will make and the tools and models employed. Once a going concern business status is determined, the expert will generally employ robust income and market approaches with the continuing business assumption embedded in the model. This status determination generally requires that an expert determine the enterprise value of a business. It does not mean that it is inappropriate to use an adjusted balance sheet approach if the Bankruptcy Code requires it, for example, in the context of a preference action under sections 547(b). Borrowing from the well reasoned commentary to SOP 90-7, an expert would determine the value of the company, compare that value to total tangible assets and intangible severable goodwill adjusted to fair value (collectively, "total asset value"); if the value of the business is greater than the total asset value as adjusted, then you have positive nonseverable goodwill that you would book as an entry on the fair value adjusted balance sheet.

We generally approach the determination of going concern as a bivalent one, a binary set – a business is either a going concern or it is not. Yet, experts have recognized in related fields that status is actually multivalent; that is, there are actually more than two outcomes to the determination of business status. In our field, business status is best understood as a continuum of conditions ranging from going concern to failed concern, the labels we attach to both termini. Technically, status may be understood as a vector of business conditions from going concern (growing) to going concern (static) to going concern (declining) to failing concern to failed concern. Our cases tend to truncate the determination, then, by concluding that either one or the other extreme is applicable. To be sure, the truncating (or rounding off) of business status is not unreasonable; however, that approach does not use all the relevant facts and paints a less than robust picture of the business condition. Therefore, a business valuation driven by a better understanding of what business status actually measures helps us account for the reality that not all going concerns are equal.

My experience also suggests that as valuations become more commonplace and courts mature as they confront this and related issues, we will begin to experience more courts embracing a bifurcated approach to valuations. I suggest that we should witness a movement to where valuation issues, such as insolvency in an avoidance action, will be tried in two phases: (1) the business determination phase and (2) the valuation phase. It should not surprise us that business determinations often masquerade as valuation determinations. What I mean by this is that many expert disputes on valuation are actually disputes of business status determinations. For example, the plaintiff's expert in a fraudulent transfer action under section 548 has opined that the debtor was insolvent as of the transfer date, employing a liquidation analysis, an analysis that assumes a failed or failing business. In contrast, the defendant's expert has opined that the debtor was solvent as of the transfer date, employing an enterprise value assessment of the debtor, an analysis that assumes a going concern. In reality, we would probably see that both experts would be close to agreement on the underlying valuation if given a business condition; that is, the experts would find their opinions relatively close if they both employed a failed business assumption or a going concern assumption. Our present trial control models fail to appreciate the economies of bifurcating the valuation process. The bifurcation model is even more compelling in the contested confirmation scenario where the estate will pay the tab of competing experts that were retained by the debtor, the creditor's committee, and possibly an equity committee. Why put the estate to the expense of full-blown valuation opinions, expert reports, depositions, and trial testimony among several experts before a court finding on the status of the business?

Myth 2: A business is a going concern unless it fails tomorrow

As mentioned, several valuation cases appear to have a pre-occupation with the phrase "deathbed" in referring to when a going concern analysis is not appropriate for a distressed business. Although the term is quite colorful, it has little practical analytical significance. The deathbed metaphor suggests that business death most be imminent, like, let's say tomorrow. This approach collapses business status determinations into two phases – going concern and tantamount to dead. So, under this approach, what would we do with a business that will not make the week? Month? Next business cycle? Year? Two Years?

Some courts have struggled with the limiting deathbed word picture. Thus, cases embrace temporal standards to assess the appropriate business status, like "liquidation value is appropriate, however, if at the time in question the business is so close to shutting its doors that a going concern standard is unrealistic,"[1] or like "liquidation was clearly imminent."[2]

A review of the better-reasoned cases suggests that the proper analytical frame of reference is to assess whether *it is more likely than not that the business will fail within the reasonably foreseeable future.*[3] I would suggest that the appropriate temporal reference would be within a year, thus, including, in most circumstances, at least one business cycle.

Myth 3: If a business is a going concern, then it must be solvent

I have been unsuccessful in determining where this myth began. I suspect this is an outgrowth of the deathbed metaphor. The thought process goes like this: the business is not dead today, is not dying tomorrow, and should survive the week; therefore, the business is a going concern and because it is a going concern, it must be solvent. Granted, I exaggerate, but only to prove my point. Once we determine that the business is a going concern, we then employ the appropriate tools and models to determine whether a business is solvent. Under this myth, I would add the statements I have heard in courts that because businesses sell in bankruptcy all the time at some positive value, businesses are generally solvent. Come on! Business assets are sold in bankruptcy all the time for positive value ***stripped of the debt that once encumbered them!*** A solvency analysis always requires a comparison of assets and liabilities at some level of abstraction. Positive asset value presents one side of the equation; however, an appropriate model must allow the trier of fact to compare assets and liabilities at some level of abstraction.

This is one of my favorite myths in that the myth uncovers the very human nature of judges and practitioners. Authorities are unanimous in that one determines value as of a given date. That date is usually tied to some event, for example, a transfer date, an obligation date, the petition date, confirmation date, effective date, etc. Thus, courts warn us that hindsight is irrelevant and, in fact, confuses the issue. Yet, experts and courts alike use hindsight all the time. For example, experts have testified and courts have observed that if a business continues to operate after the relevant date, then it must have been a going concern as of that relevant date. That is hindsight, plain and simple.

Let me offer up two examples where hindsight would lead to the wrong conclusion. In the first case, let us assume a business is in a precarious financial condition in January 20XX. The business plan is failing and customer contracts are drying up. The business may be able to operate a month or two at the most and would then have to liquidate. A transfer is made in February 20XX. Later that month, the business is awarded a new, unexpected contract by one of its competitor's customers because of a fire suffered by its competitor. The contract is large enough that it keeps the business operating for another 18 months. In 20X1, the business files a bankruptcy petition. The creditor's committee

1 Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.), 100 B.R. 127, 131 (Bankr. D. Mass. 1989).

2 Wolkowitz v. American Research Corp. (In re DAK Industries, Inc.), 195 B.R. 117, 125 (Bankr. C.D. Cal. 1996), aff'd, 170 F.3d 1197 (9th Cir. 1999)

3 See Frank R. Kennedy, Vern Countryman & Jack F. Williams, PARTNERSHIPS, LIMITED LIABILITY ENTITIES & S CORPORATIONS IN BANKRUPTCY chs. 6 and 13 (2000) (and cases cited therein).

brings an action to attack the transfer as fraudulent and seeks to show the business was insolvent in February 20XX.

Based on the facts and circumstances as known or as reasonably knowable, as of the transfer date, it appeared that the business was not a going concern and that liquidation would be necessary within the year. But an unforeseeable subsequent event occurred. The fact that a competitor suffered a fire, thus forcing its customers to seek cover from others like the business, was not known or knowable at the time of the transfer, the relevant date. To be sure, businesses catch fire, but that fact does not make the subsequent fire reasonably known. Subsequent events, like the new contract or continued operations, should be ignored.

In the second case, let us assume a business that is financially stable with modest but sustained growth. A transfer is made in February 20XX. Later that year, a terrorist attack occurs that negatively impacts the market segment, causing all businesses to begin to lose money at an alarming rate. In 20X1, the business files a bankruptcy petition. The creditor's committee brings an action to attack the transfer as fraudulent and seeks to show the business was insolvent in February 20XX.

Based on the facts and circumstances as known or knowable, as of the transfer date, the business appears to be a going concern. Again, an unforeseeable subsequent event occurred. The fact that a terrorist attack harmed the relevant market segment was not known or knowable at the time of the transfer. The subsequent terrorist event and the failure of the business should be ignored.

In summary, in both instances, subsequent events that are not known or knowable, based on the facts and circumstances, should be ignored. Often, one of those subsequent events is the continuation or failure of a business after the transfer date.

Conclusion

The developing body of law on valuations is impressive in both number and thought. Courts have been developing a level of understanding and maturity that is quite impressive. Attorneys and experts have also developed a more sophisticated approach to valuations, often prodded by well meaning judges intent on "trying to get it right." However, one area where we all might be falling down is in the threshold determination of business status. We acknowledge that business status is important if not critical to any business valuation; nonetheless, we regularly see (with notable exceptions) little analysis by experts, weak argument by counsel, and abbreviated discussion by courts. We bankruptcy academics are not immune from this criticism; we usually ignore it altogether. I find all this peculiar in light of the role business determination plays in valuation. As we all mature in the distressed business valuation discipline, let us commit ourselves to a more careful development of business status determinations and slay the myths forever. ■

With the right skills and resources...

...come extraordinary solutions.

Combining industry and functional expertise, Mesirow Financial Consulting provides you with the high-quality attention you need — when and where you need it. We offer specialized expertise on a national and local level to quickly assess complex situations and provide seasoned advice across a broad range of restructuring and related matters.

- Corporate Recovery
- Litigation and Investigative Services
- Interim Management*
- Valuation Services
- Operations and Performance Improvement
- Other Consulting Services

New York • Chicago

Boston • Charlotte • Dallas • Houston • Los Angeles • Miami

For more information, please contact: consulting@mesirowfinancial.com / 877-632-4200

*Interim Management services provided by Mesirow Financial Interim Management, LLC. Mesirow Financial Consulting, LLC is an Illinois limited liability corporation. The Mesirow Financial name and logo are registered service marks of Mesirow Financial Holdings, Inc. © 2008 Mesirow Financial Holdings, Inc. All rights reserved.

Courts Send Mixed Messages to Debt Collectors Cases

A simple message can lead to huge problems

Kenneth E. Rubinstein and Alexander G. Rheaume

Recent court opinions created a stir in the collection industry by challenging debt collectors' procedures for recovering money. While nearly everyone agrees that debt collectors need strict regulation to prevent strong-arm tactics, the courts' recent rulings left many legitimate companies wondering how to comply with state and federal regulations.

Nearly 30 years ago, Congress passed the FDCPA to curb abusive collection practices and provide a legal remedy for victims of those abuses. Unfortunately, the FDCPA has not stayed current with the times, and courts have not clarified the Act's language to reflect today's technology. The resulting confusion yields a number of traps that leave ethical collectors exposed to heavy penalties.

In fact, the FDCPA's strict liability standard created a cottage industry of "Debtor's Rights" attorneys, who seek to enforce the Act's stiff penalties for even trivial violations. These attorneys, who often threaten suit if they are not paid a quick settlement, know that the cost of defending FDCPA claims can easily reach $10,000 or more.

Moreover, if the debtor prevails, the Act requires the collector to pay the debtor's attorneys' fees and costs, even if the fees exceed the amount of the plaintiff's damages. In these instances, the debtors' attorneys understand that the collectors' legal costs in defending such actions would exceed the cost of a quick settlement.

Many collectors fall prey to lawsuits or threats based on ambiguities in FDCPA's treatment of voice messages, which many professionals believe makes it impossible for a collector to leave a message without violating the FDCPA. The FDCPA allows collectors to make telephone calls to communicate with debtors, and it is generally understood that these calls help all parties because they allow debtors to work out payment plans (where possible), and discuss the resolution of claims without the need for lawsuits, wage garnishments, foreclosures or other legal process. Unfortunately, recent decisions interpreting the FDCPA call into question whether collectors can leave any voice message without opening themselves up to significant penalties.

For example, the FDCPA requires collectors to identify themselves and to state that they are calling to collect a debt, a process many courts refer to as the "Mini-Miranda Warning." The law also generally requires collectors to refrain from communicating with third parties about the debt. While these requirements appear reasonable on the surface, they are incompatible when collectors encounter a debtor's answering machine because the collector may end up violating the Act regardless if they leave the Mini-Miranda. Courts have consistently held that a collector who omits the warning violates the FDCPA. At the same time, if the collector provides the Mini-Miranda, he or she risks violating the FDCPA if the debtor's spouse or some other third party overhears the message.

The FDCPA was enacted in 1977 at a time when answering machines were not widely used and voicemail was not yet invented. Unfortunately, courts interpreting the Act have not addressed these deficiencies in their decisions, and Congress has not updated the law. As a result, many collectors respond to this problem by refraining from leaving messages. While this tactic ensures that the collector will not leave improper messages, it also dramatically impedes communications and eliminates opportunities for agreement. The Association of Credit and Collection Professionals, an agency representing the collections industry, recommends that its collectors use the Mini-Miranda warning, but preface their messages by stating, "This is a call for [debtor's name]. If you are not [debtor's name], please hang up immediately." Nonetheless, no court has approved the language, and a court could still find a collector liable if a third party continued to listen.

The risks of significant damages under the FDCPA are very real. Without a clear path to avoid liability, debt collectors who leave voicemails may face lawsuits alleging significant damages for comparatively trivial debts. In one situation, a debtor tried to recover up to a half million dollars from a debt collector who made repeated phone calls to the debtor trying to collect student loans. In another case, a debtor recovered several thousand dollars for emotional distress when a debt collector tried to recover less than $300.

The current uncertainty surrounding FDCPA liability for leaving voice messages may have a significant impact on the business community as a whole. Debt collectors are not a particularly popular or sympathetic segment of the business community; however, most business professionals agree that collectors enable financial institutions to keep lending rates low and more capital available. As a result of the FDCPA's ambiguity, many collectors force their clients to make a choice regarding future collection methods. Businesses may choose between paying debt collectors higher costs to offset FDCPA risks for the continued efficiency of collections using voice messages, or less effective, yet safer collection methods without using voicemail. In either event, until the courts or Congress clarifies the proper method for leaving a collection voice message, the consumer ultimately loses. ■

Kenneth E. Rubinstein is an officer of Nelson, Kinder, Mosseau & Saturley, P.C., and is chairman of the firm's Creditors' Rights Group. Alexander G. Rheaume is an associate in the firm's Creditors' Rights Group with experience litigating collection related matters. Contact Rubenstein at krubinstein@nkms.com, and Rheaume at arheaume@nkms.com.

Dewey & LeBoeuf

Leadership and Innovation in our Business Solutions & Governance Group

We have provided the strategy, conducted the negotiations, handled the litigation in and out of bankruptcy court, and consummated the transactions in many of the largest and most significant bankruptcies and out-of-court restructurings, across the U.S. and around the world, in a wide variety of industries. We have designed corporate structures and provided counseling regarding enterprise liability; and we have reviewed and opined on business dealings involving the most complex aspects of creditors rights law. Our clients have included:

- Debtor companies and their creditors
- Corporate boards
- Creditors committees, trustees and examiners
- Bank lenders, bank groups and major manufacturers
- Investors in distressed companies, assets and financial instruments
- Equity owners
- All types of commercial and capital markets lenders
- Lease equity holders and lease debt holders

New York
Martin J. Bienenstock
Global Head
+1 212.259.8530
mbienenstock@dl.com

William H. Schrag
+1 212.259.6970
wschrag@dl.com

Chicago
Lewis Rosenbloom
+1 312.794.8090
lewis.rosenbloom@dl.com

David Cleary
+1 312.794.8070
david.cleary@dl.com

Los Angeles
Lisa Hill Fenning
+1 213.621.6233
lfenning@dl.com

San Francisco
Bennett Young
+1 415.951.1167
byoung@dl.com

London
Peter Sharp
+1 44.20.7459.5007
peter.sharp@dl.com

Paris
Philippe Hameau
+33 1.53.93.78.62
phameau@dl.com

www.dl.com

New York | London multinational partnership | Washington, DC
Albany | Almaty | Austin | Beijing | Boston | Brussels | Charlotte | Chicago | East Palo Alto
Frankfurt | Hartford | Hong Kong | Houston | Jacksonville | Johannesburg (pty) ltd. | Los Angeles
Milan | Moscow | Paris multinational partnership | Riyadh affiliated office | Rome | San Francisco | Warsaw

Emerging Case Law Under Chapter 15

William H. Schrag and William C. Heuer

Chapter 15 of the United States Bankruptcy Code, 11 U.S.C. §§ 101, et seq., applies to bankruptcy cases commenced on or after October 17, 2005. While Chapter 15 was enacted over two years ago, relatively few cases have invoked the power it grants to bankruptcy courts. In cases where Chapter 15 has been invoked, common issues and themes are present. This paper discusses the issues that have been litigated in reported decisions under Chapter 15.

1. Cases Concerning the "Center of Main Interests" and "Establishment" Tests

One aspect of Chapter 15 that has been the subject of litigation is whether a foreign insolvency proceeding qualifies as either a foreign "main" or "nonmain" proceeding. While broad relief is available in either "main" or "nonmain" proceedings, recognition as a foreign "main" proceeding provides the debtor immediately with the benefit of the automatic stay, and allows the foreign representative to operate any of the debtor's businesses located in the United States. 11 U.S.C. § 1520. There are three reported decisions, discussed below, addressing whether a case should be considered "main," "nonmain" or neither: (i) *In re Tri Continental Exchange, Ltd.*, 349 B.R. 627 (Bankr. E.D. Cal. Sept. 11, 2006) ("*Tri-Continental*") (Klein, Bankruptcy Judge), where the court determined that the foreign proceedings *were* foreign "main" proceedings, (ii) *In re SPhinX, Ltd.*, 351 B.R. 103 (Bankr. S.D.N.Y. Sept. 6, 2006) ("*SPhinX Funds*") (Drain, Bankruptcy Judge), *aff'd* 371 B.R. 10 (S.D.N.Y. 2007) (Sweet, District Judge), where the court determined that the foreign proceedings were *not* foreign "main" proceedings but were entitled to "nonmain" status; and (iii) *In re Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund, Ltd.,* Case Nos. 07-12383, 07-12384, 2007 WL 2683661 (Bankr. S.D.N.Y. Sept. 5, 2007) ("*Bear Stearns*") (Lifland, Bankruptcy Judge), *appeal docketed* (Sept. 10, 2007), where the court determined that the foreign proceedings were not entitled to *either* status.

In *Tri-Continental*, *supra*, the debtors (collectively, "Tri-Continental") were the subject of joint liquidations or winding-up proceedings under the laws of St. Vincent and the Grenadines. Before the proceedings were commenced, Tri-Continental had been in the business of selling insurance policies to insureds located in the United States and Canada. *Tri-Continental*, 349 B.R. at 629. Tri-Continental's business model was to provide "greatly reduced rates to industries that are difficult to insure, such as taxi drivers, truckers, roofers, bars, restaurants, and clubs." *Id.* at 630. Tri-Continental was registered to do business in St. Vincent.

Tri-Continental perpetrated an insurance fraud: while it collected premiums, claims against the insurance policies went unpaid and the company's assets were secreted away. *Id.* Criminal prosecutions were launched and, eventually, insolvency and winding-up proceedings were commenced in St. Vincent and the Grenadines. Thereafter, Tri-Continental's court-appointed Joint Provisional Liquidators commenced Chapter 15 proceedings in the United States and sought recognition of the proceedings pending in St. Vincent and the Grenadines as "foreign main proceedings." *Id.* at 631-32. A U.S.-based judgment creditor, Bennett Truck Transport LLC ("Bennett Truck"), objected, contending that the foreign proceedings were "nonmain" and seeking additional relief in the nature of restrictions on the transfer of Tri-Continental's assets located in the United States. *Id.* at 631.

A "foreign main proceeding" is an insolvency proceeding in the foreign country in which the debtor has its "center of main interests." 11 U.S.C. § 1502(4). While the phrase "center of main interests" was a new concept to U.S. courts (incorporated into the Bankruptcy Code through Chapter 15), it had been used in some European laws, so in determining where Tri-Continental's "center of main interests" was located, the court looked to the UNCITRAL Model Law on cross border insolvency for guidance. *Tri-Continental,* 349 B.R. at 633-34. In taking that approach to statutory interpretation, the court noted that use of the term "center of main interests" was "intentionally designed to promote international uniformity." *Id.* The "main" versus "nonmain" concept adopted under the UNCITRAL Model Law, in turn, was modeled on the same concept embodied in the European Union Convention on Insolvency Proceedings (the "EU Convention"). *Id.* The regulations implementing the EU Convention reveal that the "center of main interests" concept relates to "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties." *Id.* at 634 (citations omitted).

With these principles in mind, the *Tri-Continental* bankruptcy court concluded that the phrase "center of main interests" in Chapter 15 "generally equates with the concept of 'principal place of business' in United States law." *Id.* The court also noted that this conclusion is consistent with section 1516(c) of Chapter 15, which provides that in the absence of other evidence, the location of a debtor's "registered office" is *presumptively* its center of main interests. *Id.* at 635. The foreign representative bears the burden of demonstrating where the center of main interests lies. *Id.*

The *Tri-Continental* court found that the debtors' registered offices were in St. Vincent, and that the debtors "conducted regular business operations" there "in a manner that equates with a 'principal place of business' under concepts of United States law." *Id.* at 629. Thus, despite the fact that the

insurance policies were sold to, and an insurance scam was perpetrated upon, U.S. and Canadian policyholders, St. Vincent and the Grenadines were found to be the "center of main interests" and the proceedings in St. Vincent and the Grenadines were recognized as "foreign main" proceedings under Chapter 15. *Id.* at 629.

After determining that the foreign proceedings would be granted foreign "main" proceeding status, the bankruptcy court denied Bennett Truck's request for provisional relief. Bennett Truck had asked the bankruptcy court to impose transfer restrictions on approximately $1.6 million in funds recovered by the U.S. Department of Justice, over which funds the Joint Provisional Liquidators sought to obtain control. *Id.* at 636. Bennett Truck was concerned that these funds – upon which it claimed a lienholder interest – would be used to pay the Joint Provisional Liquidators' fees before Bennett Truck's claims were paid. *Id.* at 635-36. However, in denying Bennett Truck's request, the court noted that the Joint Provisional Liquidators sought only the authority to *administer* assets under section 1521(a)(5), not the authority to *distribute* assets under section 1521(b). *Id.* at 636. Thus, while recognizing that "Chapter 15 provides ample authority for [the bankruptcy court] to impose restrictions so as to protect United States creditors to a greater extent than otherwise provided in Chapter 15 and in other applicable provisions of the Bankruptcy Code," the court found that the provisional relief sought by Bennett Truck was unnecessary. *Id.* at 629, 636.

Another case involving analysis of a debtor's "center of main interests" and whether a foreign proceeding should be considered "main" or "nonmain" under Chapter 15 is *SPhinX Funds, supra.* In that case, the bankruptcy and district courts found that the foreign proceedings were entitled to "nonmain" status only. *SPhinX Funds,* 351 B.R. at 122, *aff'd* 371 B.R. at 10. The debtors in the Chapter 15 proceedings were hedge funds based in the Cayman Islands (the "SPhinX Funds"), but they had no employees or physical offices there; rather, the SPhinX Funds' business was conducted by a Delaware corporation located in New York. *SPhinX Funds,* 351 B.R. at 107-8.

Before the collapse of the SPhinX Funds, Refco Capital Markets, Inc. ("RCM"), a creditor of the SPhinX Funds and itself a debtor in U.S.-based bankruptcy proceedings, commenced a $312 million preference action in RCM's bankruptcy case against the SPhinX Funds. *Id.* at 108-9. RCM and the SPhinX Funds entered into a settlement, which required court approval in RCM's bankruptcy case. *Id.* at 109. Some SPhinX investors, however, opposed the settlement, on the grounds that it paid too much to RCM. *Id.* Shortly before the hearing for approval of the settlement, these SPhinX investors commenced involuntary "winding up" proceedings (the "First Winding-Up Proceedings") for two of the SPhinX Funds in the Cayman Islands, and Joint Provisional Liquidators were appointed. *Id.*

At the hearing on the RCM settlement, the Joint Provisional Liquidators notified the bankruptcy court that the First Winding-Up Proceedings had been commenced. *Id.* The Joint Provisional Liquidators also petitioned for recognition under Chapter 15 and requested that the hearing on approval of the settlement between RCM and the SPhinX Funds be adjourned so that they could have time to evaluate whether the settlement was fair to the SPhinX Funds (not whether the settlement was fair to RCM or its creditors or bankruptcy estate). *Id.* The bankruptcy court denied this request because the issue before the court was not whether the settlement was fair to the SPhinX Funds; rather, the issue before the court was whether the settlement was fair to *RCM and its estate. Id.* at 109-10. The settlement was approved. *Id.* at 110.

After the settlement was approved, the First Winding-Up proceedings in the Cayman Islands were dismissed against one fund and adjourned against another, and the Chapter 15 petition withdrawn. *Id.* Not deterred, several SPhinX investors appealed the order approving the settlement, which blocked implementation of the settlement because the settlement was not effective until entry of a final order not subject to appeal. *Id.* These investors then gained control over the SPhinX Funds, and commenced voluntary liquidation proceedings in the Cayman Islands (the "Second Winding-Up Proceedings"). *Id.* Once appointed, the Joint Voluntary Liquidators (i) made appearances in the settlement appeal and (ii) sought foreign "main" proceeding status (presumably because the automatic stay would apply and the RCM settlement would arguably continue to be stayed). *Id.* at 110-11. The Joint Voluntary Liquidators also attempted to enjoin all further activity on the appeal, again arguing that they needed time to investigate the propriety of the settlement from the SPhinX Funds' perspective. *Id.* at 111. This request was denied and the appeal proceeded.[1] *Id.*

The SPhinX Funds' "center of main interests" was presumptively in the Cayman Islands, that being the location of their registered office. *Id.* at 117. The bankruptcy court noted, however, that this statutory presumption could be rebutted and that it was of less weight when there was a serious dispute over primacy. *Id.* With respect to the showing that must be made to overcome the statutory presumption, the court stated:

> Various factors, singly or combined, could be relevant to such a determination: the location of the debtor's headquarters; the location of those who actually manage the debtors (which conceivably could be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes.

Id. The court also stated that "[b]ecause their money is ultimately at stake, one generally should defer

1 The complicated procedural history of the *SPhinX Funds* case played an important role in the bankruptcy court's ultimate holding that the foreign proceedings would be recognized as "nonmain" proceedings only.

. . . to the creditors' acquiescence in or support of a proposed ['center of main interests.']" *Id.*

In determining that the SPhinX Funds' "center of main interests" was *not* the Cayman Islands, the court pointed to "important *objective factors*." *Id.* at 119 (emphasis supplied). These factors included the fact that "as far as the administration of the Debtors' business [was] concerned, the SPhinX Funds' hedge fund business was conducted . . . outside of the Cayman Islands, as were most of the SPhinX Funds' back-office operations." *Id.* Also, there "were no employees or managers in the Cayman Islands, and the Debtors' boards, which contained no Cayman Islands residents, never met in the Cayman Islands." *Id.* In addition, the court found that "*pragmatic considerations* affecting the Debtors' cases" also supported a finding that the "center of main interests" was not in the Cayman Islands. *Id.* (Emphasis supplied). None of the Funds' assets (other than corporate minute books and similar records) were in the Cayman Islands and the Joint Voluntary Liquidators would have to seek the assistance of foreign, not Cayman Island, courts in order to administer those assets. *Id.* Moreover, "most, if not all [of the Funds'] creditors and investors [were] located outside of the Cayman Islands[.]" *Id.*

Despite all of these factors weighing in favor of finding that the SPhinX Funds' "center of main interests" should *not* be in the Cayman Islands, the court stated that standing alone, these factors ordinarily *might not* be enough to overcome the statutory presumption because the Funds' creditors and investors had acquiesced to a finding that the "center of main interests" was, in fact, in the Cayman Islands. *Id.* at 120-21. One additional consideration, however, was critical to the bankruptcy court's finding that the statutory presumption had been overcome:

> [A] primary basis for the Petition [for recognition as a foreign main proceeding], and the investors' tacit consent to the Cayman Islands proceedings as foreign main proceedings, is improper: that is, it has the purpose of frustrating the RCM Settlement by obtaining a stay of the appeals upon the invocation of Bankruptcy Code section 362(a) that would go into effect under section 1520(a)(1) upon such recognition.

Id. at 121. The court stated that "this litigation strategy appears to be the only reason for [the Joint Voluntary Liquidators'] request for recognition of the Cayman Islands proceedings as foreign main proceedings" and that this "strategy taint[ed] the [Joint Voluntary Liquidators'] request and the investors' consent to it, giving the clear appearance of improper forum shopping." *Id.* Accordingly, only foreign "nonmain" status was granted. *Id.* at 122. The bankruptcy court's ruling was upheld on appeal by the district court. *In re SPhinX, Ltd.*, 371 B.R. 10 (S.D.N.Y. 2007).[2]

The most recent decision regarding this issue is Bankruptcy Judge Lifland's decision in *Bear Stearns, supra,* which involved two Bear Stearns investment funds (the "Funds"). Both Funds were Cayman Islands limited liability companies with registered offices in the Cayman Islands. *Id.* at *1. Much like the case in *SPhinX Funds*, however, the Bear Stearns Funds were administered in the U.S. by a U.S. corporation, and the Funds' asset manager was located in New York (as were the assets it managed). *Id.*

On July 31, 2007, each of the Funds caused winding-up proceedings to be commenced in the Cayman Islands, and voluntary Joint Provisional Liquidators were appointed. Thereafter, the Joint Provisional Liquidators filed Chapter 15 petitions in the U.S. Bankruptcy Court for the Southern District of New York, seeking recognition of the Cayman Islands proceedings as foreign "main" proceedings or, in the alternative, as foreign "nonmain" proceedings. *Id.* at *1-2.

In its analysis, the court recognized that "Chapter 15 accords the court substantial discretion and flexibility," but also noted that "the process of recognition of a foreign proceeding is a simple single step process incorporating the definitions in section 1502 and 101(23) and (24) to determine recognition as either a main or nonmain proceeding *or nonrecognition.*" *Id.* at *3 (emphasis supplied) (citations omitted). While the Funds were registered in the Cayman Islands, the court denied foreign "main" status. *Id.* at *6. In doing so, the court emphasized that the Funds had "no employees or managers in the Cayman Islands," that "the investment manager . . . is located in New York, the Administrator that runs the back-office operations of the Funds is in the United States along with the Funds' books and records" and that prior to the Cayman Islands proceeding having been commenced, "all of the Funds' liquid assets were in the United States." *Id.* The court also noted the location of investors and the application of U.S. law as relevant to its analysis. *Id.* Considering these factors, the court found the statutory presumption had been overcome, even though no creditor had objected to foreign "main" status being granted. *Id.*[3]

The court also denied foreign "nonmain" status. *Id.* at *7. Section 1502(5) defines a "foreign nonmain proceeding" as "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment." 11 U.S.C. § 1502(5). The court focused on the "establishment" requirement and reasoned that in order to qualify for nonmain status, the Funds needed to conduct "*nontransitory* economic activity" in the Cayman Islands. In other words, the Funds had to have "a local place of business" in the Cayman Islands in order for the foreign proceedings to qualify even for "nonmain" status. *Id.* (Emphasis in original).[4] In this analysis,

2 A separate issue noted in the bankruptcy court's decision is that the statutory language permits a finding that a foreign proceeding is "nonmain" even when there would otherwise not be a "main" proceeding pending in *any* court. *SPhinX Funds*, 351 B.R. at 122.

3 Judge Lifland made clear that recognition of the foreign insolvency proceeding was not to be "rubber stamped" in a Chapter 15 case and that the facts should be reviewed independently, even in the absence of an objection. *Bear Stearns*, 2007 WL 2479483 at *6.

4 Judge Lifland's conclusions with respect to both the "center of main interests" and "establishment" of the Debtors being outside the Cayman Islands have been challenged by the Joint Provisional Liquidators in an appeal to the District Court. *Bear Stearns*, Docket No. 29 (Statement of Issues on Appeal, filed Septem-

the court said "the bar is rather high," and determined that there was "no (pertinent) nontransitory economic activity conducted locally in the Cayman Islands by the Funds; only those activities necessary to their offshore 'business.'" *Id.* As a result, foreign nonmain status was denied. *Id.*[5]

In denying nonmain status, the court recognized that its decision conflicted with the *SPhinX Funds* decisions of both the bankruptcy and district courts, but also commented that neither of the *SPhinX Funds* decisions addressed the "establishment" requirement of section 1502(5) before granting foreign "nonmain" status. *Id.* The court also rejected arguments based on cases decided under former section 304 (repealed). *Id.* at *8. The court stated that, as compared with former section 304:

> Chapter 15 . . . imposes a rigid procedural structure for recognition of foreign proceedings as either main or nonmain and thus the jurisprudence developed under section 304 is of no assistance in determining the issues relating to the presumption for recognition under chapter 15.

Id.

In its conclusion, the court commented that "[n]onrecognition of the Foreign Proceedings . . . does not leave the [Joint Provisional Liquidators] without the ability to obtain relief from U.S. courts," citing Bankruptcy Code sections 303(b)(4) and 1509(f). *Id.* However, in a footnote, the court called into question whether relief is, in fact, available to a foreign representative under section 303(b)(4). The court stated: "It would appear that the failure to repeal section 303(b)(4) along with section 304 may be a drafting error in view of the newly enacted section 1511(b) which likewise addresses the commencement of a case under sections 301 and 303. The inconsistencies of the two statutes have not been conformed." *Id.* at *8, n.15. How courts will resolve this issue, to the extent it is found to exist, remains to be seen.[6]

Tri-Continental, SPhinX Funds and *Bear Stearns* came to different conclusions as to whether foreign proceedings were "main," "nonmain" or neither. *Tri-Continental* focused on where the debtor had its registered office and conducted its business operations in concluding that proceedings in St. Vincent and the Grenadines *would* be recognized as foreign "main" proceedings. In *Sphinx Funds*, the bankruptcy court focused on the debtor's registered place of business and the consent of creditors and investors to foreign "main" status being granted, but ultimately *denied* such status since it was being sought for "an improper purpose." Finally, in *Bear Stearns*, the bankruptcy court refused to grant either foreign "main" or "nonmain" status. Clearly, this is an area of Chapter 15 jurisprudence that will continue to evolve.

2. Cases Involving Procedural Issues

The Bankruptcy Code and Bankruptcy Rules provide specific procedures for seeking the various kinds of relief available under Chapter 15. Despite these detailed provisions, questions have arisen as to how relief can be obtained and whether case law decided prior to Chapter 15's effective date remains applicable.

The decision in *United States v. J.A. Jones Constr. Group, LLC*, 333 B.R. 637 (E.D.N.Y. Nov. 29, 2005) ("*J.A. Jones*") (Go, U.S. Magistrate), addressed procedural deficiencies in a request for assistance made during the course of a U.S.-based litigation by an Interim Receiver in a Canadian insolvency proceeding. The U.S.-based litigation was a district court breach of contract action where one of the defendants was a subsidiary of a company involved in Canadian insolvency proceedings. *J. A. Jones,* 333 B.R. at 637-38. In the district court litigation, the Interim Receiver for the corporate parent of this defendant sought a stay of the litigation. *Id.* at 638. The procedure by which the Interim Receiver sought a stay, however, was by way of simply submitting a letter request to the district court in the pending litigation. *Id.* at 637-38. The stay which the Interim Receiver sought was to the same extent that a stay was available under Canadian bankruptcy law. *Id.* at 638.

The district court denied the stay sought by the Interim Receiver, largely on procedural grounds. Analyzing the request under Chapter 15, the court recognized that the "[t]he minimal requirements" of Chapter 15 "were 'designed to make recognition [of foreign proceedings] as simple and expedient as possible.'" *Id.* at 639 (citing legislative history). However, the court found that under Chapter 15, the relief sought by the Receiver "is available only after a foreign representative commences an ancillary proceeding for recognition of a foreign proceeding before a bankruptcy court." *Id.* at 638.

Because the Receiver filed only a letter request with the district court in the already- pending litigation matter, and did *not* commence the necessary ancillary proceeding under Chapter 15, the district court denied the request, stating: "[i]n the absence of recognition under [C]hapter 15, this Court has no authority to consider [the Receiver's] request for a stay. *Id.* at 639. However, emphasizing "the comity that American courts should accord foreign bankruptcy proceedings," the District Court *did* stay the litigation before it for a period of 60 days to provide the Receiver "an opportunity to seek appropriate relief under [C]hapter 15." *Id.*

Another case addressing procedural matters under Chapter 15 is *In re Ho Seok Lee*, 348 B. R. 799 (Bankr. W.D. Wash. Aug. 10, 2006) ("*Ho Seok Lee*") (Snyder, Bankruptcy Judge). Ho Seok Lee was the Court-appointed manager of Young

Emerging Case Law, Continued on Page 16

ber 20, 2007). As of the writing of this paper, the Joint Provisional Liquidators are seeking a stay pending a ruling on the appeal.

5 In an even more recent Chapter 15 case, *In re Basis Yield Alpha Fund (Master)*, Case No. 07-12762 (Bankr. S.D.N.Y.) (Gerber, Bankruptcy Judge), Judge Gerber has asked the parties to address the issues raised in the *Bear Stearns* decision at a hearing on recognition scheduled for November 19, 2007.

6 Judge Lifland's point appears to be supported by the legislative history of Chapter 15. *See* H.R. Rep. 109-31, pt. 1 at 105-06 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 169, 174 ("In any case, an order granting recognition is required as a prerequisite to the use of sections 301 and 303 by a foreign representative."). Collier's agrees. 8 **Collier on Bankruptcy** ¶ 1511.01 (15th ed. revised 2007).

Do You *REALLY* Know What Your Client's Machinery & Equipment Is Worth?

We Do And So Can You!

A substantiated, defensible value of machinery and equipment values is undoubtedly one of the most important components of insolvency. Afterall, if you guess, rely on a depreciation schedule, or the word of a "non-certified" person who may have a hidden agenda is not only inaccurate but is filled with liability!

However, a Certified Machinery & Equipment Appraisal that is USPAP (the government standard) compliant will hold up to scrutiny with the IRS, courts, lenders, and others because its backed by substantiated values and approaches you need to prevail.

2 Solutions To CYA (Cover Your Assets!)

Solution 1: Earn the professional designation of Certified Machinery & Equipment Appraiser (CMEA). Learn the approaches to value, how to accurately and correctly apply depreciation, and gain access to over 4 million comparables with a click of a mouse. Not only will you be able to deliver a substantiated defensible Certified Machinery & Equipment Appraisal, you'll expand your business and bring value to your services!

Solution 2: Call upon over 300 Certified Machinery & Equipment Appraisers coast-to-coast and worldwide to deliver a defensible report that will hold up to scrutiny.

The choice is yours but to deliver a substantiated and defensible value, you *must* do something! There is too much liability and uncertainty surrounding any other type of value. Why not add the *perfect* compliment to your business? Call us today to receive an Appraiser's Protection Pak that will provide you with additional information.

www.nebbinstitute.org (866) 632-2467

Chang Co., Ltd. ("Young Chang") in bankruptcy proceedings in Korea. *Ho Seok Lee*, 348 B.R. at 800. In the Korean proceedings a creditor, Samsong Manufacturing Co. ("Samsong"), filed secured claims against Young Chang in the amount of $2.1 billion. *Id.* The Korean bankruptcy court approved Young Chang's plan of reorganization, which provided alternative recoveries for Samsong depending on whether Samsong's claims were ultimately determined to be secured or unsecured: (i) a 40% recovery if unsecured or (ii) a recovery of 90% in cash, with an additional 10% in stock, if secured. *Id.*

After Young Chang had filed its plan with the Korean Court, but before the plan was approved, Samsong filed suit in the United States against Young Chang's wholly-owned subsidiary, AND Music Corp. ("AND Music"), in Washington state court.[7] *Id.* Before the Washington state court action went to trial, Young Chang filed a Petition for Recognition of Foreign Main Proceeding under Chapter 15 in the U.S. Bankruptcy Court. *Id.* In addition to seeking an order recognizing the Korean bankruptcy proceeding as the "Foreign Main Proceeding," Young Chang sought provisional relief against Samsong pursuant to section 1519. *Id.* at 800-01. Specifically, Young Chang sought and obtained an order providing that "any right to transfer, encumber or otherwise dispose of assets of the Debtor by any party other than the foreign representative or its designee is hereby suspended." *Id.*

After entry of the orders granting recognition of the Foreign Main Proceeding and granting provisional relief, Young Chang sought a permanent injunction enjoining Samsong "from recovering or seeking to recover any debt in excess of the amounts provided by Young Chang's Korean Plan." *Id.* at 801. In sum and substance, Young Chang wanted to permanently enjoin Samsong from pursuing the Washington state court litigation.[8] *Id.*

Samsong raised only a procedural objection in opposition to Young Chang's request for an injunction: Samsong argued that Young Chang could not seek an injunction by way of a *motion* in the Chapter 15 case; rather, Samsong argued, Young Chang was required by Bankruptcy Rule 7001 to commence *a separate adversary proceeding* in order to obtain injunctive relief. *Id.* Analyzing section 1521, the legislative history of Chapter 15 and decisions interpreting former Bankruptcy Code section 304, the Court held that since a permanent injunction *could* be entered in a Chapter 15 case, a separate adversary proceeding was *not* required. *Id.* at 801-02. The Court focused on section 1521(a), which provides that "appropriate relief" can be granted upon request of a foreign representative, and that under section 1521(a)(1), this included "staying the commencement or continuation of an individual action or proceeding concerning the debtor's assets, rights, obligations or liabilities . . . ." *Id.* The Court also pointed out that in section 1521(e), Congress provided that "the standards, procedures, and limitations applicable to an injunction shall apply to relief under [subsection (a)(1)]." *Id.* at 801.

Looking to case law preceding enactment of Chapter 15, the Court also determined that under former section 304, permanent injunctions could be obtained without the need for commencing a separate adversary proceeding. *Id.* Specifically, in *In re Rukavina*, 227 B.R. 234 (Bankr. S.D.N.Y. 1998), the court held that a foreign representative need not commence a separate adversary proceeding in order to obtain injunctive relief under section 304. *Id.* (citing *Rukavina*, 227 B.R. at 239, 240). Further, in *Ho Seok Lee*, the court noted that the legislative history of Chapter 15 indicated that Congress did not intend to *add* procedural hurdles for seeking injunctive relief that had not been previously established under section 304. *Id.* at 802. Accordingly, the Court held that a foreign representative need not commence a separate adversary proceeding in order to seek injunctive relief under Chapter 15 and entered an order permanently enjoining the Washington state court action. *Id.* at 803.

Chapter 15 has brought with it certain procedural requirements that must be adhered to, but bankruptcy courts continue to retain (and exercise) flexibility in granting relief, as demonstrated by the decisions in *J.A. Jones* and *Ho Seok Lee*.

3. Cases Involving Questions of Public Policy

Public policy concerns took center stage in *In re Ephedra Products Liability Litigation*, 349 B. R. 333 (S.D.N.Y. Aug. 11, 2006) ("*Ephedra*") (Rakoff, District Judge). In *Ephedra*, U.S.-based products liability actions had been consolidated into a multi-district federal court litigation. *Ephedra*, 349 B.R. at 334. The defendant in those actions, a Canadian-based company named Muscletech Research and Development, Inc. ("Muscletech"), eventually commenced insolvency proceedings in Canada. *Id.* The Canadian court appointed a Monitor over the insolvency proceedings; and the Monitor commenced Chapter 15 proceedings in the United States. *Id.* The Canadian insolvency proceedings were recognized as "foreign main proceedings" under Chapter 15. *Id.*

Claims resolution procedures were negotiated in the Canadian proceedings; and they were approved by the Canadian court. *Id.* Those procedures provided for (i) mandatory mediation and (ii) the estimation by a claims officer to be appointed by the Canadian court of any claims not resolved through mediation. *Id.* The Monitor sought an order under Chapter 15 enforcing the procedures that had been approved by the Canadian court. *Id.* Personal injury plaintiffs in the U.S.-based multi-district litigation objected on public policy grounds, arguing that the claims resolution process approved by the Canadian Court denied them due process and a right to a jury trial. *Id.* at 335. As authority for their objections, the plaintiffs cited Bankruptcy Code section 1506, which provides that: "[n]othing in this [C]hapter 15 prevents the court from refusing to take an action governed by this [c]hapter if the action would be

7 The decision in *Ho Seok Lee* notes that the Washington state court lawsuit sought "to recover accounts receivable that AND Music owe[d] to Young Chang" but does not otherwise describe the claims in that lawsuit. *Ho Seok Lee*, 343 B.R. at 800.

8 Despite the automatic stay under Chapter 15, a permanent injunction was necessary to protect the former debtor upon the close of the case. *Ho Seok Lee*, 348 B.R. at 802-03.

manifestly contrary to the public policy of the United States." *Id.* (citing 11 U.S.C. § 1506).

The Court rejected these arguments. *Id.* at 335-36. Looking to Congressional intent, the Court stated: "In adopting Chapter 15, Congress instructed the courts that the exception [in section 1506] should be 'narrowly interpreted' as '[t]he word 'manifestly' in international usage restricts the public policy exception to the most fundamental policies of the United States.'" *Id.* at 336 (citing, *inter alia,* H.R. Rep. No. 109-31, pt 1, at 106 n.101, *as reprinted in* 2005 U.S.C.C.A.N. 169 n.101). Secondly, the court determined that a jury trial, while an important component of the U.S. legal system, was not necessary for the rendering of a fair and impartial verdict in Canada and that the procedures approved by the Canadian court were not manifestly contrary to the public policy of the United States:

> Obviously, the constitutional right to a jury trial is an important component of our legal system . . . . But the notion that a fair and impartial verdict cannot be rendered in the absence of a jury trial defies the experience of most of the civilized world.

Id. at 337. Finally, in overruling the plaintiff's objection and approving the Canadian claims resolution procedures, the court noted that the only prejudice alleged would have been the loss of some degree of bargaining leverage. *Id.* With this in mind, the Court ruled that the section 1506 objection was without merit and that it would enforce the order of the Canadian insolvency court and require compliance with the Canadian claims resolution procedures. *Id.*

Conclusion

Upon the second anniversary of Chapter 15's effectiveness, it is clear from both the procedural and substantive issues that have been litigated that significant questions remain as to the scope of available relief, and the manner of obtaining it, under Chapter 15. ■

THIRD ANNUAL AIRA AND NYIC JOINT BANKRUPTCY CONFERENCE

Tuesday, January 29, 2008 at 11:30 a.m.

E. Discovery, Federal Rule Amendments and Bankruptcy Litigation

- **Andrew I. Silfen**, *Arent Fox LLP, Moderator*
- **David M. Zensky**, *Akin Gump Strauss Hauer and Feld LLP*
- **Stephanie Giammarco**, *BDO Seidman, LLP*
- **Hunter T. Carter**, *Arent Fox LLP*
- **Hon. Martin Glenn**, *U.S. Bankruptcy Court, S.D.N.Y.*

Description: The nature and volume of electronic information generated in the course of today's business operations and by restructuring and turnaround professionals as well as bankers and providers of financing increases significantly the opportunities and risks of discovery. The panel will discuss preparing for electronic discovery, laying the ground work for successful electronic discovery, how to conduct effective electronic discovery and implementing special practices to better protect business and restructuring professionals, bankers, secured creditors and providers of financing. The panel will also discuss the amendments to Federal Rules of Civil Procedure governing electronic discovery and other practice tips including litigation hold letters.

ARNO RISTORANTE
141 W. 38th Street
New York, NY 10018

Register now for the following CIRA Courses:

New York, NY
Part 1: July 21-23, 2008
Part 2: October 20-22, 2008
Part 3: December 8-10, 2008

Washington, DC
Part 3: March 12-14, 2008
Part 1: May 5-7, 2008
Part 2: July 23-25, 2008

Las Vegas, NV
Part 1: June 2-4, 2008

Miami, FL
Part 1: January 16-18, 2008
Part 2: April 7-9, 2008
Part 3: May 19-21, 2008

Malibu, CA
Part 2: January 28-30, 2008
Part 2: August 11-13, 2008
Part 3: November 12-14, 2008

Dallas, TX
Part 1: April 21-23, 2008
Part 2: November 5-7, 2008
Part 3: January 26-28, 2009

Visit www.airacira.org for complete course content and easy, online registration

Taxation Cases

Forrest Lewis

IRS NARROWS SCOPE OF SEC. 382 BUILT IN GAIN

When there is a change of ownership of a corporation with tax net operating losses, certain anti-loss trafficking rules found in IRC Sec. 382 kick in to reduce the amount and usefulness of the loss. These rules frequently come into play on the sale or reorganization of troubled companies. These rules call for an increase in the usability of the net operating losses when there is a "built in gain" such as the sale of an appreciated asset after the change in ownership. Some tax practitioners took the position that "prepaid income" qualified as a type of built in gain, thus increasing the amount of net operating losses which could be recognized in the first 5 years after the change in ownership. Recently the IRS issued proposed and temporary regulations which exclude prepaid income from the definition of built in gain. This regulation is unfavorable to taxpayers. (Reg. §1.382-7T)

The IRS explanation states that the Congressional Committee Reports that accompanied the enactment of section 382(h)(6)(A) both state that items of income attributable to the pre-change period include accounts receivable of a cash basis taxpayer that arose before the change date and are collected after that date, the gain on completion of a long-term contract performed by a taxpayer using the completed contract method of accounting that is attributable to the pre-change period, and the recognition of income attributable to the pre-change period pursuant to section 481 adjustments, as when the loss corporation is required to change to the accrual method.

The IRS believes that prepaid income is distinguishable from the income items described in the committee report examples (above). In each of the committee report examples, the item of income is attributable to the pre-change period because that is the period in which performance occurred and expenses were incurred to earn the income. By contrast, prepaid income is attributable to the post-change period because that is the period in which performance occurred and expenses were incurred to earn the income. Examples of prepaid income which cannot be included in built in gain under the new Regulation are: prepaid magazine and newspaper subscriptions under Sec. 455, advance payments for the sale of goods and services under Sec. 451, and deferred income from the performance of services under Rev. Proc. 2004-34.

Thus, the key is that the regulation conforms the treatment of built in gains more to the financial accounting treatment of the income. If the income was earned prior to the change in ownership, it can be built in gain which is favorable for net operating loss carryover under Sec. 382. If the income is earned after the change, the regulation bars treating it as a built in gain, which is unfavorable.

IRS ANNOUNCES NEW FINANCIAL STANDARDS FOR LIVING EXPENSES

IRS Collections Division has announced revisions to the "Financial Standards" which it uses to determine a taxpayer's ability to pay delinquent taxes. The same standards are also used by bankruptcy courts in classifying individuals in the various chapters of individual bankruptcy.

The Collection Financial Standards were revised on 10/01/07 to:

- Eliminate income ranges for National Standard Expenses (the monthly allowance for food, clothing and miscellaneous for two persons will be $925)
- Eliminate separate tables for Alaska and Hawaii, creating one set of tables for National Standard Expenses
- Create a new National Standards category for Health Care (the monthly allowance will be the health insurance premium plus $54 per person under age 65)
- Expand the number of household categories for Housing & Utility Expenses (which now includes a small amount for cell phone costs) (the monthly housing and utility allowance for Pushmataha Co., Oklahoma is $684 for 2 persons, Marin Co., California is $2,861)
- Create equal allowances for first and second vehicles under Transportation Expenses (national monthly allowance for 1 car is $458 plus a local operating cost which ranges between $169 in St. Louis and $256 in San Francisco)
- Create a separate nationwide Public Transportation allowance of $163 per month

The revised standards are effective for financial analysis conducted by IRS on or after October 1, 2007. They will be effective for bankruptcy court deliberations starting January 1, 2008.

Here is a link to the IRS webpage:

http://www.irs.gov/individuals/article/0,,id=96543,00.html

IRS PROVIDES FAVORABLE RULING ON AGING OF INDIVIDUAL TAXES IN DISASTER AREAS AND COMBAT ZONES

In Revenue Ruling 2007-59, the IRS "strong arms" the statute to provide a very narrow but taxpayer favorable position concerning the difference between due dates for individual income taxes for Bankruptcy Code purposes and the extended due dates for Internal Revenue Code purposes

pursuant to Presidential declarations. The ruling illustrates with the following examples:

"On April 12, 2007, Individual *A* timely requests a 6-month extension of time to file an income tax return for 2006 [to October 15, 2007]. *A*'s principal residence …is in State Y. On October 2, 2007, disaster *Q* strikes State Y. On October 5, 2007, the President declares a disaster … The Service issues a news release announcing relief for taxpayers affected by disaster *Q*. The news release defines the period from October 2, 2007, through December 31, 2007, as a disaster relief period and provides that the deadlines for specified acts, including the filing of an income tax return, that fall within the disaster relief period are postponed until December 31, 2007. *A* files an income tax return for 2006 showing a balance due on December 20, 2007. *A* files a Chapter 7 bankruptcy petition on November 24, 2010, listing the Service as a creditor with respect to the 2006 income tax liability. The case is treated as a "no-asset" Chapter 7 case, and the Service does not file a proof of claim with respect to *A*'s 2006 federal income tax liability. …On January 18, 2011, the bankruptcy court grants *A* a discharge pursuant to section 727(a) of the Bankruptcy Code."

The question is whether the extended filing due date of December 31 starts the three year period for determining "old and cold" tax liabilities which can be discharged in bankruptcy? The Service concludes that the three year period still starts on October 15, 2007, the original extended due date. Since the taxpayer filed his petition on November 24, 2010, the unpaid 2006 taxes can be discharged in bankruptcy.

The ruling then goes on with the example of "Individual B who serves in the US Armed Forces in an area designated by the President as a combat zone …from March 17, 2005, through August 1, 2006. On September 20, 2006, *B* files an income tax return for 2004 showing a balance due. *B* files a Chapter 7 bankruptcy petition on November 3, 2008, listing the Service as a creditor with respect to the 2004 federal income tax liability. The case is treated as a "no-asset" Chapter 7 case, and the Service does not file a proof of claim... On December 11, 2008, the bankruptcy court grants *B* a discharge pursuant to section 727(a) of the Bankruptcy Code."

The ruling holds that the due date of the 2004 return for calculating the three year period for bankruptcy purposes is still April 15, 2005. Since more than three years elapse before the petition date of November 3, 2008, the 2004 unpaid tax liability can be discharged.

Commentary: This ruling is doubly favorable since it brings valuable certainty to the issue besides increasing the chance that troubled individual taxpayers in affected areas will be able to receive a discharge for unpaid federal income taxes. ■

20/20 VISION

Weiser, with its ranking as one of the **top 20 accounting firms** and as one of *Bankruptcy Insider's* **top 20 non investment banking financial advisory firms,** is ideally positioned to understand and serve all constituents in a distressed situation.

Weiser LLP
Certified Public Accountants

- Accomplished restructuring professionals
- Bankruptcy taxation services
- Consulting and due diligence on 363 transactions
- Development and assessment of business plans
- Expert witness testimony and forensic services
- Fresh start accounting

Please visit us at:
http://www.weiserllp.com/services/bankruptcy.htm

New York 212.375.6873
New Jersey 732.205.2042

Comparative Provisions & Implications of U.S. & China Bankruptcy Codes: Moving Towards Common Ground?

John J. Rapisardi and James H.M. Sprayregen

China's recently effective Enterprise Bankruptcy Law should be recognized as groundbreaking legislation that is the culmination of China's efforts to improve and unify its bankruptcy laws, and signal its continuing embrace of a market-based economy. Given the commitment with which China seeks to become a full-fledged member of the World Trade Organization, there should be little surprise that the New Enterprise Bankruptcy Law encompasses many of the same complex bankruptcy concepts found in more established bankruptcy laws, such as the U.S. Bankruptcy Code. Even where the provisions of the nascent bankruptcy law do not fully address some of the issues that can arise in bankruptcy cases, the recognition of these issues makes it likely that future provisions promulgated by the Supreme People's Court will clarify the new law and provide procedures to address these issues. Moreover, as the first cases are being filed, the areas of the new law that need further development can be observed and tested.

The new law was formulated in order to regularize bankruptcy procedures, fairly dispose of credits and debts, protect the relative rights of creditors and debtors, and maintain China's socialist market economy. The new law eliminates the requirement under prior law of governmental approval to file a bankruptcy application. Instead, there is a fifteen-day waiting period between the time the bankruptcy application is filed and when the court must make a ruling on whether to accept the application. The new law contains provisions that are substantially different from previous bankruptcy schemes. For example, the new law provides for liquidation, reorganization, and conciliation; limits government intervention in bankruptcy proceedings; requires the appointment of an administrator to oversee the case; and acknowledges the concept of post-acceptance debtor loans. Some of the more significant provisions of the New Enterprise Bankruptcy Law are described below, along with contrasts and comparisons to their U.S. Bankruptcy Code counterparts.

Who May Be a Debtor

Unlike China's previous 1986 bankruptcy law, the new law is not limited to state owned enterprises (SOEs). The new law applies to any "enterprise legal person" that is insolvent. The omission of references to SOEs indicates that non-SOEs now qualify under a unified bankruptcy law. Individuals, however, continue to be excluded from filing bankruptcy applications. Under the U.S. system, entities eligible to file bankruptcy petitions under the relevant chapters of the Bankruptcy Code are carefully defined therein, and individuals are permitted to file for bankruptcy protection.

The New Enterprise Bankruptcy Law also requires the debtor to make a showing that it is unable to pay off the debts as they become due, and that its assets are insufficient to pay off all of its debts. These insolvency tests mirror the "balance sheet" insolvency and "equitable" insolvency tests familiar to practitioners under the U.S. bankruptcy law. Further, an enterprise legal person may apply specifically for reorganization where "there is an obvious possibility that it will lose the capability to repay its debts." This more flexible financial prerequisite allows a debtor to avail itself of the reorganization provisions of the new law, even where it would not qualify for liquidation or conciliation. These requirements generally contrast the U.S. Bankruptcy Code, which does not set forth any test of insolvency as a prerequisite for a voluntary filing by the debtor.

The Automatic Stay

The New Enterprise Bankruptcy Law contains provisions that prohibit certain actions by the debtor and creditors upon the acceptance of the bankruptcy application by the court. For example, the debtor may not pay off pre-acceptance debts. Creditors are enjoined from enforcing claims against the debtor's property. Pending litigation involving the debtor is suspended, and any post-acceptance litigation must be commenced in the court presiding over the bankruptcy proceeding.

In contrast to the limited circumstances in which the automatic stay is imposed under China's new law, the automatic stay provided for in U.S. Bankruptcy Code section 362 is extremely broad in scope, and is intended to encompass most formal or informal acts against the debtor or property of the debtor's estate. The automatic spell is necessarily broad to give effect to the goal of providing the debtor a "breathing spell" in which to attempt to reorganize without the pressure of collection actions and litigation, for example. Moreover, the automatic stay under the U.S. Bankruptcy Code is triggered upon the filing of a bankruptcy petition by the debtor, unlike in the New Enterprise Bankruptcy Law, where there is a gap period between the debtor's submission of an application and the court's acceptance of the case.

The Administrator

The provisions in the new law allowing the court to designate an administrator represents a departure from the prior Chinese bankruptcy law, which provided only for a liquidation team (usually consisting of government officials, rather than independent organizations) to take over the management of the debtor's business. This is consistent with the newly implemented reorganization and conciliation options available to debtors, and also signals the government's willingness to limit its involvement in the bankruptcy process. Under the new law, the court may designate an administrator from among qualified "social intermediary institutions" or

individuals with requisite professional knowledge from a social intermediary institution listed on registers compiled by the provincial courts. Provisions clarifying and specifying procedures regarding the designation and compensation of administrators were recently promulgated by the Supreme People's Court and likely will aid in the implementation of the administrator provisions under the new law. Among the clarifications provided by the designation and compensation provisions is the likelihood that foreign professionals with relevant experience—such as international accounting and law firms—are *not* eligible to be appointed administrators.

Once designated, the role of the administrator is similar to that of a trustee under U.S. bankruptcy law. The administrator essentially is charged with taking over the debtor's property, managing the debtor's business, and is held accountable to the court and representatives of the creditors. Among the administrator's duties are the following: (i) investigate the debtor's property and draft a master property report; (ii) determine the daily expenses and other necessary expenses for the debtor; (iii) determine whether the debtor's business shall continue to operate before the first creditors' meeting is convened; (iv) manage and dispose the debtor's property; (v) participate in lawsuits or arbitrations on the debtor's behalf; and (vi) convene the creditors' meeting.

By comparison, under the U.S. law, in a chapter 7 liquidation, the United States Trustee appoints a disinterested person that is a member of a panel of private trustees as an interim trustee. Subsequently, the creditors may elect a disinterested person to serve as trustee during the pendency of the case. The primary duty of the chapter 7 trustee is to collect and liquidate the property of the debtor's estate for distribution to creditors, in accordance with the best interest of the parties. Unlike under the Chinese system (where an administrator remains in place even after an administrator is designated), a trustee generally is not appointed in a chapter 11 reorganization—the debtor continues to manage its own affairs as a debtor in possession.

The Creditors' Meeting

A creditor who has lawfully asserted a claim is a member of the creditors' meeting and may attend the creditors' meeting and vote. Resolutions of the creditors' meeting are passed if adopted by more than half in number of the creditors eligible to vote, and more than half in amount of unsecured credits eligible to vote. Unless appealed within fifteen days of adoption, resolutions are binding on all creditors. The duties of the creditors' meeting includes investigating the validity of claims, oversight of the administrator's performance and compensation, determining whether to continue or terminate the debtor's business, and determining whether to adopt any plans. Lastly, the creditors' meeting may establish a creditors' committee to, among other things, supervise the management and disposal of the debtor's property and the distribution of the bankruptcy estate, and perform other duties authorized by the creditors' meeting. The committee is to consist of not more than nine creditor representatives, of which one must be a representative of the debtors' employees.

Similarly, in a chapter 11 case under the U.S. Bankruptcy Code, the United States Trustee is required to appoint a committee of unsecured creditors as soon as practicable following the commencement of the case. The appointment of the creditors' committee is intended to ensure that the interests of unsecured creditors are represented and protected, and to establish a body to supervise the debtor or trustee and negotiate a plan of reorganization. The creditors committee may investigate the debtor, participate in the plan process, request the appointment of a trustee or examiner, and perform other services in the interest of its constituents. Under U.S. law, the members of the committee consists of the persons, willing to serve, that hold the seven largest claims against the debtor, although there is no statutory bar to having more or fewer than seven members, nor is there a requirement that any member represent employee interests. Upon request of a party in interest, the court may order the U.S. Trustee to change committee membership to ensure adequate representation of the creditor body.

Claims and Priority

The New Enterprise Bankruptcy Law recognizes the following classes of claims, in order of descending priority: (i) secured claims; (ii) labor claims; (iii) tax claims; and (iv) unsecured claims. Unlike the prior Chinese bankruptcy law, the new law provides for secured claims to be paid first in priority over labor claims; previously, as a result of China's emphasis on providing full employment for its workers, rights of holders of secured claims could be compromised to ensure that labor claims were paid. China's shift to a market-based economy and its desire to participate fully as a member of the World Trade Organization likely has had an impact on this apparent shift in focus from protecting workers' rights to facilitating secured lending. Even so, China remains more deferential to labor claims than the U.S., as there is no separate class for labor claims under the U.S. law (although the Bankruptcy Code does afford some priority of payment to allowed unsecured wage claims of employees, up to $10,950). Classification of claims under U.S. law generally are similar: the Bankruptcy Code groups claims into secured claims, priority claims, and general unsecured claims.

Procedurally, under the Chinese law, the People's Court sets a bar date for asserting claims, and any creditor failing to timely assert a claim cannot exercise its rights under the new law, including participating at creditors' meetings and voting on resolutions. Creditors asserting claims must submit written materials and evidence in support of the claims. If the debtor and creditors do not object to the claim, the court confirms the claim by

order. Otherwise, parties may litigate the claim before the court. Apart from these provisions, the new law does not provide any guidance on the timing or procedures of the claims reconciliation process.

The U.S. Bankruptcy Code has similar provisions relating to the claims process. Bar dates for filing proofs of claim are set by the court, and a creditor failing to timely file a proof of claim are not treated as creditors for the purposes of voting or distribution. Late proofs of claim may be filed, but only with the court's permission and for cause. The filing of a proof of claim is *prima facie* evidence of the validity of the claim.

Secured Claims and Adequate Protection

As noted above, the priority of secured claims over labor claims is a significant amendment to the prior Chinese bankruptcy law. In addition, the new law permits a secured creditor to hold a secured claim for up to the value of the collateral, and a deficiency claim to the extent that the value of the collateral is less than the amount of the secured claim. It should be noted, however, that the availability of a deficiency claim for secured creditors is limited to liquidation cases and not reorganization cases under the new law, as it is drafted. It is possible that this anomaly is the result of a drafting oversight, and future clarification or correction may remedy the inconsistency.

The bifurcation of a secured claim under the New Enterprise Bankruptcy Law is analogous to the treatment of secured claims under U.S. law. The U.S. law, however, provides for several other protections for the secured creditor that are not present in China's new law. For example, under the U.S. Bankruptcy Code, a secured creditor in a chapter 11 case may choose to have its claim secured in its entire amount, rather than bifurcated with a deficiency claim. As such, the creditor is entitled to have his entire claim treated as a secured claim even if the value of the collateral is less than the amount of the debt, so that the creditor may receive the benefit of any enhanced value from an appreciation in the value of the collateral. Also under the U.S. law, a secured creditor is entitled to any accrued interest, fees, and other charges to the extent that the claim is over-secured.

The concept of adequate protection, familiar to the U.S. bankruptcy practice, appears in a similar, but more limited, form under China's new law. The administrator may take back collateral pledged or withheld by paying off debts or providing security, to the extent that the amount paid or the alternate security provided is limited to the then-current market value of the collateral, if the value of the collateral is lower than the amount of secured claims thereon. Under U.S. law, a secured creditor may seek adequate protection from the diminution in value of its collateral as a result of the automatic stay, the debtor's use of the collateral, or the granting of another lien against the property to secure post-petition financing. Adequate protection can come in various forms, including periodic cash payments, additional or replacement liens, or the "indubitable equivalent" of the secured creditor's interest in the property.

Executory Contracts

In contrast to the well-developed U.S. law with respect to executory contracts, the New Enterprise Bankruptcy Law contains only one provision relating to the rejection or assumption of contracts. The new law provides that, following the court's acceptance of a bankruptcy application, the administrator is authorized to reject or assume a pre-acceptance executory contract. The administrator (or the debtor, if permitted to continue to manage its affairs) must notify the contract counterparty within two months after acceptance of the application (or 30 days after receiving demand from the counterparty for a determination), or the contract is deemed rejected. If the administrator decides to assume a contract, the counterparty may demand security, and if the administrator is unable to provide security, the contract is deemed rejected. The requirement of providing security in order to assume a contract is similar to the concept of adequate assurance of future performance under U.S. law. The new law does not otherwise address the assumption and assignment of contracts.

The ability to assume or reject executory contracts, and the requirement to provide what is essentially adequate assurance of future performance, are rooted in the U.S. Bankruptcy Code as well. Under the U.S. law, the trustee generally may assume or reject executory contracts and unexpired leases at any time prior to the confirmation of a plan, although counterparties may seek an earlier determination. In a liquidation case, if the trustee does not assume or reject within 60 days of the commencement of the case, the contract or lease is deemed rejected. Further, with respect to commercial leases, the trustee must assume or reject within the first 120 days of the case. The court may grant a single 90-day extension, but no additional extensions are permitted without the lessor's prior written consent. Unlike the Chinese law, the U.S. Bankruptcy Code requires court approval of assumptions and rejections of contracts and leases, and requires that all defaults be cured upon assumption.

Reorganization

One of the more notable features of the New Enterprise Bankruptcy Law is the inclusion of a chapter on reorganization. As with the U.S. Bankruptcy Code provisions on voluntary and involuntary chapter 11 filings, either the debtor or creditors may file an application for reorganization under the new law. Consistent with an application for a liquidation proceeding, the filing of a reorganization application does not commence the reorganization proceeding; the court must examine the application and issue an order permitting the debtor to commence the reorganization process. As discussed above in *Who May Be a Debtor*, the

debtor must demonstrate one of the tests for insolvency in order to qualify for reorganization.

With respect to an involuntary reorganization, the new law offers little more than that "creditors" may file. In contrast, the U.S. Bankruptcy Code expressly provides that a bankruptcy petition may be filed by three or more creditors with undisputed, non-contingent, unsecured claims in the aggregate amount of at least $13,475 more than the value of any lien on the property. Under both U.S. and Chinese law, an involuntary liquidation may be converted to a reorganization case. Under the New Enterprise Bankruptcy Law, the debtor or equity holders representing more than one-tenth of the debtor's registered capital may apply to the People's Court to convert the case to a reorganization proceeding. Similarly, a debtor in an involuntary chapter 7 case may, as an absolute right, convert the case to a chapter 11 reorganization at any time during the case.

Another significant aspect of the chapter on reorganization is the provision relating to post-acceptance financing, often a critical element of a debtor's ability to continue to operate during the reorganization process, as exemplified in the U.S. system by the importance of debtor in possession (DIP) financing. Even so, the Chinese law contains only one provision addressing the issue, which provides that "[d]uring the reorganization period, if the debtor or the administrator borrows for the purpose of continuing to operate its business, a security interest may be created for such a loan." Although important in that the new law recognizes the concept of secured DIP financing, the provision is a far cry from the well-developed scheme under the U.S. Bankruptcy Code, which provides a range of protections to post-petition lenders, from lending on a superpriority basis to offering priming liens.

The new law requires the debtor or the administrator to submit a reorganization plan within six months from the date of the commencement of the reorganization procedure. For "justifiable reason," this period for submitting a plan may be extended for another three months at the request of the debtor or administrator. Depending upon who is controlling the case, the debtor or the administrator may submit a plan; creditors are not permitted to file a competing plan. Under the U.S. Bankruptcy Code, the debtor is given a period of exclusivity in which only it may file a plan of reorganization, but at the expiration of that time period (along with any permitted extensions), any party in interest may file a plan. Moreover, the Chinese law provides that if no plan is submitted within the time required for the debtor or administrator to submit a plan, the court shall issue an order terminating the reorganization procedure and declaring the debtor bankrupt.

Under the New Enterprise Bankruptcy Law, any plan that is submitted must contain the following: (i) the operation scheme of the reorganized enterprise; (ii) the classification of the claims; (iii) the adjustment scheme of the claims; (iv) the repayment scheme of the claims; (v) the time limit for executing the plan; (vi) the time limit for supervising the implementation of the plan; and (vii) other plans that are beneficial to the reorganization of the debtor. These requirements are far fewer and less comprehensive than the plan requirements under the U.S. Bankruptcy Code. Also, the U.S. Bankruptcy Code contains extensive provisions on disclosure requirements in connection with any solicitation of plan acceptances, so that creditors have access to "adequate information" in order to make an "informed judgment" regarding any proposed plan; there is no analogous counterpart in the New Enterprise Bankruptcy Law.

The new law provides that voting on a proposed plan is conducted by class, and a plan is deemed to be passed by a class if more than one-half of the creditors of a voting group present and entitled to vote, and representing more than two-thirds of the total claims of the group, vote to pass the plan. Similarly, in the U.S., a class of claims accepts a plan if creditors that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class vote to accept the plan. The difference between the two laws is that class acceptance under the Chinese law requires the affirmative vote of more than two-thirds in amount of *all* claims, not just claims held by voting creditors.

If the plan is not passed, the new law provides for something similar to cramdown under U.S. law. The new law allows the debtor or administrator to engage in negotiations with non-accepting voting groups, and then to conduct a second round of voting following the negotiations. If those voting groups decline to have a second round of voting, or do not pass the plan after the second round of voting, the debtor or administrator may request that the court approve the plan if all the following conditions are satisfied:

(i) secured claims will be full paid with respect to such property, and any losses from the late payment will be compensated fairly;

(ii) employee claims and taxes will be fully paid;

(iii) unsecured claims will be repaid in a proportion that is not less than the proportion available under a liquidation procedure;

(iv) adjustment to investors' rights and interests is fair and equitable;

(v) members of the same voting group are treated fairly and equally, and the repayment priority does not violate the payment priority scheme under Article 112; and

(vi) the business operation plan is feasible.

The provisions in the new law embody concepts similar in many respects to those in the U.S. Bankruptcy Code relating to cramdown, particularly the requirement of the "fair and equitable" test. However, the Chinese scheme does depart significantly from the

U.S. scheme in some areas, including the leverage that labor and tax claims have over the debtor—those claims can always refuse to accept a plan because the cramdown provisions require that they be paid in full.

If a plan is not timely submitted, or is not passed by the voting class and fails to be crammed down, the court may terminate the reorganization procedure. In addition, creditors may seek to terminate a reorganization and convert it into a liquidation if the debtor is unable or fails to execute the plan of reorganization. Finally, during the reorganization period, the administrator and interested parties may petition the court to terminate the reorganization procedure for the following: (i) the management and financial situation of the debtor deteriorates to the point that there is no possibility to save the debtor; (ii) the debtor commits fraudulent conduct, maliciously decreases assets, delays without cause in paying debts or takes other actions disadvantageous to creditors; or (iii) the debtor's behavior causes the administrator to become unable to perform his duties. These circumstances are similar to the standard used in the U.S. Bankruptcy Code to appoint a trustee in a chapter 11 reorganization, although the appointment of a trustee does not terminate the case, but rather terminates the debtor's authority to continue to operate as a debtor in possession. Moreover, under U.S. law, the debtor or a party in interest may seek a conversion of a chapter 11 case to a chapter 7 liquidation or a dismissal of a chapter 11 case for cause, including the continued or significant diminution is estate assets.

The New Enterprise Bankruptcy Law has a pair of provisions that, when read together, operate to discharge the debtor of claims treated under a confirmed plan of reorganization. These provisions provide that the plan is binding on the debtor and all creditors, and that the debtor is exempted from repayment liability for debts that have been reduced or exempted in accordance with the plan upon the completion of the implementation of the plan. This is similar to the discharge granted a debtor under U.S. law, whereby the confirmation of a plan relieves a debtor from all prepetition liabilities in exchange for the treatment of such liabilities under the plan. The debtor is thus given a "fresh start" to operate its business outside of bankruptcy.

Conclusion

The New Enterprise Bankruptcy Law is first and foremost a new law that manages to encompass many concepts present in well-established laws like the U.S. bankruptcy law, but remains untested and rudimentary in many respects. The numerous advances of the new law, however, should not be overlooked, as they represent a substantial milestone in China's effort to implement a bankruptcy system that will accommodate its progression towards a market economy. ■

Appendix Continued on Next Page

CAPSTONE CAPITAL PARTNERS

Turnaround & Special Situation Acquisitions

We Buy and Build Companies, We Don't Just Buy and Sell Them

Capstone Capital Partners is a value oriented, boutique private equity firm dedicated to making control equity investments in underperforming or distressed lower-middle-market companies. We are primarily interested in industrial and distribution businesses with $15 to $75 million in annual revenues that require management expertise, access to capital, and strategic support to improve operational performance.

For more information including our investment criteria, please contact Terry Morgan at (440) 247-3646, tmorgan@capstonecapitalpartnersllc.com or visit www.capstonecapitalpartnersllc.com

Comparison of U.S. Bankruptcy Code and New Chinese Bankruptcy Law

U.S. Bankruptcy Code	New Chinese Bankruptcy Law
• Eligibility for Chapter 11 – no requirement to demonstrate insolvency	• Must establish inability to pay debts as they mature or have insufficient assets to pay debts; Court must be satisfied reorganization is necessary.
• Who May be a Debtor – all but railroads, insurance companies and banks. Section 109.	• Enterprise Legal Person. Article 2.
• Debtor allowed to operate business in the ordinary course. Section 363(b).	• Debtor may "manage its affairs" under administrator's supervision. Article 73.
• Duties and powers of debtor in possession/trustee. Section 1106.	• Duties and powers of administrator. Article 25.
• Executory contracts. Section 365. o Provides for assumption and rejection.	• Executory contracts. Article 18. o Provides for assumption and rejection.
• Appointment of Trustee. Section 1104. • Conversion to Chapter 7/dismissal. Section 1112.	• Termination of Reorganization Procedure. Article 78.
• Administrative Claims/Actual & Necessary Benefit to the Estate. Section 503(b)/507(a). o Paid prior to other unsecured claims.	• Bankruptcy Expenses and Common-Interest Debts. Articles 41-43. o Paid prior to other unsecured claims.
• DIP Financing. Section 364. o Provides detailed rules.	• Loans permitted during Reorganization Period. Article 75. o Additional rules/guidance needed.
• Creation of Bankruptcy Estate. Section 541.	• The Debtor's Property. Article 30.
• Automatic Stay. Section 362. o Enjoins all acts and actions against debtors and debtor's property.	• Suspension of acts against debtor's property. Article 19. • Suspension of Litigation (litigation may resume after Administrator takes over). Article 20.
• Venue. 28 U.S.C. § 1408. o Location of Chapter 11 case: domicile, or principal place of business/assets in the U.S. during 180 days prior to filing (or greatest portion thereof), or district where bankruptcy case of an affiliate is pending	• Venue. Article 3. o Location of case: debtor's domicile – place of main business office or company registration.
• Preferences. Section 547. o Recovery of transfers, made within 90 days prior to filing, on account of antecedent debt and giving advantage to preferred creditor.	• Avoidance of Payment. Article 32. o Avoidance of transfers made to creditors by insolvent debtor within 6 months prior to filing.
• Fraudulent Conveyances. Section 548. o Avoidance of transfers made within 2 years prior to filing, either with the intention to defraud creditors or by an insolvent debtor for grossly inadequate consideration.	• Fraudulent Transfers. o Avoidance of certain transactions made within 1 year prior to filing. Article 31. o Avoidance of actions to hide assets or fabricate debts. Article 33.
• Time Deadline to File Claims. Section 501/Bankruptcy Rules 3001/3007.	• Time Deadlines. Articles 45 & 48. • Filing Written Claims. Article 49.
• Doctrine of Excusable Neglect.	• Eliminated in enacted law.
• Unmatured Interest Not Allowed on Unsecured Claims. Section 502(b).	• No Unmatured Interest on Claims. Article 46.
• Obligations of Joint Debtors. Section 509(b).	• Rights of Creditors against Joint Debtors. Article 52.
• Creditors' Meeting. Section 341.	• Creditors Allowed to Attend Creditors' Meeting. Article 59. • Timing of Creditors' Meeting. Article 62. • What Can Occur at Meeting. Article 61. • Creditors' Meeting Governance. Articles 60, 61, 64.
• Appointment of Creditors' Committee. Section 1102(a). o Ordinarily holders of 7 largest unsecured claims. o May be expanded, including to accommodate small business creditors with disproportionately large claims.	• Appointment of a Creditors' Committee o No greater than 9 – with one representative of labor claims. Article 67. o Secured creditors not eligible to vote on any plans at creditors' meetings. Article 59.
• Powers/Duties of Creditors' Committee. Section 1104(b). o Oversees/monitors case.	• Powers and Duties of Creditors' Committee. Article 68. o Supervises management, disposal and distribution of debtor's property. o Proposes convention of creditors' meeting. o Exercises other functions consigned by the creditors' meeting.
• Contents of Plan of Reorganization. Section 1123.	• Contents of Plan. Article 81.
• Classification of Claims. Section 1122. o Claims in same class must be similar. o Business justification for separation of similar claims. o Convenience claims allowed.	• Classification. Article 82. o Separate claim classes, for secured claims, labor claims, taxes, and unsecured claims. o "Small-amount claim subgroup" of unsecured claims allowed.
• Voting on Plan. Section 1126. o By class. o More than 1/2 in number of claims voting, and at least 2/3 in amount of claims voting.	• Voting Requirements. Article 84. o By class. o More than 1/2 in number of creditors present, and more than 2/3 in total amount of credits.
• Cramdown. Section 1129(b). o Unfair discrimination of similarly situated claims prohibited.	• Cramdown. Article 87. o Introduction of concept of unfair discrimination.
• Exclusive Time to File a Plan. Section 1121. o 120 days. o Can be extended to 18 months.	• Time to File a Plan. Article 79. o 6 months. o Can be extended for an additional 3 months upon "reasonable grounds."

Bankruptcy Cases

Baxter Dunaway

First Circuit

Is an oversecured creditor entitled to collect a bargained-for prepayment penalty from a solvent debtor, regardless of the penalty's reasonableness?

This bankruptcy dispute presents a question of first impression in the First Circuit concerning a commercial lender's right to receive a bargained-for prepayment penalty from a solvent debtor. Following other circuits, the First Circuit held that an oversecured creditor is entitled to collect a bargained-for prepayment penalty from a solvent debtor, regardless of the penalty's reasonableness. *Gencarelli v. UPS Capital Business Credit*, — F.3d —, 2007 WL 2446883, 48 Bankr.Ct.Dec. 210, Bankr. L. Rep. P 81,006 (1st Cir. 2007).

The debtors conceded liability for the loan balances (including accrued interest); those balances have been paid in full and are not at issue in this appeal. However, the debtors balked at paying the prepayment penalties. Debtor averred that, under the Code, an oversecured creditor is entitled to recover such costs only to the extent that they are "reasonable. 11 U.S.C.A. § 506(b). He posited that the prepayment penalties demanded by creditor were unreasonable because they bore no rational relationship to the added expense that prepayment might inflict on the lender. Accordingly, the claims should be disallowed. But creditor argued that "a finding that fees, costs, or charges are unreasonable under § 506(b) means only that they cannot be allowed as a secured claim, and instead must be treated as an unsecured claim. The Court agreed with the creditor.

According to the court, section 506(b)'s reasonableness standard is not relevant to the question of whether an oversecured creditor is entitled to collect a contractually-based prepayment penalty from a solvent debtor. It directs to section 502 of the Code and to a wealth of case law holding that if fees, costs, or other charges are deemed unreasonable, an oversecured creditor nonetheless may collect them as unsecured debt (subject to the provisions of section 502). Section 506 furnishes a series of rules for determining whether and to what extent a claim is secured (and, therefore, entitled to priority), it does not answer the materially different question of whether the claim itself should be allowed or disallowed. *See* 4 Lawrence P. King et al., *Collier on Bankruptcy* § 506.01, at 506-6 (15th ed.2007). Rather, the general rules that govern the allowance or disallowance of claims are set out in section 502. For the same understanding, see *Welzel v. Advocate Realty Inv., LLC (In re Welzel)*, 275 F.3d 1308, 1318 (11th Cir.2001) (en banc). The court added that once a claim for fees is found to be allowable under section 502, it then must be assessed for reasonableness under section 506 in order to determine its priority. 2007 WL 2446883 *4. To the extent that the contract between the parties calls for unreasonable fees, the fees should be bifurcated and the unreasonable portion should be treated as an unsecured claim.; *Jospeh F. Sanson Inv. Co. v. 268 Ltd. (In re 268 Ltd.)*, 789 F.2d 674, 678 (9th Cir.1986); *United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc'y (In re United Merchs. & Mfrs., Inc.)*, 674 F.2d 134, 138 (2d Cir.1982) (emphasizing, in dictum, that section 506 speaks only to whether costs can be treated as secured claims).

Research References:Bankruptcy Service, L. Ed. § 23:78; Norton Bankruptcy Law and Practice (2d ed.) § 43:3; Bankruptcy Law Manual 5d § 6:43; West's Key Number Digest, Bankruptcy 2853.20(3), 2853.20(5); 2007 No. 11 Bankruptcy Service Current Awareness Alert 3.

Ninth Circuit

To issue a preliminary injunction to stay proceedings between two nondebtor parties, must a bankruptcy court balance debtor's likelihood of success in reorganization against the relative hardship to the parties?

When, under 11 U.S.C. § 105(a) the section of the Bankruptcy Code authorizing the court to enter any order necessary or appropriate to carry out the provisions of title 11, a debtor applies for a preliminary injunction to stay a proceeding in which the debtor is not a party, the bankruptcy court must apply the usual preliminary injunction standard, balancing debtor's likelihood of success in reorganization against the relative hardship of the parties, as well as considering the public interest, if warranted. *In re Excel Innovations, Inc.*, -- F.3d —, 2007 WL 2555941 (C.A.9), 48 Bankr.Ct.Dec. 212, (9th Cir. 2007).

In the non-bankruptcy context, courts have consistently required trial courts deciding preliminary injunction motions to balance the moving party's likelihood of success on the merits and the relative hardship of the parties. The moving party must show: (1) a strong likelihood of success on the merits, (2) the possibility of irreparable injury to plaintiff if preliminary relief is not granted, (3) a balance of hardships favoring the plaintiff, and (4) advancement of the public interest (in certain cases). Alternatively, a court may grant the injunction if the plaintiff demonstrates *either* a combination of probable success on the merits and the possibility of irreparable injury *or* that serious questions are raised and the balance of hardships tips sharply in his favor. *In re Excel Innovations, Inc.*, — F.3d —, 2007 WL 2555941 *5.

The majority of circuits that have reviewed injunctions staying actions against non-debtors have applied the usual preliminary injunction standard. *Am. Imaging Servs. v. Eagle-Picher Indus., Inc.* (*In re Eagle-Picher Indus., Inc.*), 963 F.2d 855, 858 (6th Cir.1992); *Piccinin*, 788 F.2d at 1008 (4th Cir.1986); *Commonwealth Oil Ref. Co. v. EPA* (*In re Commonwealth Oil Ref. Co.*), 805 F.2d 1175, 1188-89 (5th Cir.1986). As the Fifth Circuit pointed out in *Commonwealth Oil*, the traditional approach is strongly supported by the legislative history of § 105(a). 805 F.2d at 1188-89. The relevant Senate report explained that § 105(a) grants bankruptcy courts "all the

Bankruptcy Cases, Continued on Page 28

LEADERSHIP. PROBLEM SOLVING. VALUE CREATION.

Alvarez & Marsal is the leading independent global professional services firm with regional offices in Hong Kong, Singapore and Shanghai. Our experienced professionals around the world excel at problem solving and value creation.

Serving investors from pre-acquisition to exit, our integrated diligence services combine operating experience with world-class finance, accounting and consulting expertise, paving the way to successful investments.

When the stakes are high, look to Alvarez & Marsal for insight, action and results. Find out more about our global reach and local approach.

Visit **alvarezandmarsal.com/asia**

WORLDWIDE PERFORMANCE IMPROVEMENT:

- Performance Improvement
- Turnaround and Restructuring
- Supply Chain Management
- Transaction Advisory
- Dispute Analysis & Forensics
- Business Intelligence

ALVAREZ & MARSAL

NORTH AMERICA • EUROPE • ASIA • LATIN AMERICA

© Copyright 2007 Alvarez & Marsal Holdings, LLC. All Rights Reserved.

Bankruptcy Cases *Continued from Page 26*

traditional injunctive powers of a court of equity. "S.REP. NO. 95-989, at 51 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5837. "Stays or injunctions issued under these other sections will not be automatic upon the commencement of the case, but will be granted or issued under *the usual rules for the issuance of injunctions.*" *Id.* (emphasis added). The Second, Third, and Eighth Circuits have similarly applied the traditional standard with respect to stays that are not automatic under § 362(a). *See NLRB v. Superior Forwarding, Inc.*, 762 F.2d 695, 699 n. 3 (8th Cir.1985) (staying NLRB regulatory proceeding against debtor); *Wedgewood Inv. Fund v. Wedgewood Realty Group, Ltd.* (*In re Wedgewood Realty Group, Ltd.*), 878 F.2d 693, 700-01 (3d Cir.1989) (reimposing automatic stay); *Manville Corp. v. Equity Sec. Holders Comm.* (*In re Johns-Manville Corp.*), 801 F.2d 60, 68-69 (2d Cir.1986) (reversing stay of shareholder action seeking to compel debtor to hold an annual meeting).

The Seventh Circuit, in contrast, has expressly held that the moving party need not show irreparable harm. *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir.1998); *In re L & S Indus., Inc.*, 989 F.2d 929, 932 (7th Cir.1993). The Seventh Circuit's approach rests upon the notion that "[w]hen the evidence shows that the defendants are engaged in ... the act or practices prohibited by a statute which provides for injunctive relief to prevent such violations, irreparable harm to the plaintiffs need not be shown." *In re Chicago, Milwaukee, St. Paul and Pac. R.R.*, 738 F.2d 209, 213 (7th Cir.1984).

Research References: Bankruptcy Service, L. Ed. §§ 12:714, 12:746 to 12:753, 12:754 to 12:756, 12:773 to 12:776; Norton Bankruptcy Law and Practice (2d ed.) §§ 4:4, 4:140, 36:4; Bankruptcy Law Manual 5d §§ 2:15, 5:3; West's Key Number Digest, Bankruptcy 2124 to 2126, 2394 to 2396, 2461to 2463; 2007 No. 11 Bankruptcy Service Current Awareness Alert 6.

Second Circuit

For purposes of application of 11 U.S.C.A. § 523(a)(4), is there a requirement of some showing of wrongful action?

As a matter of first impression, Second Circuit holds that defalcation for purposes of application of 11 U.S.C.A. § 523(a)(4) requires some showing of wrongful action. Under this discharge exception for defalcation while acting in fiduciary capacity, defalcation requires showing of conscious misbehavior or extreme recklessness, akin to showing required for scienter in securities law context. In re Hyman, 48 Bankr. Ct. Dec. (CRR) 211, 2007 WL 2492789 (2d Cir. 2007).

While the Code generally allows for the discharge of debts, significant exceptions exist. .Among them is § 523(a)(4) excepting from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."11 U.S.C. § 523(a)(4). This exception, like most, must be narrowly construed. *Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998) (observing that exceptions to discharge " 'should be confined to those plainly expressed' ").

There has been much debate among the circuits over whether a "defalcation" under § 523(a)(4) includes all misappropriations or failures to account or only those that evince some wrongful conduct *See* Zohlman v. Zoldan, 226 B.R. 767, 775 (S.D.N.Y.1998) (discussing the circuit split). In *Cent. Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 511-12 (2d Cir.1937), Judge Learned Hand wrestled with this problem without resolving it. The Fourth, Eighth, and Ninth Circuits hold that an innocent mistake can constitute a defalcation. *In re Uwimana*, 274 F.3d 806, 811 (4th Cir.2001) ("[N]egligence or even an innocent mistake which results in misappropriation or failure to account is sufficient."); *In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir.2001) ("Even innocent acts of failure to fully account for money received in trust will be held as non-dischargeable defalcations."); *In re Cochrane*, 124 F.3d 978, 984 (8th Cir.1997) ("Defalcation includes the innocent default of a fiduciary who fails to account fully for money received.").

The majority of the Circuits addressing this issue, however, require some level of wrongful conduct in order to find a defalcation under § 523(a)(4). The Fifth, Sixth, and Seventh Circuits require a level of fault greater than mere negligence. *In re Schwager*, 121 F.3d 177, 185 (5th Cir.1997) ("While defalcation may not require actual intent, it does require some level of mental culpability. It is clear in the Fifth Circuit that a 'willful neglect' of fiduciary duty constitutes a defalcation-essentially a recklessness standard."); *Meyer v. Rigdon*, 36 F.3d 1375, 1384-85 (7th Cir.1994) ("[A] mere negligent breach of a fiduciary duty is *not* a 'defalcation' under section 523(a)(11)."); *In re Johnson*, 691 F.2d 249, 257 (6th Cir.1982) (ruling that while "subjective intent to violate a known fiduciary duty or bad faith is irrelevant," the misuse of monies as the result of negligence or a mistake of fact does not constitute defalcation). The Tenth Circuit's standard is not entirely clear but at least requires "some portion of misconduct." *Compare In re Storie*, 216 B.R. 283, 288 (B.A.P. 10th Cir.1997) (announcing a standard requiring that includes "intentional, wilful, reckless or negligent" breaches of fiduciary duty), *with In re Millikan*, 188 Fed.Appx. 699, 702 (10th Cir.2006) (unpublished) (declining to identify a specific standard but requiring "some portion of misconduct" to prove defalcation). The First Circuit set the highest bar, requiring a showing of extreme recklessness, "akin to the level of recklessness required for scienter [in securities law]." *In re Baylis*, 313 F.3d 9, 20 (1st Cir.2002). In so ruling, the First Circuit interpreted "defalcation" as requiring a degree of fault, "closer to fraud, without the necessity of meeting a strict specific intent requirement. *Id.* at 18-19.

In light of this persistent confusion, the Second Circuit aligned itself with the First Circuit, WL 2492789 *6. *See Baylis*, 313 F.3d at 20, in holding that defalcation under § 523(a)(4) requires a showing of conscious misbehavior or extreme recklessness-a showing akin to the showing required for scienter in the securities law context. The Court believes that these concepts-well understood and commonly applied in the securities law context-strike the proper balance under § 523(a)(4).

Bankruptcy Cases, Continued on Page 30

This standard ensures that the term "defalcation" complements but does not dilute the other terms of the provision-"fraud," "embezzlement," and "larceny"-all of which require a showing of actual wrongful intent. See 4 Collier on Bankruptcy § 523.10(1)(a) (15th ed. rev.2007) (" 'Fraud' for purposes of this exception has generally been interpreted as involving intentional deceit, rather than implied or constructive fraud.").

Research References: Bankruptcy Service, L. Ed. §§ 27:1084, 27:1149, 27:2117, 27:2124, 27:2139, 27:2144, 27:2169, 27:2179, 27:2477; Norton Bankruptcy Law and Practice (2d ed.) § 47:21; Bankruptcy Law Manual 5d §§ 4:36, 4:53; West's Key Number Digest, Bankruptcy 3376 to 3376(5); 2007 No. 11 Bankruptcy Service Current Awareness Alert 5.

Eighth Circuit

Can a debtor in possession secretly bid on estate property at a profit to the debtor in possession?

The Eighth Circuit rules that debtor in possession may not bid on estate property, except in a manner consistent with its fiduciary duties of good faith, fair dealing, and loyalty. *In re Brook Valley VII, Joint Venture*, 496 F.3d 892, 48 Bankr.Ct.Dec. 166 (8th Cir. 2007).

For a debtor-in-possession, the "duty of loyalty" includes an obligation to refrain from self-dealing, to avoid conflicts of interests and the appearance of impropriety, to treat all parties to the case fairly, and to maximize the value of the estate. Chapter 7 trustee filed adversary complaint against debtors' principals, seeking to recover for alleged breaches of fiduciary duty by principals in connection with estate property that they sold while debtors were operating as Chapter 11 debtors-in-possession. The Court of Appeals found debtors' principals violated their fiduciary duties of loyalty while debtors were operating as Chapter 11 debtors-in-possession where, only 17 days after filing the bankruptcy petitions, principals consented to the foreclosure sale of debtors' real property, thus implicitly representing to the bankruptcy court that they believed foreclosure to be in the estates' interests. Then, instead of making efforts to obtain financing on behalf of debtors to salvage the property, they secretly purchased the properties for themselves, through another entity, at a price considerably less than the properties' appraised value, and when objection was raised, principals misled the court about their holdings in the entity that purchased the properties.

Debtors argued the trustee's adversary complaint constituted an impermissible collateral attack on the validity of the foreclosure sale, as would have fallen within scope of the Federal Rule of Civil Procedure governing relief from judgment. Under this Rule, once a sale of assets has been approved by a final order of the bankruptcy court, it is "a judgment that is good as against the world, not merely as against parties to the proceeding." *Regions Bank v. J.R. Oil Co., LLC*, 387 F.3d 721, 732 (8th Cir.2004). Under this standard, property rights acquired at a foreclosure sale cannot be challenged unless the procedural rules allow for a collateral attack. *See* Fed. R.Civ.P. 60(b); Fed. R. Bankr.P. 9024. Thus, if the trustee discovers that the order permitting a foreclosure sale has been obtained wrongfully, Rule 60(b) governs his ability to obtain relief from the otherwise final judgment.

The Court of Appeals held that Chapter 7 trustee's adversary proceeding against debtors' principals and entities controlled by them, by which he sought to recover for alleged breaches of fiduciary duty by principals in connection with estate property that they sold while debtors were operating as Chapter 11 debtors-in-possession, did not constitute an impermissible collateral attack on the validity of the foreclosure sale, as would have fallen within scope of the Federal Rule of Civil Procedure.. The trustee did not seek to abrogate the final sale but, rather, he sought a remedy for the alleged breaches of fiduciary duty, and the remedy presumed the continued validity of the foreclosure sale itself.

Research References: Bankr. Serv., L Ed §§ 37:79 to 37:81, 37:84, 37:125 to 37:129; Norton Bankr. L. & Prac. 2d §§ 27:2 to 27:4; Bankruptcy Law Manual 5d § 5:3; West's Key Number Digest, Bankruptcy 3067, 3067.1, 3072 to 3072(2), 3622; 2007 No. 11 Bankruptcy Service Current Awareness Alert 4.

Sixth Circuit

Does debtor's failure to appeal, or to obtain stay pending appeal of, order of bankruptcy court approving sale prevent debtor from later mounting collateral attack on this unappealed sales order?

Debtor's failure to appeal, or to obtain stay pending appeal of, order of bankruptcy court approving sale, to malpractice insurer, of debtor's legal malpractice against attorney that he had retained to file petition and to represent him in bankruptcy prevented debtor from later mounting collateral attack on this unappealed sales order. *In re Parker*, 499 F.3d 616, Bankr. L. Rep. P 81,003 (6h Cir. 2007). In other words, the debtor can not continue to pursue a malpractice claim which the bankruptcy had previously sold and the debtor did not appeal the order to sale or obtain a stay pending appeal.

This case involved a dispute between debtor and his bankruptcy counsel for malpractice in filing the bankruptcy case. Attorney that had been retained by Chapter 7 debtor to file petition and to represent debtor in bankruptcy case brought adversary proceeding to enjoin debtor from pursuing legal malpractice claims against him, after these claims were purchased in court-approved sale by his malpractice insurer. The United States Bankruptcy Court granted injunctive relief, and debtor appealed. The Court of Appeals affirmed the injunction against the debtor.

There is a split in the cases on the effect of a parties failure to appeal or obtain a stay pending appeal of a bankruptcy courts order of sale. Title 11 U.S.C. § 363(b) permits a bankruptcy trustee to "sell ... property of the estate" after notice and hearing. Once the bankruptcy court authorizes the sale of property under § 363, that same section limits appellate review:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity

> that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal. 11 U.S.C. § 363(m).

By its terms then, "[b]ankruptcy's mootness rule applies when an appellant has failed to obtain a stay from an order that permits a sale of a debtor's assets." *In re 255 Park Plaza Assocs. Ltd. P'ship*, 100 F.3d 1214, 1216 (6th Cir.1996) (internal quotation marks and citation omitted). 499 F.3d 616, 621. What is more, it "limits appellate review of a consummated sale ...*regardless of the merits of legal arguments raised against it*." *In re Made in Detroit, Inc.*, 414 F.3d 576, 581 (6th Cir.2005) (emphasis added). A majority of circuits construe § 363(m) as creating a *per se* rule automatically mooting appeals for failure to obtain a stay of the sale at issue. *See In the Matter of The Ginther Trusts*, 238 F.3d 686, 689 (5th Cir.2001); *United States v. Salerno*, 932 F.2d 117, 122-123 (2d Cir.1991); *In re Stadium Mgmt. Corp.*, 895 F.2d 845, 847 (1st Cir.1990); *Matter of Gilchrist*, 891 F.2d 559, 561 (5th Cir.1990); *In re The Charter Co.*, 829 F.2d 1054, 1056 (11th Cir.1987); *In re Sax*, 796 F.2d 994, 997 (7th Cir.1986); *In re Magwood*, 785 F.2d 1077, 1080 (D.C.Cir.1986).

The Third Circuit applies an alternative two part approach, finding an appeal moot under § 363(m) if the party failed to obtain a stay *and* reviewing courts cannot grant effective relief without impacting the validity of the sale. *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490, 499 (3d Cir.1998) (rejecting the *per se* rule); *see also Pittsburgh Food & Beverage, Inc. v. Ranallo*, 112 F.3d 645, 649 (3d Cir.1997) (declining to adopt either the *per se* rule or the two part approach). This court, the Sixth Circuit, has yet to decide whether to adopt the *per se* rule preferred by the majority of sister circuits. Because the result in the instant case will be the same under either formulation, the Court again declined to adopt one controlling approach. Under the majority's approach, debtor's failure to obtain a stay would doom the appeal; the result under the Third Circuit's two-part approach would be the same because debtor had failed to obtain a stay of the sale and no effective relief could be granted without impacting the validity of the sale.

Research References: Bankr. Serv., L Ed §§ 20:419 to 20:423; Norton Bankruptcy Law and Practice (2d ed.) §§ 37:27, 148:61; Bankruptcy Law Manual 5d §§ 5:48, 7:6; West's Key Number Digest, Bankruptcy 3079 to 3081, 3776.5(5); 2007 No. 11 Bankruptcy Service Current Awareness Alert 2.

Third Circuit

Under 11 U.S.C. § 365(f)(2)(b), does adequate assurance of future performance for assumption and assignment require assuring performance of an integral, if nonmonetary, term of a contract?

The Third Circuit clarifies that adequate assurance of future performance for assumption and assignment under 11 U.S.C.A.§ 365(f)(2)(B) includes assuring performance of an integral, if nonmonetary, term of a contract. *In re Fleming Companies, Inc.*, 499 F.3d 300, 48 Bankr.Ct.Dec. 188, Bankr. L. Rep. P 80,996 (3rd Cir. 2007).

The debtor, Fleming Companies, Inc. (Fleming), is a wholesale supplier of grocery products to supermarkets. Albertson's, a supermarket chain, operates retail grocery stores. In most cases, Albertson's stores are supplied by warehouse distribution

Greenberg Traurig – One Powerful Team

Our Business Reorganization and Bankruptcy Practice is one of the largest and most active in the United States. As part of an integrated international network of professionals who focus on all aspects of insolvency, our attorneys respond quickly to complex troubled situations arising anywhere and in any industry. Our understanding of different cultures and business practices is a critical aspect to the success of cross-border restructurings.

Greenberg Traurig

www.gtlaw.com

Mark D. Bloom
305.579.0537
bloomm@gtlaw.com

Keith J. Shapiro
312.456.8405
shapirok@gtlaw.com

ALBANY · AMSTERDAM · ATLANTA · BOCA RATON · BOSTON · CHICAGO · DALLAS · DELAWARE · DENVER · FORT LAUDERDALE · HOUSTON · LAS VEGAS · LOS ANGELES · MIAMI · NEW JERSEY · NEW YORK · ORANGE COUNTY · ORLANDO · PHILADELPHIA · PHOENIX · SACRAMENTO · SILICON VALLEY · TALLAHASSEE · TAMPA · TYSONS CORNER · WASHINGTON, D.C. · WEST PALM BEACH · ZURICH

The hiring of a lawyer is an important decision that should not be based solely upon advertisements. Before you decide, ask us to send you free written information about our qualifications and experience. Greenberg Traurig is a trademark and trade name of Greenberg Traurig, LLP and Greenberg Traurig, P.A. © 2007 Greenberg Traurig, LLP. Attorneys at Law. All rights reserved. †This number is subject to fluctuation.

centers that Albertson's owns and operates. Albertson's constructed a large distribution facility (the "Tulsa Facility") to supply its stores throughout the Midwest. After operating at only 60% capacity, however, Albertson's decided to sell the Tulsa Facility. In 2002, Fleming purchased the Tulsa Facility. In return, Fleming received the warehouse, the inventory in the warehouse, and Albertson's agreement to a long-term supply arrangement for its Oklahoma stores.

According to Albertson's, the Tulsa Facility was a key element in the bargain between Albertson's and Fleming. The Tulsa supply agreement emphasized the importance of a supply of products "from the Tulsa Facility" because the Tulsa Facility contained not only many of its former employees but also the infrastructure created by Albertson's. Fleming and Albertson's operated under the supply agreement for less than one year before Fleming filed for bankruptcy on April 1, 2003. Throughout that time, Fleming was unable to meet the required service levels. By August 2003, Albertson's stopped ordering grocery products from Fleming. Albertson's switched its source of supply for the Oklahoma market from the Tulsa Facility to its own warehouse in Fort Worth, Texas.

On August 15, 2003, the Bankruptcy Court entered an Order approving the sale of Fleming's assets indirectly to AWG. On August 23, 2003, Fleming closed the Tulsa Facility. On September 3, 2003, Fleming filed a motion to assume and assign the Alberton"s supply agreement to AWG pursuant to 11 U.S.C. § 365. AWG proposed to supply Albertson's Oklahoma stores from AWG's Oklahoma City distribution center. Albertson's opposed the motion for a variety of reasons, among them that AWG's electronic ordering, billing and inventory systems were not compatible with Albertson's and switching to AWG's system would have been costly and inefficient for Albertson's. According to Albertson's, AWG's deliberate decision *not* to acquire and retain the Tulsa Facility created a real and cognizable economic detriment that contravened the essence of the contract embodied in the term "supply ... from the Tulsa Facility."

The Bankruptcy Court conducted a hearing on the motion for assumption and assignment At the hearing, AWG's testified that it was capable of fully performing the supply agreement: Albertson's would be able to purchase its products from AWG at the same price and on the same terms that Albertson's expected to receive from Fleming, pursuant to the agreement, including freight charges.

The Court of Appeals held that assignment was not permitted, where material and significant term of agreement could not be performed by prospective assignee. Provision in executory supply agreement, stating that Chapter 11 debtor would supply wholesale groceries to non-debtor grocery retailer "from its Tulsa Facility" was "material and significant term" of the executory contract, and thus, debtor's rejection of the Tulsa Facility lease precluded adequate assurance of future performance by prospective assignee, as required for assignment of the contract. The non-debtor retailer not only bargained for timely delivery and agreed-upon prices, it also bargained for the benefits of expedience of a trained staff, and a proven electronic system of record-keeping, which were only available "from the Tulsa Facility."

Research References: Bankruptcy Service, L. Ed. §§ 21:518, 21:522, 21:523; Norton Bankruptcy Law and Practice (2d ed.) § 39:32; Bankruptcy Law Manual 5d §§ 8:40, 8:41, 8:43, 8:48, 13:28; West's Key Number Digest, Bankruptcy 3105, 3105.1, 3107, 3110, 3110.1, 3112, 3114; 2007 No. 10 Bankruptcy Service Current Awareness Alert 9. ■

Prof. Dunaway, Section Editor, is also Professor Emeritus at Pepperdine University, School of Law.

CDBV COURSE DATES

Register now for the following CDBV Courses:

Part 1

Malibu, CA: January 28-30, 2008

Miami, FL: April 7-9, 2008

Washington, DC: July 23-25, 2008

Malibu, CA: August 11-13, 2008

New York, NY: October 20-22, 2008

Dallas, TX : November 5-7, 2008

Part 2

Chicago, IL: March 3-6, 2008

Malibu, CA: May 12-15, 2008

New York, NY: September 15-18, 2008

Part 3

Chicago, IL: June 16-19, 2008

Malibu, CA: August 18-21, 2008

New York, NY: November 17-20, 2008

Visit www.airacira.org for complete course content and easy, online registration

and bankruptcy liquidation firms. This provision enhances the justice and professional level of bankruptcy procedure. For the time being, local bankruptcy administrator lists have been formed to handle bankruptcy cases; bankruptcy administrator has become a new profession.

The new Bankruptcy Law changes the running mechanism of China's bankruptcy system. In the past, the government played the central role in bankruptcy procedure. In the new Bankruptcy Law, the court shall play the central role in bankruptcy procedure and other processes. The law requires the court to use its discretionary power to control the complete bankruptcy procedure to secure a fair and transparent process, and at the same time, without damaging the efficiency of market economy. The new Bankruptcy Law brings great challenges to the courts and they are required to make psychological and professional preparations to meet the challenge. The court system and the judges are required to face the current situation and adapt to the new changes in trial system, professional accomplishment, and judicial integrity.

III. It Encourages Rehabilitating Enterprise by Reorganization

Reorganization is an important system adopted by the new Bankruptcy Law, providing for a court-controlled, enterprise rehabilitating procedure. There are large numbers of enterprises in China in need of enterprise restructuring to survive business distress. But due to the lack of legal rules in the old bankruptcy law, enterprises could not reorganize under a legal framework and out of court workouts also faced difficulties because of lack of legal foundation. The new Bankruptcy Law fills this gap with its reorganization system and also enables future reorganization in court and out of court workouts to be more standardized, transparent, and equitable. Among the 12 chapters of the new Bankruptcy Law, chapter 8 which covers "reorganization" is the longest chapter, accounting for one fifth of the whole law. The introduction of reorganization procedure makes the new Bankruptcy Law not just a law of market exit, a law of doom, or a law of cleaning out poor enterprises, but also a law of enterprise survival, revival, and turnaround. The key of bankruptcy law lies in reorganization. The aim of the new Bankruptcy Law is not to liquidate enterprise but to allow more enterprises on the verge of bankruptcy to turnaround.

The introduction of the reorganization system will facilitate the restructuring of listed corporations. Bankruptcy reorganization enjoys the following advantages: First, it is a court monitored restructure and enjoys mandatory effect. All other litigations shall stay upon the court's acceptance of the filing of reorganization. For instance, the debt to creditors may be suspended, and even the foreclosure by the secured creditors also stays. Second, it is more market driven. There are multiple players entitled to filing for reorganization. According to the new Bankruptcy Law, not only the debtor and the creditors are entitled to filing for reorganization, the equity holders may also file for reorganization under certain conditions. The new Bankruptcy Law introduces the DIP system, which generally allows the incumbent management to continue control of the business and may manage the business for half a year or longer, but they must propose a reorganization plan during this period. This plays a positive role in facilitating successful reorganization. Third, it provides multiple reorganization measures. The debtor may flexibly adopt the allowed measures to achieve its purpose of restoring business operation, liquidating debt, and rehabilitating by restructuring. The debtor may not only delay payment of debt or exempt or reduce the amount of debt, but also transfer its shares without consideration, reduce or increase registered capital, transform debt into equity, issue new shares or corporate bond to specific subject, transfer business or assets, etc. Besides, the rules of reorganization are also multiple and flexible. For instance, in case not all the classes unanimously pass the reorganization plan with legitimate majority vote, as long as there is one class passing the vote, the bankruptcy administrator, upon considering the specific situations of the enterprise, may decide to submit the reorganization plan to the court for a cram down. The cram down, however, must be subject to the conditions stipulated by article 87 to ensure that the vested interests of all the parties are not infringed.

Reorganization procedure adopted by the new Bankruptcy Law advocates for enterprise rehabilitation, and this comports with the ongoing industrial restructuring activities of some enterprises. Some state owned enterprises on the verge of bankruptcy expect outside strategic investors to solve their huge amount of debt through bankruptcy and restructuring procedure. The key of bankruptcy reorganization is not simply a transfer of assets, but the investment and development plan of the outside investors after they acquire the enterprise.

IV. It Protects the Creditors' Interests and Reduces the Transaction Costs of Bond Issuance

The new Bankruptcy Law benefits the protection of creditors' rights in the following aspects: First, the filing party of bankruptcy procedure includes both creditor and debtor. Once bankruptcy proceeding is initiated, the court shall not refuse to accept the case without justified reason. Second, concerning bankruptcy requirements, once the debtor enterprise fails to pay its debts as they come due or appear to be incapable of paying off its debts, the creditors may file for bankruptcy and take proper measures with the consent of the court. Third, it establishes a bankruptcy administrator system. Once the debtor gets into trouble the creditor may take over the enterprise in accordance with judicial arrangement. Fourth, it sets up a bankruptcy reorganization system. When the creditor believes the debtor enterprise still has a hope of survival it may require the debtor to make a plan of reorganization. A good reorganization procedure brings the creditor more collection value than liquidation does. Last, it sets up a creditors' committee and creditors' meeting system. Article 61 vests large power to creditors. Article 69 especially provides the creditors' committee may supervise the bankruptcy administrator on ten types of acts concerning dealing

with debtor's assets.

The new Bankruptcy Law also solves the dispute since 2004 concerning whether a secured claim or employee claim (wage claims and other material benefits claims) has priority in liquidation and establishes the principal of secured claim priority. This principle helps the enterprise to reduce the cost of bond issuance. According to the old enterprise bankruptcy law, the debtor should liquidate employee claims first and the deficiency should be collected from secured assets. This obviously endangers the interests of secured creditors. The new Bankruptcy Law follows ordinary international practice to establish the principle of paying off secured claims in priority to better secure the rights of bond investors, which reduces the demand by bond investors from bond issuers for a premium caused by potential risk of bond claim liquidation. However, the priority claims set up in the new Bankruptcy Law only refers to secured claims to the extent of the value of the collateral, and if the secured claims can not be fully covered by the collateral, the deficiency shall be considered as general claims. General claims are inferior to employee claims and other material benefits claims of employees in liquidation.

V. "Fake Bankruptcy, Real Debt Evasion" (Evasion of Debt under the Disguise of Bankruptcy) Shall be Prosecuted for Criminal Liability

It is not unusual that the enterprise goes bankrupt while the responsible persons slip away with money. A problem which has long been a legal gap and attracted close attention by practitioners in industry is how to avoid management benefiting from enterprise bankruptcy and further prevent state-owned assets from being appropriated by management.

In order to eradicate the "fake bankruptcy, real debt evasion" problem, the new Bankruptcy Law focuses on the provisions of stay of procedure and the withdrawal and a voidance of acts performed prior to bankruptcy. It also strengthens the monitoring of "fake bankruptcy, real debt evasion" as well as bankruptcy liability of management.

Article 31 provides that the bankruptcy administrator may request the court to withdraw the following acts related the debtor's assets performed within one year before the court accepts the bankruptcy filing: transferring assets without compensation, performing transaction with obviously unreasonable price, providing asset security for the unsecured debt, paying off undue debt, and renouncing claims. Article 33 provides that the acts related to the debtor's assets, such as concealing or transferring assets or fabricating debt or admitting false debt in order to evade debt, are void.

Article 6 explicitly provides: "The management of the bankrupt enterprise shall be investigated for legal responsibility in accordance with the law." Article 125 also stipulates that directors, supervisors or officers violating their fiduciary duties and causing the bankruptcy shall bear civil liability. In addition, the aforementioned persons are forbidden to act as directors, supervisors or officers in any enterprises within three years after the end of the bankruptcy proceeding.

Article 15 explicitly stipulates that from the date when the court's acceptance of the bankruptcy filing is served to the debtor to the date of the ending of the bankruptcy proceeding, the relevant persons in the debtor enterprise bear the following liabilities: to take good care of the assets, seals, accounts or documents under his possession and management, to work according to the requirements of the court and bankruptcy administrator and truthfully answer enquiries, to sit in the creditors' meeting and truthfully answer creditors' inquires; not to leave his domicile without the permission of the court, and not to get new positions in other enterprises as director, supervisor or officer.

VI. Some Defects in the System Design of the New Bankruptcy Law

There are still some defects in the system design of the new Bankruptcy Law. The defects in enterprise reorganization may affect strategic investors and financial investors.

The first deflect is about the aim of reorganization. It only stipulates rehabilitating reorganization without including liquidating reorganization. In international practice, the reorganization procedure consists of two types of procedures. The rehabilitating type of reorganization, if without success, may be transformed into the liquidation type of reorganization

The second defect lies in the threshold of filing for reorganization. Under the new Bankruptcy Law both debtor and creditor may file for reorganization and the provision is too broad and general. Creditors should be required to reach a certain proportion in number in order to be qualified to file reorganization and a hearing should be held to justify if the reorganization procedure is necessary. But the new Bankruptcy Law of China requires the court to make decision on whether to accept the case or not within fifteen days after receiving the application. The requirement is too high.

The third defect is the definition of debtor in possession. The debtor may manage the assets by itself (DIP), but the law does not specify whether it is operated by the board of directors or by the general shareholders meeting.

The fourth defect is that it does not make restrictions on the debtor's power during reorganization. Enterprises in reorganization are in an "unsound" state and the law should make certain restrictions on the DIP by making some prohibitive stipulations.

The last defect is that the law does not make stipulations about a creditors market and claims market. The old creditors are only passive parties in the reorganization process: we must allow active parties, that is new creditors, to enter the reorganization process in order to better promise success in reorganization. Thus there is need for markets such as a claims market where creditors may sell their claims at a discount. ■

The author is a professor from China University of Political Science and Law and a member of the drafting group for the new bankruptcy law

JOB POSTING

Forensic Accountant

Blum Shapiro, Connecticut's largest independent accounting & consulting firm is seeking an experienced Forensic Accountant for its Litigation Services & Business Valuation Group

Work and learn along with our experienced team of professionals. Assignments include fraud investigations, forensic accounting, bankruptcy and expert testimony.

The ideal candidate should have 3-6 years of combined general and forensic accounting experience. Tax experience helpful. CPA preferred.

Blum Shapiro offers a competitive salary along with a generous benefit package. E-mail your resumeand/or letter along with salary requirements in confidence to careers@blumshapiro.com or fax to 860-521-9241 or

Blum, Shapiro & Co., P.C.
Human Resources –PRF1
29 South Main Street, Box 272000
West Hartford, CT 06127-2000
EOE

ANNOUNCEMENT

KURTZMAN CARSON CONSULTANTS appoints financial professional Jon Orr as Chief Financial officer

EL SEGUNDO, August 27, 2007 – Kurtzman Carson Consultants (KCC), a provider of administrative-support solutions for the legal and financial industries, appointed Jon A. Orr as chief financial officer (CFO) to lead the company's financial operations. In this role, Mr. Orr oversees the firm's financial planning and analysis, in addition to the management of accounting, treasury and financial reporting functions for the company.

"Jon's high-level experience in corporate finance, complemented by his in-depth understanding of the restructuring and transactional issues facing our clients, makes him a natural fit as the CFO of KCC," said Eric Kurtzman, KCC's CEO and co-founder. "His financial expertise represents a strong addition to KCC's executive committee and we are delighted to have him join the team."

Prior to joining KCC, Mr. Orr served as managing director of FTI Consulting's Corporate Finance and Restructuring practice where he consulted with clients in numerous financial matters involving corporate finance, business restructuring, and transaction advisory issues. Previously, he worked for AlixPartners in its Business Turnaround Services practice and PricewaterhouseCoopers in its Business Restructuring Services and Tax practices.

Mr. Orr is a Certified Public Accountant (CPA) and Certified Insolvency and Restructuring Advisor (CIRA). He is a member of the Association of Insolvency and Restructuring Advisors (AIRA) and the Turnaround Management Association (TMA). He holds a Bachelor of Science in Business Administration degree in Finance and Accounting from Creighton University in Omaha, Neb.

NEW AIRA MEMBERS

Clifford Chen
AlixPartners, LLP

Michael Foreman
Dorsey & Whitney LLP

John Hall
Grassmueck Group

Abhisek Hazarika
Grant Thornton LLP

Jatin Karani
Grant Thornton LLP

Benjamin Mann
Grant Thornton LLP

Bojan Stoyanov
Huron Consulting Group

Beverly Tittle
Stout Risius Ross, Inc.

Alexander Grau
American Capital Strategies

Annette Jarvis
Ray Quinney & Nebeker

Peter Rubsam
Willamette Management Associates

Craig Russillo
Schwabe Williamson & Wyatt

Anuj Singhal
U of C

Stephen Spitzer
AlixPartners LLP

Elhajamin Young
Huron Consulting Group

Marta Alfonso
Rachlin Cohen and Holtz

David Bowles
TriArc Associates, Inc.

Brian Choe
Alvarez & Marsal

Mi-Goung Choi
Huron Consulting Group

Nathan Cook
AlixPartners, LLP

Anderson Price
AlixPartners, LLP

Robert Torti
AlixPartners

Tom Vukota
Manulife Capital

Steven Waterman
Ray Quinney & Nebeker

John Weitnauer
Alston & Bird LLP

Megan Dooley
FTI Consulting

Don Levy
Kroll Zolfo Cooper

Michael Borkowski
Kapila & Company

Alastair Marshall
PricewaterhouseCoopers

Noemie Alliel
Xroads

Rian Branning
FTI Consulting

Christopher Brokmeier
FTI Consulting

Annie Chan
Ernst & Young

Jeffrey Jones
Barrier Advisors

Andrew Koo
Ernst & Young

James Lupton

Sandi Magder

Lenka San-Roman

Michael Sauer
Compeer Partners

Matthew Siegel
Huron Consulting Group

Richard Van Es
Van Es Consulting LLC

Edmung Yeung
Deloitte Touche Tohmatsu

Loren Friedman
Curtis, Mallet-Prevost, Colt & Mosle LLP

John Weiss
Greenberg Traurig LLP

Asahi Choi
FTI Consulting

Tanner MacDiarmid
Alvarez & Marsal

Alan Scott
Almar Real Estate Group

Juan Anich
Allende & Brea

11 NEW CIRAS JOIN THE RANKS

Brian Ayash
Alvarez & Marsal LLC

Suruchi Banez
Kapila & Company

Brian Creek
FTI Consulting Inc

Ivo Hofstad
FTI Consulting Inc

Jeffrey Beunier
Turning Leaf Capital management, LLC

Megan Iacono
Deloitte Financial Advisory Services LLP

Mary McMickle
Kapila & Company

Gregory Richards
RSM McGladrey Inc

David Siegel
Berkowitz Dick Pollack & Brant CPAs

Mary Korycki
Alvarez & Marsal LLC

Matthew Winn
CQ Insullation

MEMBERS ON THE MOVE

The following members have recently changed firms, positions or addresses. Please update your contact lists.
If you would like to report a recent move, please go online to www.airacira.org

Nicole Horton
Macquarie
10100 Santa Monica Boulevard, Suite 1800
Los Angeles, CA 90067
Nicole.horton@macquarie.com

Teri Stratton
Macquarie
10100 Santa Monica Boulevard, Suite 1800
Los Angeles, CA 90067
Teri.stratton@macquarie.com

Martin Nachimson
Macquarie
10100 Santa Monica Boulevard, Suite 1800
Los Angeles, CA 90067
Martin.nachimson@macquarie.com

Mandy Townsend
Conway MacKenzie & Dunleavy
401 S. Old Woodward Avenue, Suite 340
Birmingham, MI 48009
mwt@c-m-d.com

Victor G. Caruso
Morgan Joseph & Co.
600 Fifth Avenue, 19th Floor
New York, NY 10020
vcaruso@morganjoseph.com

Steve Alexander
Adams Produce Company, Inc.
4145 Old Leeds Lane
Birmingham, AL 35213
Steve.alexander@adamsproduce.com

Robert Giambalvo
Giambalvo, Giammarese & Stalzer, CPAs, PC
One John Street, PO Box 885
Babylon, NY 11702
robg@ggscpas.com

William Hughes
XRoads Solutions Group, LLC
1821 East Dyer Road, Suite 225
Santa Ana, CA 92705
bhughes@xroadsllc.com

Ronald Quintero
R.G. Quintero & Co.
590 Madison Avenue, 21st Floor
New York, NY 10022
q@rgquintero.com

Christopher Alberta
Conway MacKenzie & Dunleavy
1270 Avenue of the Americas, 23rd Floor
New York, NY 10020
calberta@c-m-d.com

Jeffrey Beunier
Turning Leaf Capital Management, LLC
PO Box 61169
Denver, CO 80206
jbeunier@turningleafcap.com

CLUB 10

Firms with 10 or more professionals who have received their CIRA certification or have passed all three examinations:

Firm	Count
FTI Consulting Inc	**68**
Alvarez & Marsal LLC	**51**
AlixPartners, LLP	**43**
Kroll Zolfo Cooper LLC	**37**
Deloitte.	**32**
Mesirow Financial Consulting LLC	**27**
Grant Thornton LLP	**23**
Huron Consulting Group LLC	**19**
Navigant Capital Advisors LLC	**18**
Capstone Advisory Group LLC	**16**
KPMG LLP	**16**
LECG LLC	**16**
PricewaterhouseCoopers LLP	**15**
BDO Seidman LLP	**13**
Protiviti Inc	**12**
J H Cohn LLP	**11**

Association of Insolvency & Restructuring Advisors

221 Stewart Avenue, Suite 207
Medford, OR 97501
Phone: 541-858-1665
Fax: 541-858-9187
aira@airacira.org
www.airacira.org

Presorted
First-Class Mail
U.S. Postage
PAID
Jefferson City, MO
Permit No. 266

AIRA Officers and Board of Directors

PRESIDENT: ALAN HOLTZ, CIRA
AlixPartners, LLP
PRESIDENT ELECT : GRANT STEIN, ESQ.
Alston + Bird LLP
CHAIRMAN: SONEET KAPILA, CIRA
Kapila & Company
VICE PRESIDENT, INTERNATIONAL: STEPHEN DARR, CIRA, CDBV
Mesirow Financial Consulting LLC
VICE PRESIDENT CIRA/CDBV: ANTHONY SASSO, CIRA
Deloitte Financial Advisory Services LLP
VICE PRESIDENT OF DEVELOPMENT: FRANK CONRAD, CIRA
Weiser LLP
VICE PRESIDENT OF MEMBERSHIP: GINA GUTZEIT, CIRA
FTI Consulting, Inc./Palladium Partners
SECRETARY: PHILIP J. GUND, CIRA
Marotta Gund Budd & Dzera, LLC
TREASURER: MATTHEW SCHWARTZ, CIRA
Bederson & Company LLP

DANIEL E. ARMEL, CIRA
ROBERT BINGHAM, CIRA
Kroll Zolfo Cooper LLC
ERIC DANNER, CIRA
CRG Partners Group LLC
JAMES DECKER, CIRA
Alvarez and Marsal Corporate Finance
MITCHELL E. DRUCKER
Garrison Investment Group
HOWARD M. FIELSTEIN, CIRA, CDBV
Margolin Winer & Evens, LLP
MICHAEL GOLDSTEIN, ESQ.
Stutman, Treister & Glatt, PC
GREGORY HAYS, CIRA
Hays Financial Consulting, LLC
MARGARET A. HUNTER, CIRA
THOMAS P. JEREMIASSEN, CIRA
LECG, Inc.
BERNARD A. KATZ, CIRA
J. H. Cohn, LLP
FARLEY LEE, CIRA, CPA
Deloitte Financial Advisor Services LLP
H. KENNETH LEFOLDT, JR., CIRA
Lefoldt & Company
WILLIAM K. LENHART, CIRA
BDO Seidman LLP
JAMES M. LUKENDA, CIRA
Huron Consulting Group LLP
KENNETH J. MALEK, CIRA
Grant Thornton LLP
J. ROBERT MEDLIN, CIRA
FTI Consulting, Inc.
PAUL D. MOORE, ESQ.
Duane Morris LLP
THOMAS A. MORROW, CIRA
AlixPartners, LLC
DAVID R. PAYNE, CIRA, CDBV
D. R. Payne & Associates, Inc.
THEODORE PHELPS, CIRA, CDBV
Phelps Consulting Group
MARC ROSENBERG, ESQ.
Kaye Scholer LLP
DURC SAVINI
Miller Buckfire & Co.
ANDREW SILFEN, ESQ.
Arent Fox PLLC
PETER STENGER, CIRA
Grant Thornton
MICHAEL E. STRANEVA, CIRA
Ernst & Young, LLP
JOEL A. WAITE, ESQ.
Young Conaway Stargatt & Taylor, LLP
SPECIAL COUNSEL:
KEITH J. SHAPIRO, ESQ.
Greenberg Traurig, LLP

EXECUTIVE DIRECTOR:
GRANT W. NEWTON, CIRA