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BANKRUPTCY UPDATE

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NEW CREDITORS' COMMITTEE INFORMATION ACCESS DUTIES UNDER BANKRUPTCY AMENDMENTS ADDRESSED IN *REFCO*

In a matter of first impression, the court in the *Refco* Chapter 11 cases (*In re Refco Inc., et al.*, Case No. 05-60006-RDD (Bankr. S.D.N.Y.) [1] has addressed the new information-sharing obligations of a statutory creditors' committee under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Recently enacted Bankruptcy Code section 1102(b)(3) requires creditors' committees to (i) provide access to information to non-committee members with claims of a type similar to those represented by such committee, (ii) solicit and receive comments from non-committee members, and (iii) be subject to court order compelling additional reports or disclosure to be made to such non-committee members. Since this Code section became effective, on October 17, 2005, questions have arisen as to how to reconcile the committee's fiduciary duties with its newly stated information-sharing obligations.

Shortly after its appointment, the *Refco* creditors' committee sought an order clarifying its duties under section 1102(b)(3), specifying that it was not required, at first instance, to divulge any (i) confidential, proprietary or nonpublic information concerning the debtors, or (ii) any other information if the effect of such disclosure would constitute a waiver of the attorney-client privilege or other privilege of the committee. The court entered an interim order pending a final hearing. An *ad hoc* committee of the debtors' senior noteholders filed an objection, the focus of which was to force the committee to disclose confidential information to parties that were prepared to agree to confidentiality constraints.

1 Akin Gump represents the co-chair of the Official Committee of Unsecured Creditors of Refco Inc., et al.

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With additional input from the debtors and the U.S. Trustee, the objection of the *ad hoc* noteholder committee was resolved in the form of a revised order entered by the Court on December 23, 2005 ("Information Access Order"). Notable aspects of the Information Access Order are as follows:

- Relieves the creditors' committee, without further order of the court, from any obligation to divulge information (i) that could reasonably be determined to be confidential, nonpublic or proprietary, (ii) the disclosure of which could reasonably be determined to result in a general waiver of the attorney-client or other applicable privilege, or (iii) whose disclosure could reasonably be determined to violate an agreement, order or law, including securities laws.
- Establishes detailed procedures and qualitative criteria for responding to creditor information requests. The creditors' committee is required to comply with the information request, or explain why the request is being denied, within 10 days of receipt of any request. If the request is denied because the request implicates protected information or is unduly burdensome, the requesting creditor may, after a good-faith effort to resolve the dispute, seek to compel disclosure for cause.
- Requires the creditors' committee to consider, when evaluating information requests, whether (i) the requesting creditor is willing to agree to reasonable confidentiality and trading restrictions with respect to the requested confidential information, and represents that such trading restrictions and any information-screening process employed by the requesting creditor complies with applicable securities laws, and (ii) under the particular facts, such agreement and any information-sharing process that it implements will reasonably protect the confidentiality of such information.
- Requires the creditors' committee to establish and maintain a Web site providing creditors with, among other things, (i) general information about the Chapter 11 cases, (ii) monthly committee-written reports summarizing recent events, proceedings and public financial information, (iii) a calendar with upcoming significant events in the cases, (iv) a nonpublic registration form for creditors to request "real-time" case updates via electronic mail, (v) a nonpublic form to submit creditor questions, comments and requests for information, (vi) responses to creditor questions, comments and requests for information, (vii) answers to frequently asked questions, and (viii) access to the claims docket.
- Relieves the debtors, creditors' committee and any of their respective officers, directors, employees, advisors, attorneys, members and agents (acting in such capacity) from liability for any act or omission in connection with the preparation, dissemination or implementation of the creditor information protocol, the creditors' committee Web site and other information to be provided pursuant to section 1102(b)(3) except where the act or omission is determined to constitute a breach of fiduciary duty, gross negligence or willful misconduct.

Bankruptcy Judge Robert D. Drain issued an opinion on January 20, 2006, explaining the legal underpinnings of the Information Access Order. While neither the Code nor the legislative history provides much guidance for construing a creditors' committee's obligation to provide "access to information," legal and practical considerations guided the court's analysis – which begins with section 704(7) of the Code. That section requires Chapter 7 and Chapter 11 trustees to furnish information requested by a party in interest, unless otherwise ordered by the court. The court determined that existing

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section 704(7) was roughly analogous to new section 1102(b)(3). Case law construing section 704(7) makes clear that while a trustee's duty to comply with information requests is construed broadly, it is not without limitation. Trustees may obtain protective orders to prevent waiver of attorney-client privilege, or to prevent disclosure of confidential or proprietary information. More importantly, the court noted that the limitations on a trustee's disclosure obligations derived from the trustee's fiduciary duties to the estate and creditors. The court found further support in case law predating the Code, noting that no creditors' committee has ever been required to "forward all of the raw data it receives and considers in the process of carrying out its duties."

Practical considerations stemming from a broad construction of section 1102(b)(3) were also considered. Taking note of the myriad functions a creditors' committee may serve in a Chapter 11 case, the court was troubled that unlimited disclosure obligations would hinder the committee's ability to effectively carry out these functions, including, without limitation, the committee's oversight and plan negotiation function, as well as the creditors' committee's ability to pursue actions on behalf of the bankruptcy estate. Also of concern to the court was the potential for "mischief" that might arise by requiring the unfettered release of protected information to parties engaged in distressed debt trading.

Giving effect to the information-access duties imposed by section 1102(b)(3) required the court to engage in a careful balancing act. On one hand, the court noted that it must be sensitive to the creditors' committee's need to preserve access to sensitive confidential information, to preserve the attorney-client privilege and to comply with securities laws. On the other hand, the court explained that unsecured creditors have the right to be informed of material developments in a case before they are presented with what, in practical terms, may be a *fait accompli*. The court believed that the Information Access Order appropriately balanced these tensions.

The Information Access Order is important because it represents one of the first attempts by a bankruptcy court to construe the information access duties imposed by new Code section 1102(b)(3), and likely will serve as a template for orders in future complex Chapter 11 cases. While many questions remain unresolved, the *Refco* Information Access Order and accompanying opinion demonstrate that bankruptcy courts likely will construe the information-access duties narrowly to limit the disclosure of information that is privileged, proprietary or confidential. That said, creditors who desire confidential nonpublic information and are willing to become restricted now have a statutory basis to seek to compel a creditors' committee to provide such information to them, under appropriate circumstances, whereas in the past, such creditors could only lobby the creditors' committee for *ex officio* status.

Order Regarding Creditor Access to Information Pursuant to 11 U.S.C. section 105(a), 1102(b)(3), and 1103(c), Case No. 05-60006-RDD (Bankr. S.D.N.Y.) [Doc. No. 888] entered December 23, 2005.

To view, please visit www.akingump.com/docs/pdf/FRN_200602_5.pdf.

Memorandum of Decision on Official Committee's Motion for Order Regarding Access to Information Under 11 U.S.C. section 1102(b)(3)(A), Case No. 05-60006-RDD (Bankr. S.D.N.Y.) [Doc. No. 1025], entered January 20, 2006.

To view, please visit www.akingump.com/docs/pdf/FRN_200602_6.pdf.

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CHAPTER 11 "TRADING ORDERS": REGULATING POSTPETITION TRANSFERS OF DEBT AND EQUITY SECURITIES AND CLAIMS

The recent increase in second lien and mezzanine financing as popular options, and the continued growth of the secondary market in debt and equity securities, has had an impact upon the reorganization process, and has served to focus attention upon postpetition trading in claims and interests. In response, two very different types of "trading orders" have become commonplace in larger Chapter 11 cases. So-called "screening orders" address the trading of the debtor's debt or equity securities by members of official creditors' committees. Their purpose is to foster compliance with securities laws by establishing parameters within which committee members may continue to trade in the debtor's securities consistent with their fiduciary duties on the committee, thereby facilitating the committee members' ability to continue to trade while serving on a committee. Other "trading orders," also known as "NOL Orders," limit the transfer of claims against the estate and are intended to protect valuable net operating losses ("NOL") and other tax attributes, pursuant to section 382(l)(5) of the Internal Revenue Code (the "L5 Exception"), as important assets of the debtor's estates. NOL trading orders seek to avoid a change of control of the debtor caused by unchecked trading in the debtor's equity and debt.

NOL TRADING ORDERS

NOL trading orders have become ubiquitous in bankruptcies of corporations with significant tax attributes.[2] Currently, there are two general types of NOL trading orders: (1) the traditional order, which limits certain trading as of the date the order is entered by the bankruptcy court in the beginning of the case (the "Traditional Order"); and (2) the newer type of order, which has developed over the past two years and does not restrict trading at the outset of the bankruptcy case but may require certain holders that do trade during the course of the debtor's bankruptcy to "sell-down" at the end of the case (the "Sell-Down Order").

2 NOL trading orders, for example, either have been entered or are pending in the bankruptcy cases of UAL Corp.; Northwest Airlines Corp.; Delphi Corp.; WorldCom, Inc.; Loral Space & Communications, Ltd.; and Mirant Corp.

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TRADITIONAL TRADING ORDERS

Generally, Traditional Orders restrict the acquisition of claims by "Substantial Claimholders" or acquisitions of claims that would result in a holder becoming a "Substantial Claimholder." A person is a Substantial Claimholder if the debtor believes such holder will receive five percent or more of the stock of the reorganized debtor on the effective date (the "Threshold Amount"). The Traditional Order:

(a) requires Substantial Claimholders to identify themselves to the debtor and report any intent to acquire additional claims and sets a Threshold Amount which limits the amount of claims that can be acquired by Substantial Claimholders ("Claims Transactions"), and

(b) requires an approval period for Claims Transactions, typically 10 to 15 days, during which the debtor may object to the transaction (the transaction would be delayed pending the resolution of an objection).

Traditional Orders often provide exceptions to the claims trading restrictions:

(a) Substantial Claimholders may sell to any transferee that (i) is not a Substantial Claimholder and (ii) will not become a Substantial Claimholder as a result of the transfer

(b) Substantial Claimholders may sell to a transferee that is a Substantial Claimholder, but immediately prior to such transfer such transferee only holds claims that either (i) it acquired 18 months prior to the debtors' petition date, or (ii) are "ordinary course" claims (e.g., trade debt) continuously held by such transferee, and

(c) Substantial Claimholders may acquire claims as a result of a foreclosure or other involuntary transfer from an equity participant or from a lessor in a leveraged lease transaction.

The most significant benefit of the Traditional Order is that it avoids the potential requirement for a sell-down at the end of the bankruptcy case. The most significant drawback is that it restricts trading throughout the course of the bankruptcy case.

SELL-DOWN ORDERS

Towards the end of the debtor's bankruptcy case, the parties will determine whether the L5 Exception is beneficial, and if so, the Threshold Amount will be calculated. Those claimholders that exceed the Threshold Amount may be required to "sell-down" below the Threshold Amount ("Sell-Down Order") in order to permit the debtor to preserve the L5 Exception. Under Sell-Down Orders, claimholders may trade based on their own assessment of the risk of a subsequent sell-down requirement (e.g., a trader may believe (or be willing to risk) that the debtor (i) will engage in a merger transaction that will render the L5 Exception worthless, (ii) never qualified for the L5 Exception as of the petition date, or (iii) will benefit more by electing out of the L5 Exception). Sell-Down Orders typically do not require a claimholder to sell-down below the amount held by it on the date the trading order is entered.

The most significant benefit of the Sell-Down Order is that it allows for unfettered trading during the course of the bankruptcy case. The most significant drawback is that it may require a sell-down during a limited time period at the end of the case (such sell-down procedure is, as of the date of this article, untested).

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THE PARTICIPATION RESTRICTION

The NOL Trading Orders recently entered in the *Delphi Corporation, et al.* and *Delta Airlines Inc., et al.* cases, pending in the Bankruptcy Court for the Southern District of New York, include sell down mechanisms, but also include similar "Participation Restrictions." A Participation Restriction generally provides that any entity participating in formulating a debtor's plan of reorganization shall not, and shall not be asked to, disclose (or otherwise make evident) to the debtor that any claims beneficially held by such entity against the debtors were acquired by the entity within 18 months of the commencement of the debtor's bankruptcy case ("Newly Traded Claims"). Participation Restrictions generally provide that certain activities do not, in and of themselves, violate the restriction, such as membership on a creditors' committee or voting to accept or reject a proposed plan (the "Participation Restriction"). Applicable Treasury regulations proscribe treating a claimholder's debt as "qualified indebtedness" if such holder violates the activities subject to the Participation Restriction, and therefore Participation Restrictions are put in place in order to better ensure qualification for the L5 Exception.

To view the Delphi Trading Order, please visit www.akingump.com/docs/pdf/FRN_200602_2.pdf.

SCREENING WALL ORDERS

Screening Wall Orders, by contrast, address the trading in the debtor's securities by members of an official creditors' committee. As committee members, these creditors often have access to nonpublic information. Access to such information implicates securities law concerns, just as knowledge of securities trades may affect issues under consideration by a committee.

In response, Screening Wall Orders typically provide that members of official creditors' committees, acting in any capacity and who are engaged in the trading of securities for others or for their own accounts as a regular part of their business, may continue to trade in the debtor's securities if they comply with certain procedures. Committee members will not violate their fiduciary duties as committee members by trading in a debtor's securities during the pendency of the debtor's bankruptcy cases, if they establish, effectively implement and adhere to certain information-blocking policies and -procedures to isolate its trading activities from its activities as a member of an official creditors' committee. Such procedures prevent the committee member's trading personnel from using or misusing nonpublic information obtained by the committee member's personnel engaged in committee-related activities and precludes such committee-side personnel from receiving inappropriate information regarding trading in the debtor's securities by the committee member's trading-side personnel in advance of such trades.

Screening Wall Orders have been helpful in reconciling a committee member's fiduciary duties to the creditors of a debtor's estate and its fiduciary duties to maximize returns to their respective clients through trading securities.

To view the Delta Screening Wall Order, please visit www.akingump.com/docs/pdf/FRN_200602_1.pdf.

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SUPREME COURT RULES THAT SOVEREIGN IMMUNITY DEFENSE CANNOT BE ASSERTED BY STATES IN FEDERAL BANKRUPTCY PROCEEDINGS

The U.S. Supreme Court, in *Central Virginia Community College et al. v. Katz,* 546 U.S. ____ (2006), 2006 WL 151985, held in a 5-to-4 decision that a liquidating trustee's proceeding to recover preferential transfers made by a debtor to state agencies is not barred by the doctrine of sovereign immunity. The significance of the *Katz* decision resides in its broader holding – that states have no sovereign immunity in federal bankruptcy proceedings.

The extent of states' sovereign immunity in federal bankruptcy proceedings became a pressing issue following the Supreme Court's ruling in *Seminole Tribe v. Florida*, 517 U.S. 544 (1996), in which the Court held that Congress' Article I powers could not be used to abrogate states' immunity from suits in federal court. Because the Constitution's Bankruptcy Clause is an Article I power, a widely held belief post-*Seminole* was that states' sovereign immunity remained viable in bankruptcy cases and proceedings. Following *Seminole Tribe*, a majority of federal courts of appeals ruled that Congress' enactment of section 106 of the Code (which subjects states to suit in bankruptcy cases and proceedings) was unconstitutional.

Two years ago, however, the Supreme Court, in *Hood v. Tennessee Student Assistance Corp. (In re Hood),* 541 U.S. 440 (2004), held that sovereign immunity cannot be raised by a state as a defense to a proceeding initiated by a debtor to determine the dischargeability of student loan debt. The narrow ruling relied upon the Supreme Court's determination that a suit to determine the dischargeability of student loan debt is not a "suit against the State" for purposes of the Eleventh Amendment's embodiment of states' constitutional sovereign immunity from suit. Unaddressed by *Hood* was whether a sovereign immunity defense was barred where the trustee actually sued to recover avoidable transfers from a state or state agency. More importantly, *Hood* did not resolve the uncertainty post-*Seminole Tribe* concerning whether a bankruptcy exception to states' sovereign immunity existed.

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Katz is significant because it confirms that a bankruptcy exception to state sovereign immunity does indeed exist notwithstanding *Seminole Tribe*. The Supreme Court's holding is premised on the view that states gave up their immunity to suit in federal bankruptcy cases and proceedings arising under the Constitution's Bankruptcy Clause at the "plan of the [Constitutional] Convention." Through the act of ratifying the Constitution, the Supreme Court explains that states acquiesced in a subordination of whatever sovereign immunity they might otherwise have asserted in bankruptcy proceedings. Examining the history surrounding the adoption of the Constitution's Bankruptcy Clause, the breadth of *in rem* bankruptcy jurisdiction at the time of adoption, and legislation both proposed and enacted under its auspices immediately following ratification of the Constitution, the Supreme Court concludes that states agreed in the plan of the Constitutional Convention not to assert sovereign immunity defenses they might otherwise have had in proceedings brought pursuant to the Constitution's Bankruptcy Clause.

Katz may not be the final say on the efficacy of state sovereign immunity in the bankruptcy arena. Justice Thomas, in a dissent joined by Chief Justice Roberts and Justices Scalia and Kennedy, criticized the majority opinion contending that nothing in the text, structure or history of the Constitution indicates that the Bankruptcy Clause, in contrast to other Article I powers, was intended to abrogate states' sovereign immunity. The dissent further criticized the majority opinion for neither overruling nor applying the analytical framework of *Seminole Tribe*. Justice O'Connor's replacement will have the ability to tip the scale on this issue should the Supreme Court decide to revisit it in the future. Stay tuned.

To view the *Katz* Opinion, please visit www.akingump.com/docs/pdf/FRN_200602_7.pdf.

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POSTPETITION LENDERS CAN DIRECT AND LIMIT THE DEBTOR'S USE OF DIP LOAN PROCEEDS

In a recent decision, the 9th Circuit considered the extent to which a postpetition lender may control the use of funds loaned to a debtor. In the decision, *In re Cooper Commons LLC,* 430 F.3d 1215 (9th Cir., December 7, 2005, No. 03-56818)[3], the 9th Circuit held that a lender may specify that its postpetition loans can be used only for certain purposes that may exclude payment to the debtor's counsel.

Cooper Commons, LLC ("Cooper Commons" or the "Debtor"), a real estate developer, filed a voluntary Chapter 11 petition, during the construction and sale of a 62-unit condominium development in West Hollywood, California. Its principal creditor, Comerica Bank ("Comerica"), held a senior security interest

3 Petition for certiorari filed (December 5, 2005 (No. 05-768)).

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in the development. Cooper Commons acted as debtor-in-possession for nine months, until the appointment of a Chapter 11 trustee (the "Trustee"). During this period, the debtor negotiated three agreements with Comerica for continued financing necessary to the completion of the condominiums. These agreements included provisions for payment of specified amounts to the debtor's professionals.

After his appointment, the Chapter 11 Trustee filed a motion asking the bankruptcy court to approve additional financing from Comerica consisting of roughly $4.25 million to finish construction on the condominiums, plus an additional $888,469 to pay for the services of the Trustee and the Trustee's professionals. Neither the motion nor the loan agreement provided for payment to debtor's counsel. At the hearing on the motion, the debtor objected to the failure to provide for payment to debtor's counsel.

In approving the proposed financing, the bankruptcy judge found that "the postpetition financing has been negotiated in good faith and at arms'-length . . . . Any credit extended . . . shall be deemed to have been extended . . . in good faith . . . ." The bankruptcy judge also found that the proposed financing arrangement was fair and reasonable; that the bankruptcy estate's value increased because of it but would decrease without it; and that it left none of the bankruptcy estate's creditors worse off than they otherwise would have been.

On appeal, debtor's counsel argued that the financing arrangement violated Code section 507(a)(1) of the Bankruptcy Code because the financing agreement did not provide for the equal priority of administrative claimants. The 9th Circuit rejected this argument, noting that any provisions of the financing agreement that Comerica might have bargained for or that helped motivate its extension of credit were protected by Code section 364(e), which provides:

> The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, of a grant under this section of a priority or a lien, *does not affect the validity of any debt so incurred,* or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien were stayed pending appeal.

The court reasoned that Comerica's motive in lending money was to ensure the completion of the condominiums, and that payments to professionals whose services were no longer required would not likely help that objective. The court concluded that the financing agreement cannot be undone, the $888,469 cannot be ordered redistributed and the loan amount cannot be adjusted upward.

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Finally, the court, in discussing whether Comerica acted in good faith with respect to the financing, deferred to the bankruptcy court's finding that Comerica acted in good faith for the purposes of Code section 364(e).

This case demonstrates that a lender's best opportunity to control the use to which its funds may be put is at the time of entry into the postpetition loan. If the limitations relate to the lender's incentive to loan, and the court enters a finding of good faith, Code section 364(e) should protect the loan and permit its enforcement according to its terms.

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ASSUMPTION OF "CRITICAL VENDOR" CONTRACTS: GRANTING DEBTORS FLEXIBILITY IN NEGOTIATING WITH SUPPLIERS

The Delphi Corporation Chapter 11 case recently provided some insight into a unique issue regarding the relationship between debtors and suppliers of critical goods. Although some courts have authorized debtors to make postpetition payments of prepetition claims of so-called "critical vendors," other courts have ruled such payments to violate the priority scheme set forth in the Bankruptcy Code. *See, e.g., Capital Factors, Inc. v. Kmart Corp. (In re Kmart), 291 B.R. 818 (S.D.N.Y. 2003).* In a motion filed in the Bankruptcy Court for the Southern District of New York, Delphi Corporation (*In re Delphi Corp., et al.,* Case No. 05-44481-RDD)[4], the nation's largest auto-parts supplier, sought to utilize the provisions of Bankruptcy Code section 365 as a way to avoid confronting this issue.

In its Motion, Delphi requested that the court approve procedures by which Delphi could assume certain agreements with suppliers as "executory contracts." These supply contracts provided the sole source of goods essential to Delphi's business. In its court papers, Delphi asserted that the purpose of the motion was to enable Delphi to ensure continuity of supply to avoid imminent shutdown of business operations. Ordinarily, executory contracts must be assumed in whole cloth and prepetition claims must be cured by payment in full of all past-due amounts, including prepetition claims. Delphi's proposed procedures, however, provided for modification of the contracts to terms more favorable to Delphi, and cure by payment of only a portion of the amount due the vendor.

Though couched as a motion to establish procedures to assume executory contracts under Bankruptcy Code section 365, the creditors' committee argued that the motion, in reality, was a disguised "critical vendors" motion, under which Delphi sought authority to pay prepetition claims of certain vendors in

4 Akin Gump represents suppliers and reclamation claimants in the Delphi Chapter 11 case.

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exchange for continued supplies of critical parts. For that reason, the creditors' committee, at first, objected to the motion.

Although vendors stood to benefit from the assumption of their contracts and payment of at least a portion of their prepetition claims, the motion initially caused an uproar from the suppliers and other interested parties, because the motion was ambiguous as to whether Delphi would need consent from a supplier in order to assume the modified version of their contract and pay only a portion of the arrearage. Under the provisions of section 365 of the Bankruptcy Code, an executory contract cannot be rejected in part and assumed in part. Assumption of a contract carries with it all of the burdens as well as all of the benefits of the contract. *In re City Stores Company,* 21 Bankr. 809 (Bankr. S.D.N.Y. 1982); *In re Yonkers Hamilton Sanitorium Inc.,* 22 Bankr. 427 (Bankr. S.D. N.Y. 1982). Furthermore, a debtor does not have the right to extend or vary terms of an assumed executory contract, and a court has no authority to vary terms of a contract assumed under provisions of the law. *In re Rigg,* 198 B.R. 681 (Bankr. N.D. Tex. 1996); *In re Mellen,* 79 Bankr. 385, 387 (Bankr. N.D. Ill. 1987).

Moreover, Courts consistently have held that they are prohibited from forcing a party to enter into a contract or to modify the terms of an existing contract. No power exists in the courts to make contracts for parties. They must make their own contracts. The courts reach their limit of power when they enforce contracts that parties have made. *In re Buffalo & E. R. Co.,* 250 N.Y. 275, 165 N.E. 291 (1929); *see also Hendershott v. Dale Leonard Prospecting Co.,* 298 Mich. 367, 373 (1941) (Courts cannot make contract different from the agreement entered into by the parties). Moreover, the liberty to contract is no right at all if it is not accompanied by freedom not to contract. *Joseph Martin, Jr. Delicatessen, Inc. v. Schumacher,* 52 N.Y.2d 105, 417 N.E.2d 541 (1981); *see also Evans v. Norris,* 6 Mich. 369, 372 (1859) (freedom of contract entails that courts enforce only obligations assented to by the parties).

Accordingly, Delphi appeared to be requesting an extraordinary remedy that would significantly alter the landscape for contractual relationships with debtors. As a result, several parties in interest filed objections to the motion that specifically addressed the issue of whether Delphi could assume contracts which it had unilaterally modified prior to assumption.

Negotiations ensued among lawyers for Delphi, the creditors' committee, counsel representing its suppliers and a bank group. Ultimately, the motion and accompanying order were clarified to make plain that contracts which were modified could only be assumed with consent of the supplier and the debtor. The creditors' committee and the bank group retained a right of oversight pursuant to an objection procedure that permitted them to monitor the implementation of the order.

Bankruptcy Judge Robert Drain approved the motion, stating that, "[t]his is extraordinary relief [but I am] satisfied that this is a critical time in Delphi's business, with the expiration of numerous contracts." Judge Drain also said that he viewed Delphi's requested relief as giving it flexibility to negotiate new contracts and that he had to assume that suppliers will know what they are doing if they agree to contract extensions.

Thus, while it remains an issue whether the Bankruptcy Code permits payment of prepetition claims to "critical vendors" outside of a plan of reorganization, by treating the vendors' supply contracts as

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"executory contracts," Code section 365 provided Delphi with a means to accomplish much the same end.

To view the Delphi Corp. Order Approving Procedures to Assume Certain Amended and Restated Sole Source Supplier Agreements, please visit www.akingump.com/docs/pdf/FRN_200602_3.pdf.

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MODIFICATION TO EMPLOYEE BENEFITS: A COMMON THEME IN RECENT CHAPTER 11 CASES

Escalating costs attributable to employee pension plans and employee benefits have been identified as an instigating factor in numerous high-profile Chapter 11 cases – *In re Delta Air Lines, Inc., In re Northwest Airlines Corp., In re UAL Corp., In re Delphi Corp.* and *In re Anchor Glass Container Corp.,* to name a few. Modifications to employee benefits are at the heart of the debate in several of these cases. A recent amendment to the Bankruptcy Code calls into question whether prepetition modifications to retiree benefits are without limitation.

Section 1114 of the Bankruptcy Code prevents a Chapter 11 debtor from unilaterally modifying or terminating certain retiree benefits, such as health insurance, during the pendency of the bankruptcy case unless an authorized representative (typically an official retiree Committee) is appointed and agrees to the modification, or the bankruptcy court authorizes the modification. An increasing number of debtors have argued, however, that section 1114 does not apply to benefits afforded to employees under prepetition plans, which, by their terms, are subject to amendment. The argument is that the debtor does not have to comply with the standards set forth in section 1114 where it expressly reserved the right under a pre-bankruptcy benefit plan to unilaterally terminate or modify benefits under such plan. The vast majority of courts that addressed this issue prior to the effective date of the Bankruptcy Abuse and Prevention Act of 2005 (the "Bankruptcy Amendments") agreed that section 1114 was not applicable, and thus did not prevent a debtor from modifying or terminating benefits, prepetition or postpetition, where the debtor has reserved the right to do so. *In re Chateaugay Corp.,* 945 F.2d 1205, 1207 (2d Cir. 1991); *In re Doskocil Companies, Inc.,* 130 B.R. 870 (Bankr. D. Kans. 1991). As noted by one court, "[Had] Congress intended to override property rights arising under the state law, [the statute] would have been written to expressly achieve that result." *In re Jones & Lamson Machine Co.,* 102 B.R. 12, 16 (Bankr. D. Conn. 1989); *but see In re Farmland Industries, Inc.,* 294 B.R. 903, 917 (Bankr. W.D. Mo. 2003).

As part of the Bankruptcy Amendments, Congress amended section 1114 to include a provision that on its face purports to limit a debtor's ability to modify retiree benefits on the eve of bankruptcy. New Bankruptcy Code section 1114(*l*) provides that if the debtor, while insolvent, modifies retiree benefits within 180 days prior to the filing of the petition, the Bankruptcy Court will reinstate such benefits, unless the court finds that the balance of the equities clearly favors the modification. 11 U.S.C. section 1114(*l*). How this provision will generally be interpreted in circumstances where the debtor was simply exercising its contractual rights to terminate benefits is largely unknown. This issue, however, was recently addressed in the Chapter 11 case of Anchor Glass Container Corporation ("Anchor Glass"), pending in the Bankruptcy Court for the Middle District of Florida (Tampa) (*In re Anchor Glass Container Corp.,* Case No. 8:05-bk-15606-ALP)[5].

Anchor Glass, a leading manufacturer of glass containers and specialty glass products, filed for Chapter 11 protection on August 8, 2005. Prior to the filing, on July 20, 2005, Anchor Glass notified certain retired employees who were participants under the company's comprehensive medical and dental plan

5 Akin Gump currently represents an ad hoc committee of Anchor's senior secured noteholders.

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(the "Plan") that the company intended to exercise its contractual right to modify the Plan, effective October 1, 2005, such that if the participants sought continued coverage they would be required to pay all premiums required by the provider. Anchor Glass commenced its bankruptcy case before the Plan modification was to become effective. Following the bankruptcy filing, certain of the participants (the "Movants") affected by the modification moved the bankruptcy court for the appointment of a committee of retired employees ("Retiree Committee") pursuant to new Code section 1114(*l*). The Movants argued that because the modification to the Plan was to occur postpetition, section 1114 applied and a Retiree Committee must be appointed to protect the interests of all affected Plan participants. The Movants also suggested that section 1114(*l*) required the reinstatement of the modified benefits.

The court denied the Movants' request, finding that the modification actually took place prepetition, as of the effective date of the letter, and that by its plain language, section 1114 was not applicable to a prepetition modification of retiree benefits. In addressing section 1114(*l*), the court noted that this section on its face does not preclude a debtor from taking unilateral action, but rather requires a litigation by a "party in interest" directed at a consideration of the balance of the equities before benefits are reinstated. The court went on to say that section 1114(*l*) does not require, nor does it contemplate, the appointment of a Retiree Committee.

This is an important ruling because it recognizes that section 1114(*l*) is not intended to flatly usurp a company's contractual right to modify a benefits plan prepetition, and it limits the application of 1114(*l*) to only those circumstances where the balance of the equities clearly favor the reinstatement. Thus, it is likely that retiree benefits will remain a target for cost-cutting measures, notwithstanding the revisions to Bankruptcy Code section 1114.

To view the Anchor Glass Order on Motion to Appoint a Committee to Represent Retired Employees, please visit www.akingump.com/docs/pdf/FRN_200602_4.pdf.

For further information on the *Anchor Glass* bankruptcy case, please contact:

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LEASE REJECTION CLAIMS NOT ALWAYS LIMITED BY THE CODE SECTION 502(B)(6) CAP

Ordinarily, a landlord's claim for damages arising from the rejection of a nonresidential real property lease is capped, under Code section 502(b)(6), at the rent reserved by the lease for the greater of one year or 15 percent not to exceed three years of the remaining term of the lease. But what if the landlord seeks compensation from a non-debtor obligor on the lease, or seeks payment from a source other than the debtor? The 5th Circuit Court of Appeals recently decided that the cap on a landlord's damages for rejection of a lease only applies if the landlord files a proof of claim for its lease rejection damages. If, instead, the landlord simply draws on the letter of credit serving as security for the lease, the limitation set forth in 11 U.S.C. section 502(b)(6) will not apply.

In *EOP – Colonnade of Dallas, L.P. v. Faulkner as Trustee of the SBTI Liquidating Trust (In re Stonebridge Technologies, Inc.),* 430 F.3d 260 (5th Cir. 2005), the 5th Circuit stated that this result is required by the plain meaning of section 502(b)(6) and because of the established precedent in the 5th Circuit that letters of credit and the proceeds therefrom are not property of the debtor's bankruptcy estate. By its terms, section 502(b)(6) only applies to claims filed under section 501 of the Bankruptcy Code. Accordingly, if a landlord does not file a proof of claim, the limitation of section 502(b)(6) is not triggered. Furthermore, though the letter of credit was originally pledged by the debtor-lessee, the letter of credit exists outside of the debtor's estate because it is a separate contract between the issuer and the beneficiary.

Accordingly, landlords who are concerned about a prospective tenant's financial circumstances would be well-served by demanding an irrevocable letter of credit as part of the security deposit for real property leases, and seeking recovery under that letter of credit, rather than from the debtor, once a bankruptcy case is filed.

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IN THE NEWS

Akin Gump represented the creditors' committees in four of the 20 largest restructurings of the year, tying the firm in first place with Otterbourg, Steindler, Houston and Rosen.
(*The Deal's Bankruptcy Insider*, February 6, 2006)

In a ranking of the 12 largest bankruptcy cases filed in 2005, Akin Gump represents four creditors' committees and three major creditors. (*Turnarounds and Workouts*, January 15, 2006)

Peter Gurfein and Patrick Ivie co-authored "The Third Circuit Agrees – Substantive Consolidation Is An Extraordinary Remedy" *Daily Bankruptcy Review*, September 28 , 2005.

Mickey Sheinfeld has written a chapter titled "Guiding Directors in Corporate Solvency and Insolvency" in a four-volume work titled "*The Accountable Corporation.*" (Part IV of Volume 1)

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