Pratt's

Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT™ JULY/AUGUST 2014

EDITOR'S NOTE: BUSY BOARDS AND BANKRUPTCY
Steven A. Meyerowitz

BOARD BUSYNESS AND THE RISK OF CORPORATE BANKRUPTCY
Olubunmi Faleye, Harlan Platt, and Marjorie Platt

SECOND CIRCUIT CLARIFIES CHAPTER 15 ELIGIBILITY REQUIREMENTS: *DRAWBRIDGE SPECIAL OPPORTUNITIES FUND LP V. BARNET (IN RE BARNET)*
Scott C. Shelley

PUSHING THE BORDERS OF CHAPTER 15: WHEN A FOREIGN REPRESENTATIVE "FLOUTS" THE PURPOSES OF CROSS-BORDER INSOLVENCY IN THE UNITED STATES
Dennis L. Jenkins and Benjamin Schak

FIRST CIRCUIT ADOPTS FLEXIBLE APPROACH TO DETERMINE AMOUNT OF POST-PETITION INTEREST TO BE PAID TO OVERSECURED CREDITOR
Andrew Kamensky and David E. Bane

DISTRESSED INVESTING—A TRADE IS A TRADE, BUT A FUND MAY NOT BE AN ELIGIBLE ASSIGNEE
Larry G. Halperin, Joon P. Hong, and Andrew Wool

DISTRICT COURT ADOPTS SUBJECTIVE GOOD FAITH DEFENSE FOR FRAUDULENT TRANSFER CLAIMS IN SIPA CASE
Michael L. Cook, Harry S. Davis, and Michael Court

TURNING PAPER INTO CASH: POST-JUDGMENT COLLECTION METHODS
Michael T. Benz and Mark A. Silverman

IN RE PIAZZA (11TH CIRCUIT): BAD FAITH CONSTITUTES "CAUSE" FOR DISMISSAL UNDER SECTION 707(A)
Ryan D. Thompson

SEVENTH CIRCUIT CONFIRMS THE INDEPENDENCE OF THE "SETTLEMENT PAYMENT" AND "SECURITIES CONTRACT" SAFE HARBORS OF 11 U.S.C. § 546(e)
Jason W. Harbour and Shannon E. Daily

FRENCH BANKRUPTCY LAW BECOMES MORE CREDITOR FRIENDLY
Pierre Clermontel, Antoine d'Ornano, Peter Hockless, Pierre Maugüé, Philippe Tengelmann, and My Chi To

RECENT CHALLENGES TO CREDIT BIDDING—A NEW TREND?
Michael Friedman, Larry G. Halperin, and Simone Tatsch

DEBTOR'S ESTATE EXPANDED WITH SUPREME COURT RULING IN *CLARK V. RAMEKER*
Marc P. Solomon and Hanna Lahr

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Kent K. B. Hanson, J.D. at .... 1-800-424-0651 ext. 3207
Email: .... kent.hanson@lexisnexis.com
For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . (518) 487-3000
Fax Number . . . . (518) 487-3584
Customer Service Web site . . . . http://www.lexisnexis.com/custserv/
For information on other Matthew Bender publications, please call

Your account manager or . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . (518) 487-3000

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] (LexisNexis A.S. Pratt);
Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (LexisNexis A.S. Pratt)

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. A.S. Pratt is a trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2014 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt™ Publication

Editorial Offices
121 Chanlon Rd., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

(2014–Pub.4789)

Editor-in-Chief & Board of Editors

EDITOR-IN-CHIEF
Steven A. Meyerowitz
President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena
Bilzin Sumberg Baena Price & Axelrod LLP

Leslie A. Berkoff
Moritt Hock & Hamroff LLP

Ted A. Berkowitz
Farrell Fritz, P.C.

Michael L. Bernstein
Arnold & Porter LLP

Andrew P. Brozman
Clifford Chance US LLP

Kevin H. Buraks
Portnoff Law Associates, Ltd.

Peter S. Clark II
Reed Smith LLP

Thomas W. Coffey
Tucker Ellis & West LLP

Michael L. Cook
Schulte Roth & Zabel LLP

Mark G. Douglas
Jones Day

Timothy P. Duggan
Stark & Stark

Gregg M. Ficks
Coblentz, Patch, Duffy & Bass LLP

Mark J. Friedman
DLA Piper

Robin E. Keller
Lovells

Matthew W. Levin
Alston & Bird LLP

Patrick E. Mears
Barnes & Thornburg LLP

Alec P. Ostrow
Stevens & Lee P.C.

Deryck A. Palmer
Pillsbury Winthrop Shaw Pittman LLP

N. Theodore Zink, Jr.
Chadbourne & Parke LLP

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company., Inc. Copyright 2014 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. All rights reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For permission to photocopy or use material electronically from *Pratt's Journal of Bankruptcy Law*, please access www.copyright.com or contact the Copyright Clearance Center, Inc. (CCC), 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400. CCC is a not-for-profit organization that provides licenses and registration for a variety of users. For subscription information and customer service, call 1-800-833-9844. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974.

Distressed Investing—A Trade Is a Trade, But a Fund May Not Be an Eligible Assignee

Larry G. Halperin, Joon P. Hong, and Andrew Wool*

There are two recent rulings related to the trading of distressed debt: the first confirms that a "trade is a trade" and the second puts in doubt the common belief that funds are financial institutions for the purposes of the "Eligible Assignee" definition in credit agreements.

A TRADE IS A TRADE

Under New York law, the general rule is that when two parties agree on the material terms of a transaction, subject only to the agreement and execution of definitive documentation, the parties have an enforceable contract and have a duty to negotiate definitive documentation in good faith. Applying the general rule to a standard distressed debt trade, when the parties say "done" on the phone, having agreed on the price, the quantity and the debt to be sold/purchased, the parties have an enforceable trade.

In *Stonehill Capital Management LLC v. Bank of the West*,[1] a New York trial court held that parties entered into an enforceable contract to buy and sell a collection of loans notwithstanding the absence of a final executed sale agreement. The buyer, Stonehill Capital Management LLC and its affiliated funds ("Stonehill"), was deemed the winning bidder at an auction for certain loans held for sale by Bank of the West (the "Bank") at a purchase price below par. Before executing a final sale agreement, the Bank learned that Stonehill was providing financing to the underlying borrower, the proceeds of which would be used to pay off the loans at par plus accrued interest. Accordingly, the Bank stood to realize a greater recovery if it kept the loans on its books than it would if it sold the loans to Stonehill. The Bank argued that no binding sale agreement existed because the acceptance of Stonehill's bid was expressly "[s]ubject to the mutual execution of an acceptable Loan Sale Agreement" and the parties failed to execute such definitive documentation.[2]

The court held that the material terms of the sale were established once the Bank accepted Stonehill's bid, thus creating an enforceable contract. The court explained that under New York law, agreeing "subject to" definitive documentation does not preclude the finding of an enforceable contract if the transaction's material terms are

---

* Larry Halperin is a partner in the Banking Group and Litigation, Bankruptcy and Restructuring Group of Chapman and Cutler LLP and co-office leader of the firm's New York office. Joon P. Hong is a partner in the firm's Banking Group and Litigation, Bankruptcy and Restructuring Group. Andrew Wool is an associate in the firm's Litigation, Bankruptcy and Restructuring Group. The authors can be reached at halperin@chapman.com, joonhong@chapman.com, and wool@chapman.com, respectively.

[1] 2014 NY Slip Op 30751(U) (N.Y. Sup. Ct. Mar. 24, 2014).

[2] *Id.*

otherwise reasonably certain.[3] In addition, the court found that the Bank did not fulfill its obligations to negotiate definitive documentation in good faith. As a result, the court ruled that the Bank breached its agreement to sell the loans to Stonehill.

The court's holding in *Stonehill* reaffirms the common market principle that "a trade is a trade." That is, so long as the material terms of a trade are established (*e.g.*, price, quantity, description of debt), orally or otherwise, the parties have entered into an enforceable contract.

BUT A FUND MAY NOT BE AN ELIGIBLE ASSIGNEE

Hedge funds have been active participants in the secondary loan trading market for a long time, and although there have been isolated attempts by some borrowers to try to limit activist funds from buying their debt, funds have generally not had much difficulty purchasing loans in the secondary market and becoming lenders by assignment.

But in *Meridian Sunrise Village, LLC v. NB Distressed Debt Investment Fund Ltd.*,[4] the U.S. District Court for the Western District of Washington went against market expectations and upheld a bankruptcy court's ruling that hedge funds were not eligible purchasers of the debtor's loans because the funds were not "financial institutions."

Meridian had entered into a loan agreement with U.S. Bank to borrow funds for the construction of a shopping center. The loan agreement limited the sale of the loans only to "Eligible Assignees," which was defined to mean "any commercial bank, insurance company, financial institution or institutional lender" approved by the agent and, unless an event of default had occurred, the borrower. Soon after funding the loan, U.S. Bank assigned portions of the loans to other commercial bank lenders, including Bank of America.

Following an event of default, U.S. Bank requested that Meridian waive the Eligible Assignee limitations so as to facilitate sales of the loans by the lenders. Meridian, however, declined to waive the limitations. U.S. Bank then informed Meridian that it would begin charging the default rate of interest if Meridian did not agree to eliminate the Eligible Assignee restrictions, which in turn prompted Meridian to file for protection under Chapter 11 of the Bankruptcy Code. During the pendency of the bankruptcy proceeding, Bank of America sold its interest in the loans to a hedge fund, which then further assigned portions of its interests to two affiliated funds (collectively, the "Funds"). The Funds opposed confirmation of

[3] *Id.* ("A loan 'subject to a mutually acceptable' agreement does not necessarily condition assent on the execution of a definitive agreement as long as '[t]he agreement [is] reasonably certain as to material terms.'" (quoting *Emigrant Bank v UBS Real Estate Secs., Inc.*, 49 A.D.3d 382, 383–84 (N.Y. App. Div. 2008))). The *Emigrant Bank* court distinguished "subject to" language from unequivocal reservations of assent which make it clear that parties do not intend to be bound until execution of definitive documentation.

[4] No. 13-5503, 2014 U.S. Dist. LEXIS 30833 (W.D. Wash. Mar. 7, 2014).

Meridian's proposed plan of reorganization.

Meridian objected to the transfer of the loans to the Funds and sought to enjoin the Funds from exercising their rights as Eligible Assignees, including the right to vote on the proposed plan. The bankruptcy court granted the injunction and subsequently confirmed the plan without taking into account the vote of the Funds. The Funds appealed both the injunction and the confirmation of the plan.

On appeal, the Funds argued that the term "financial institutions" should be interpreted broadly, based upon definitions found in common and legal dictionaries, to include any entity that handles the investment of funds. The district court, however, stated that the loan agreement's limitations on assignments would have no limiting effect at all if lenders were free to assign the loans to "virtually any entity that had some remote connection to the management of money-up to and including a pawnbroker."[5] In addition, the district court determined that when the term "financial institution" was read in the context of the other phrases in the "Eligible Assignee" definition in the loan agreement (*i.e.*, "commercial bank," "insurance company" and "institutional lender"), it could only mean entities that made loans; otherwise, the surrounding phrases and the term "financial institution" itself would all become nonsensical.[6]

Finally, the district court looked at U.S. Bank's previously unsuccessful attempts to eliminate the restrictions regarding who could be an Eligible Assignee as further evidence that the parties intended "financial institutions" to exclude entities like the Funds. The district court went on to conclude that even if the Funds had been permitted to vote on the plan, their vote would not have changed the outcome because they would effectively have had only one vote (not the three that the Funds asserted), because they had artificially increased their voting power by splitting their claims among affiliate funds.

As funds have come to play a larger role in the primary and secondary loan markets, concerns that may have initially existed regarding their status as eligible assignees have largely fallen away. There has also been a move away from listing various types of entities as "Eligible Assignees," and many credit agreements now permit borrowers (absent an event of default) to consent to assignments on an case by case basis, which consent cannot be unreasonably withheld. This is the approach taken by the LSTA under the terms of its Model Credit Agreement.

CONCLUSION

The ruling in *Meridian Sunrise*, although it is fact specific and resulted from the application of Washington law, reminds us again that normal expectations and standard practices are often challenged in bankruptcy proceedings and that courts of equity may sometimes upend market expectations and conventions. The case

[5] *Id.* at *10.

[6] *Id.* at *11.