NORTH DAKOTA BANKERS ASSOCIATION

LEGAL UPDATE

A newsletter covering bank legal and compliance information.

Volume 21 • Issue 4

April 15, 2021

GENERAL BANKING LITIGATION

Bank That Mistakenly Wired $900 Million of its Own Funds Not Entitled to Recover the Money [SD NY]

On August 11, 2020, Citibank mistakenly wired $900 million to participants in a loan on which it served as administrative agent. Instead of just sending the participants the periodic interest payment that was due, it accidentally paid off the entire loan to the penny. After it realized its mistake, it sought to recover the erroneous payment. While some of the participants returned the money, others refused to, perhaps, in part, because the debtor was not perceived to be a strong credit risk at the time. When a number of the participants refused to return the money, Citibank sued for the funds, claiming wrongful conversion and unjust enrichment.

In IN RE CITIBANK AUGUST 11, 2020 WIRE TRANSFERS, 2020 U.S. Dist. LEXIS 216009 (Feb. 16, 2021), the district court for the Southern District of New York decided, applying New York law, that Citibank was not entitled to recover the money even though sending the money to the participants had obviously been an error. The court first considered whether it had jurisdiction over the matter and concluded that, while it did not have the diversity jurisdiction that Citibank had pled, it had federal subject matter jurisdiction under the Edge Act because the case before it was a civil suit, Citibank is a federally chartered bank, and claims asserted in the suit arise out of international banking because, among other things, some of the transfers went to foreign bank accounts. Ultimately, the Court held that the money did not have to be returned, even though the transfers were erroneous, because the defendants had established the "discharge for value" defense that is available under New York law. The Restatement of Restitution and Unjust Enrichment explains that "[T]he discharge for value rule . . . allows a creditor to escape restitution where he has mistakenly received finds that discharged a debtor owed to him so long as he was unaware of the transferor's error." It cuts off "what would otherwise be a valid restitution claims" including "one based on mistake . . ." The three requirements of the defense are that (1) the payment discharges a valid debt; (2) the recipient made no misrepresentations to cause the erroneous payment; and (3) the recipient had no notice of the error at the time of the payment. The court noted that even though constructive notice of the error of the payment would be sufficient to allow Citibank to recover the money, here the circumstances with the borrower, Revlon, were such that a lender could believe it had decided to pay off the loan. Finally, the court noted that the issue was a difficult one and, but for controlling authority from the New York State Court of Appeals (the highest court in that state) and the adoption of that authority by the Second Circuit Court of Appeals, the matter could have been resolved differently. *[Faculty Editor & Editorial Board]*

Investment Firm Could Rely on Facially Valid Power of Attorney to Process Large Withdrawals From Investment Account [17TH CIR]

After plaintiff became seriously ill with pancreatic cancer, he granted his brother a power of attorney. The brother subsequently took a power of attorney to the plaintiff's investment firm, and over a period of time, withdrew large amounts of money from the sickly brother's account. After the plaintiff realized the brother had withdrawn over $300,000 and was feeling better, the plaintiff sued investment firm for negligence, and the investment firm moved for summary judgment. After the action was dismissed, the plaintiff appealed.

In CALVEY v. STIFEL, NICOLAUS & CO., No. 20-3243, 2021U.S. App. LEXIS 7703 (6th Cir. Mar. 9, 2021) (unpublished opinion), the Seventh Circuit Court of Appeals held that, under Ohio law, an investment firm could rely on a facially valid power of attorney. Here, although the firm did

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

owe the client a duty of care, the firm had no duty to check the withdrawals with the client. Moreover, the firm could not be liable for conversion. Indeed, the circuit court noted, the plaintiff never suggested he had not initially signed a power of attorney. Accordingly, the circuit court upheld the grant of summary judgment. *[Faculty Editor & Editorial Board]*

SECURITY INTERESTS

First Priority Awarded to the First Creditor That Perfected Its Security Interest Unless Another Creditor Had A Perfected Purchase Money Security Interest [WD KY]

Two debtors operated a farm and received funding through various lending institutions. The first lender filed a financing statement in 2013 and a second financing statement in 2016. The first lender claimed "all farm and business machinery, equipment and tools" as collateral. The second lender filed a financing statement in 2017 which claimed all "farm equipment" as collateral. A third lender in 2018 filed a financing statement claiming "all farm business machinery, equipment and tools" as collateral. Additionally, the debtors received funding from four other lenders, each claiming as collateral various pieces of farm equipment. Two of these four lenders never perfected the loan by filing a financing statement. The situation was complicated because the debtors claimed to have transferred the collateral from themselves personally to a general partnership in which they were the only two partners. Moreover, some of the equipment was subject to perfected purchase money security interests

In NUTRIEN AG SOLS., INC. v. DUVALL (IN RE DUVALL), Nos. 19- 11272(1)(12), 20-1012, 2021 WL 399910, 2021 Bankr. LEXIS 21 (Bankr. W.D. Ky. Jan. 7, 2021) the court held that the first lender who attached and perfected his security interest had priority over the other lenders. The second lender had the next priority over other lenders, and this priority carried down throughout the remaining lenders in order of perfection, with one exception: the lenders that had perfected purchase money security interests in equipment had priority over lenders without purchase money security interests under UCC § 324 as adopted in Kentucky.

The court considered it to be irrelevant that the debtors had contended they transferred the property from themselves to the general partnership for multiple reasons. First, the debtors had not proved that the transfers occurred. Second, even if the transfers had occurred, the secured parties had not released their security interests on the property and therefore the property continued to be subject to those security interests. *[By Grant Coffey grant.coffey@ttu.edu]*

What a Difference a Border Makes: Oklahoma Oil Producers Win in Priority Dispute and Texas Oil Producers Lose in Same Chapter 11 [5TH CIR]

This case was a priority dispute in certain oil and its proceeds between a bank and producers that were located in Oklahoma and Texas. A Delaware entity was a debtor in a Chapter 11 case pending in San Antonio, Texas and had purchased oil from producers prepetition. A bank had a security interest in that oil and its proceeds and had perfected its security interest by filing a financing statement with the secretary of state of Delaware.

The Texas producers claimed their purchase money security interests primed the security interests of the bank because of a non-uniform Texas statute, Texas Uniform Commercial Code (U.C.C.) § 9.343, which on its face gives oil and gas interest holders a superior interest over previously perfected security interests when the oil has been transferred to a "first purchaser," such as the debtor in this case.

The Oklahoma oil producers also claimed that they had priority over the bank because a provision of Oklahoma real estate law provides that producers had a purchase money security interest in oil or its proceeds for which they had not been paid prime competing interests.

In DEUTSCHE BANK TR. CO. AMS. v. U.S. ENERGY DEV. CORP. (IN RE FIRST RIVER ENERGY, L.L.C.), 986 F.3d 914 (5th Cir. 2021) the Fifth Circuit Court of Appeals looked closely at the various statutes to determine if the laws of Delaware, Texas or Oklahoma would apply. The circuit court began its analysis by noting that it had not yet determined the appropriate choice of law test to apply in bankruptcy cases. It therefore looked to the Restatement (Second) of Conflict of Laws. Considering the Restatement, the circuit court concluded that when it applied an "Erie" test, looking to the choice of law of the forum, or a federal choice of law, Delaware law controlled. Accordingly, the Texas producers' security interests were subordinate to the security interests of the bank and the Oklahoma security interests had priority over the Bank's security interests.

The circuit court noted that Delaware law requires that creditors file financing statements with state offices in order to perfect a security interest. The bank had done so and had

remained perfected since 2015. Delaware law provides that the location of the debtor determines perfection and priority of non-possessory security interests as does the U.C.C. of Texas. The Debtor, which was formed under Delaware law, was located in Delaware for U.C.C. choice of law purposes.

The resolution of the issue also was grounded in the statutes in Texas and Oklahoma. The Texas statute was incorporated into the Texas adaptation of Article 9 of the U.C.C. It provided for an unlimited prior security interest for producers in the oil in the hands of the first purchaser and its proceeds that is unlimited in time. Under the Texas U.C.C., the perfection and priority of a security interest is determined by the "location" of a debtor and the "location "of a corporate debtor is where it is incorporated. Here, the Delaware corporate debtor was located in Delaware and the Delaware U.C.C. had no special provision granted priority to holders of purchase money security interests in oil. By contrast, the Oklahoma law was not part of the Oklahoma U.C.C. but rather was part of the Oklahoma real property law and created a statutory lien. Delaware law recognizes statutory liens created by other states, and therefore Delaware courts would defer to the statutory lien of Oklahoma and give it priority over the security interest perfected under Delaware law.

It bears emphasis that the circuit court recognized that the resolution of this case may not have been that which the Texas legislature had anticipated, and suggested that the legislature may wish to address the issue.

BANKRUPTCY

Wyoming Gas Gathering Agreement is Executory Contract That Can Be Rejected in Bankruptcy Case [BKR D DE]

A debtor in the oil and gas business filed a voluntary chapter 11 bankruptcy petition. A creditor and the debtor disputed the rights granted to the creditor under a gas gathering agreement. The agreement gave the creditor the right to gas gathering, processing, dehydrating and treatment. The agreement was known as L63. The creditor contended that the L63 agreement gave rise to a covenant that ran with the land, while the debtor argued the original agreements merely created executory contracts that could be rejected in bankruptcy. The debtor sought to reject the agreements as executory agreements under the Bankruptcy Code because it had failed to be able to market its assets successfully so long as it was a party to the L63 agreement. Despite the efforts of the debtor, it received no binding offers because of the minimum volume requirements of the L63 agreement with the creditor. The debtor therefore filed an adversary proceeding seeking a declaratory judgment that the L63 was not a covenant that ran with the land but rather was an executory contract. However, the L63 did contain language that suggested the agreement between the parties created a covenant that ran with the land.

In IN RE SOUTHLAND ROYALTY COMPANY, LLC, 623 B.R. 64 (Bankr. D. Del. 2020), the bankruptcy court evaluated the claims of a debtor involving the gas gathering agreement. The court focused on the L63 agreement and determined that it had several issues. They included: 1) whether the L63 agreement was an executory contract or a covenant that ran with the land, 2) whether the L63 minimum volume commitment could be severed from the agreement, and 3) whether the debtor may sell the [sic] its assets free and clear of the interest arising under the L63 agreement. On the first issue, the court evaluated the nature of the contract and concluded that the services provided by the creditor in the agreement failed to burden the land under Wyoming property law. On issue two, the court held that because the L63 minimum volume commitment is not a covenant running with the land, it is severable under traditional equitable principles. However, due to the intertwined nature of the agreements with other fee structures, the court refused to separate the various agreements, thereby holding the agreements to be non-severable. Finally, the court held that the creditor may be compelled to accept a monetary satisfaction of its interest as a result of the L63 agreement and therefore the contract could be rejected. Indeed, the court reasoned that even if the agreement was a covenant that ran with the land it could be rejected because it also was an executory contract. *[By Jimmy D. Vaughn jimmy,d.vaughn@ttu.edu]*

Lender's Plan Confirmed Because Debtors' Proposed Plan was Not Feasible [ED WA]

The debtors consisted of two LLCs that owned a vineyard and a wine making facility. The lender had offered a secured line of credit to the winemaking facility, guaranteed by the vineyard, and certain non-debtors. The LLC that owned the vineyard had also borrowed under a term loan facility, which was secured by the vineyard, additional real estate held in trust, and certain non-debtors. When the debtor failed to pay the line of credit, the lender accelerated all of the indebtedness and sought appointment of a receiver. The debtors filed a chapter 11 petition in response. The debtors and the lender submitted dueling proposed reorganization plans to the bankruptcy court.

In IN RE CLAAR CELLARS LLC, 623 B.R. 578 (Bankr. E.D. Wash. 2021), the court determined that the debtors' plan was not feasible and confirmed the lender's plan instead. The court analyzed the debtors' plan based on the requirements of § 1129 of the Bankruptcy Code. The court noted that the plan had been filed in good faith, as required in § 1129(a)(3). The court next looked at whether the plan complied with other requirements of the Code, as required by § 1129(a)(l). In that analysis, the court reasoned that the Debtor's proposed plan did not comply with Bankruptcy Code sections 1123(a)(3), (a)(5), and 524(e). Section 1123(a)(5) requires "adequate means" for implementation of a plan and (a)(3) mandates specificity in a plan. The proposed plan did not include details relating to when the proposed actions would be taken, what milestones the debtor would need to reach, or any goal posts the debtors had to meet. As such, the debtors' plan lacked adequate means and specificity and left the lender without any guidance as to how the debtor would achieve the outcome proposed by the plan. Secondly, the plan sought to shield the assets of non-debtor guarantors from the bank, which is prohibited under Bankruptcy Code § 524(e). The court also concluded that the plan did not meet the requirements of § 1129(a)(l l). That section requires the debtor show the reorganization plan is feasible or likely to succeed. The court expressed concerns about the projected revenues, the lack of concern over COVID-19's impact on the businesses, and the current state of the wine market. Additionally, the plan hinged on a possible sale of the land and upon securing new financing, yet there was no indication such events would happen.

After finding that the debtors' plan was not feasible, the court next looked at whether the lender's proposed plan met the statutory requirements. The court determined that the lender's plan was submitted in good faith and that Bankruptcy Code § 1129(a)(9) was met because the lender agreed to lend additional funds to the debtor if necessary to pay for the expenses of administering the estates. Additionally, the court found that Bankruptcy Code § 1129(b) was met because the plan did not enable the lender to recover more than 100% on its claims and preserved any remaining value for the non-debtors thus treating them fairly. Lastly, the court addressed all of the debtors' concerns regarding the lender's proposed plan, rejecting each in tum. Because the lender's proposal met all of the Code's requirements, and the debtors' proposal did not, the court confirmed the lender's plan. *[BBy Jimmy D. Vaughn jimmy,d.vaughn@ttu.edu]*

Lender's Plan Confirmed Because Debtors' Proposed Plan was Not Feasible [ED WA]

The debtors consisted of two LLCs that owned a vineyard and a wine making facility. The lender had offered a secured line of credit to the winemaking facility, guaranteed by the vineyard, and certain non-debtors. The LLC that owned the vineyard had also borrowed under a term loan facility, which was secured by the vineyard, additional real estate held in trust, and certain non-debtors. When the debtor failed to pay the line of credit, the lender accelerated all of the indebtedness and sought appointment of a receiver. The debtors filed a chapter 11 petition in response. The debtors and the lender submitted dueling proposed reorganization plans to the bankruptcy court.

In IN RE CLAAR CELLARS LLC, 623 B.R. 578 (Bankr. E.D. Wash. 2021), the court determined that the debtors' plan was not feasible and confirmed the lender's plan instead. The court analyzed the debtors' plan based on the requirements of § 1129 of the Bankruptcy Code. The court noted that the plan had been filed in good faith, as required in § 1129(a)(3). The court next looked at whether the plan complied with other requirements of the Code, as required by § 1129(a)(l). In that analysis, the court reasoned that the Debtor's proposed plan did not comply with Bankruptcy Code sections 1123(a)(3), (a)(5), and 524(e). Section 1123(a)(5) requires "adequate means" for implementation of a plan and (a)(3) mandates specificity in a plan. The proposed plan did not include details relating to when the proposed actions would be taken, what milestones the debtor would need to reach, or any goal posts the debtors had to meet. As such, the debtors' plan lacked adequate means and specificity and left the lender without any guidance as to how the debtor would achieve the outcome proposed by the plan. Secondly, the plan sought to shield the assets of non-debtor guarantors from the bank, which is prohibited under Bankruptcy Code § 524(e). The court also concluded that the plan did not meet the requirements of § 1129(a)(l l). That section requires the debtor show the reorganization plan is feasible or likely to succeed. The court expressed concerns about the projected revenues, the lack of concern over COVID-19's impact on the businesses, and the current state of the wine market. Additionally, the plan hinged on a possible sale of the land and upon securing new financing, yet there was no indication such events would happen.

After finding that the debtors' plan was not feasible, the court next looked at whether the lender's proposed plan met the statutory requirements. The court determined that the lender's plan was submitted in good faith and that Bankruptcy Code § 1129(a)(9) was met because the lender agreed to lend

additional funds to the debtor if necessary to pay for the expenses of administering the estates. Additionally, the court found that Bankruptcy Code § 1129(b) was met because the plan did not enable the lender to recover more than 100% on its claims and preserved any remaining value for the non-debtors thus treating them fairly. Lastly, the court addressed all of the debtors' concerns regarding the lender's proposed plan, rejecting each in tum. Because the lender's proposal met all of the Code's requirements, and the debtors' proposal did not, the court confirmed the lender's plan. *[By Melissa Clark melissa.l.clark@ttu.edu]*

Releases of Liability as to Non-Debtor Found to Lack Creditor Intent [BKR D DE]

A debtor producing raw materials for the oil and gas fracing [sic] industry defaulted on two long-term secured operating capital loans. The company initially attempted a private restructuring, hiring reorganization professionals and creating a general restructuring committee. A natural disaster impacted the ability of the company's signature processing facility to produce at its peak levels, and though a business interruption insurance claim was submitted to insurance, the company continued to struggle due to what the court described as a "market...crowded with...suppliers." Due to these difficult market conditions, the out-of-court restructuring negotiations ultimately failed, and the company filed for a chapter 11 reorganization. The debtor proposed a plan that received an objection from the unsecured creditors committee and other creditors. The nature of the objections were that the plan was not fair and equitable under section 1129(b)(l) of the Bankruptcy Code because the noteholders were to receive more than they are entitled and because the plan was said to violate the best interests test of section 1129(a)(7) as there existed unencumbered assets with value that should go to unsecured creditors under a hypothetical chapter 7 liquidation. In addition, the unsecured creditors committee alleged that the plan's third party releases of liability violated the good faith requirement under section 1129(a)(3).

In IN RE EMERGE ENERGY SERVS., LP, No. 19-11563, 2019 Bankr. LEXIS 3717 2019 WL 7634308 (Bankr. D. Del. 2019), the court first addressed the fair and equitable argument of one of the lower classes of creditors who had rejected the plan as a class. It was argued by those creditors that the debtors total enterprise value exceeded the value of the debt owed to senior classes of creditors, and thus a cramdown of the plan over the junior creditors' objection was not appropriate. The court hosted a battle of the experts between the parties in order to value the total enterprise, and while the court found that both experts "testified credibly" it chose to accept the debtor's discounted cash flow analysis over the creditors' expert. Next, the court applied the best interests test to determine that the creditors objecting to the plan would not have received anything under a hypothetical chapter 7 liquidation, and did not credit the objection of the unsecured creditors committee that the debtor's proposed liquidation analysis used low estimates and assumptions of value. Finally, the court addressed the contention that the plan's requirement of creditors to release claims held against non-debtor third parties was through an improper process. The process to obtain the releases from certain classes of creditors was an affirmative opt-out, where the creditor was required to take a separate action to opt out of the third party releases. The court determined this type of system did not demonstrate the required intent of the creditor to release the third party claims, and denied confirmation of the plan until the release process was amended. *[By Kurt Brown kurt.brown@ttu.edu]*

Debtor Who Had Run Defunct Small Business Did Not Qualify to Be Subchapter V Chapter 11 Debtor [BKR ND TX]

Chapter 7 debtors sought to convert their chapter 7 bankruptcy case to a case under subchapter V of chapter 11 of the Bankruptcy Code. The United States Trustee and certain creditors opposed the conversion, claiming that the debtors were ineligible for subchapter V.

In IN RE JOHNSON, No. 19-42063- ELM, 2021 Bankr. LEXIS 471 (Bankr. N.D. Tex. 2021) the bankruptcy court held that the debtors did not qualify to be debtors under subchapter V of chapter 11 of the Bankruptcy Code, although they did qualify for chapter 11. To be eligible to relief under subchapter V of chapter 11, Code section 101(51)(D) provides that a debtor must be "engaged in commercial or business activities" or be an affiliate of such a debtor (subject to limited exceptions). A person "engaged in" a business is a person currently occupied with or busy with a commercial enterprise or business activities and not a person who at some time in the past was so engaged. Here the debtor husband had been engaged in a business in the past but was not currently engaged in such a business. The wife, a full-time nurse, was also not engaged in business and because the conversion was conditioned on both debtors being eligible for subchapter V treatment, the wife's ineligibility was an independent reason that the debtors could not convert to subchapter V of chapter 11. *[Faculty Editor & Editorial Board]*

Thank the Lord for Relief: Administrative Decision to Refuse PPP Loan Based on Bankruptcy Status Violates APA and Bankruptcy Code [BKR D NM]

A chapter 11 debtor-in-possession which was a Roman Catholic Diocese relied on tithing and various donations to continue its operations. During the pandemic, the ability to tithe members diminished greatly. The date of the initial pandemic lockdown order in New Mexico coincided with the biggest tithing day of the year. Because of the financial distress of the pandemic compounding the diocese-debtor-in possession's dire financial situations, the debtor-in-possession applied for a PPP Loan provided for in the CARES Act, signed by the President on March 27, 2020. This application sought to use the money to pay the debtor-in-possession's 70 employees. In spite of meeting all eligibility requirements under the CARES Act, the Small Business Administration (the "SBA") rejected the request. The SBA issued an "interim final rule" (a process blessed by the Administrative Procedures Act m emergency situations) that disqualified bankruptcy debtors from receiving PPP Loans. As a result of this, a potential lender did not act on the debtor-In-possession's PPP loan application. Subsequently the debtor-in-possession filed a complaint alleging the decision of the SBA was arbitrary and capricious and violated the Bankruptcy Code § 525(a), which prohibits certain discrimination against debtors.

In IN RE ROMAN CATHOLIC CHURCH OF ARCHDIOCESE OF SANTA FE, 615 B.R. 644 (Bankr. D. N.M. 2020), the court evaluated the claim of the chapter 11 debtor-in-possession, that the SBA violated the Administrative Procedures Act by acting in an arbitrary and capricious manner by issuing a blanket denial of PPP loans due to a debtor-in-possession's status as a bankrupt party. The court held that under normal circumstances a potential borrower's bankruptcy status is relevant for a loan program. The PPP program, however, is a grant. The court rejected the SBA's argument that bankrupt parties pose significant risks, stating that, "the bankrupt party under chapter 11 is under the supervision of the government." The court additionally refused to exercise Chevron deference to the determination of the agency because Congress directly addressed eligibility requirements within the CARES Act. Congress excluded mid-sized business from eligibility expressly in § 4003(c)(3)(D). It refused to do so for small businesses. The court also held the SBA's rule qualified as discriminatory under 11 U.S.C. § 525(a), which provides a government entity may not deny a grant solely because a debtor filed for bankruptcy. The court concluded the PPP loan qualified as a governmental grant because the PPP offer only occurs at behest of the government. For these reasons the court held that the SBA violated the APA with its "inexplicable and high-handed decision attempting to rewrite the PPP's eligibility requirements" and its actions violated 11 U.S.C. §525(a). By separate and final judgment the court granted relief to the debtor-in-possession in the amount requested in the original loan Note: The Fifth Circuit Court of Appeals has upheld the SBA's determination to deny PPP loans to entities in chapter 11. Hidalgo Cty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cty. Emergency Serv. Found.), 962 F.3d 838 (5th Cir. 2020). *[By Jimmy D. Vaughn jimmy.d.vaughn@ttu.edu]*

General Reference to Pandemic Could Not Excuse Subchapter V Debtor From Meeting Plan Filing Deadline [BKR ED NY]

The debtor had an online business fulfilling orders for Amazon. It filed its subchapter V chapter 11 case in July, 2020. In late October, 2020, after the 90-day deadline to file a plan of reorganization had passed, the debtor moved for an extension of that deadline. The debtor pointed to only two reasons the court should grant an extension: a general reference to the pressures of the pandemic and the distraction of the holidays.

In IN RE ONLINE KING LLC, No. 1-20-42591-las, 2021 Bankr. LEXIS 198 (Bankr. E.D.N.Y. Jan. 19, 2021) the court denied the extension. It reasoned that it had two issues to address: (1) whether it could enter relief on a nunc pro tunc basis and whether the reasons for the extension were sufficient under the Bankruptcy Code. To answer both of these questions, the court took a hard look at the statutory language. First, the court concluded, nothing required that the extension order be sought or entered before the expiration of the 90-day period. However, the debtor had failed to demonstrate adequate grounds for an extension of the time period. 11 U.S.C. § 1189(b) requires that the need for an extension is "attributable to circumstances for which the debtor should not justly be held accountable." Here, vague references to the pandemic and the high holy days were insufficient justification. The specificity of the statutory language required that the debtor put forth good reasons that the deadline could not be met. Indeed, here there was no showing that the debtor did not understand that the deadline was approaching or that the debtor had made progress m negotiating a reorganization plan. *[Faculty Editor & Editorial Board]*

Insider Can Lend to Debtor-in Possession, But Lending Cannot Be a Sub Rosa Plan [BKR SD NY]

A group of debtors collectively serving as the leading airline in Latin America filed for chapter 11 reorganization after suffering almost nonexistent travel during the height of the 2020 novel coronavirus pandemic and a corresponding loss of revenues. The debtors filed a motion to approve the airline's debtor-in-possession financing and several creditors, including the committee representing unsecured creditors, objected to the motion. They alleged that the entity extending the junior, undercollateralized portion of the debtor-in possession financing was really the original shareholders seeking to secure a "sweet deal" at the expense of unsecured creditors. The capital structure of the airline included a revolving credit agreement, local unsecured bank loans, international and domestic bonds, and secured lending or leases relating to the acquisition of airplanes. Creditors also raised issues regarding whether the proposed financing was within the good business judgment of the corporations' officers and directors and fulfilled their fiduciary duties.

In IN RE LATAM AIRLINES GRP. S.A., Case No. 20-11254, 2020 Bankr. LEXIS 2405, 2020 WL 5506407 (Bankr. S.D.N.Y. 2020), the court first addressed the contention that the proposed financing could not satisfy the "business judgment" rule, which allows a court to approve actions outside of the ordinary course of business that are consistent with the business judgment of the debtor's officers and directors. The court noted that the business judgment rule is not the appropriate test for insider agreements, but instead the court must apply the heightened scrutiny of the "entire fairness" standard to determine the appropriateness of a transaction between the debtor and its insiders. Here, the court was not convinced that because the debtor-in possession financing package had to be accepted in its entirety the loan from a noninsider senior lender should be suspect merely due to the presence of insider junior lenders as parties to the financing agreement. Accordingly, the court concluded the debtor-in-possession financing satisfied the entire fairness standard. The court next addressed the absolute priority principle of bankruptcy. The absolute priority issue arose from the contention of some creditors that the junior priority shareholders were skipping ahead in payment priority by entering into the debtorin-possession financing as junior undercollateralized lenders. The debtor countered that these creditors were offering new value to the debtor and were not being compensated for their old equity positions with a new property interest. The court determined that the debtor did engage in sufficient marketing to attract potential lenders before choosing to enter into a loan with the junior insider lenders, and therefore had not violated absolute priority rule. Finally, the court considered whether the debtor-in-possession financing agreement with the junior lenders was an impermissible sub rosa plan that would dictate the terms of any future reorganization plan. The court concluded that the financing improperly favored existing shareholders by allowing those shareholders, as debtor-in-possession junior lenders, to direct how and when the company would emerge from the bankruptcy case. In rejecting the debtor's request to approve the debtor-in-possession financing, the court stated that "bankruptcy courts do not allow terms in financing arrangements that convert the bankruptcy process from one designed to benefit all creditors to one designed for the unwarranted benefit of the post-petition lender." *[By Kurt Brown kurt.brown@ttu.edu]*

CONSUMER PROTECTION

Dodd-Frank Arbitration Ban Not Retroactive But Extends to All Documents Within the Credit Transaction [D MD]

The debtor had an online business fulfilling orders for Amazon. It filed its subchapter V chapter 11 case in July, 2020. In late October, 2020, after the 90-day deadline to file a plan of reorganization had passed, the debtor moved for an extension of that deadline. The debtor pointed to only two reasons the court should grant an extension: a general reference to the pressures of the pandemic and the distraction of the holidays.

In IN RE ONLINE KING LLC, No. 1-20-42591-las, 2021 Bankr. LEXIS 198 (Bankr. E.D.N.Y. Jan. 19, 2021) the court denied the extension. It reasoned that it had two issues to address: (1) whether it could enter relief on a nunc pro tunc basis and whether the reasons for the extension were sufficient under the Bankruptcy Code. To answer both of these questions, the court took a hard look at the statutory language. First, the court concluded, nothing required that the extension order be sought or entered before the expiration of the 90-day period. However, the debtor had failed to demonstrate adequate grounds for an extension of the time period. 11 U.S.C. § 1189(b) requires that the need for an extension is "attributable to circumstances for which the debtor should not justly be held accountable." Here, vague references to the pandemic and the high holy days were insufficient justification. The specificity of the statutory language required that the debtor put forth good reasons that the deadline could not be met. Indeed, here there was no showing that the debtor did not understand that the deadline was approaching or that the debtor had made progress m negotiating a reorganization plan. *[By Kurt Brown kurt.brown@ttu.edu]*

Tracy Kennedy
NDBA General Counsel

Role of NDBA General Counsel

NDBA's general counsel serves as the attorney for the association. Although Tracy is pleased to be able to serve as a resource for NDBA members in responding to their questions, she is providing general information, not legal advice. Banks must obtain legal advice from counsel who has been retained by the bank to represent the bank's interests in a specific matter.

To contact Tracy Kennedy, NDBA General Counsel, call 701.772.8111 or email at tracy@ndba.com.