AMERICAN BANKRUPTCY INSTITUTE

Southwest Bankruptcy Conference 2021

Chapter 11 Cases in the Headlines

CONCURRENT SESSION

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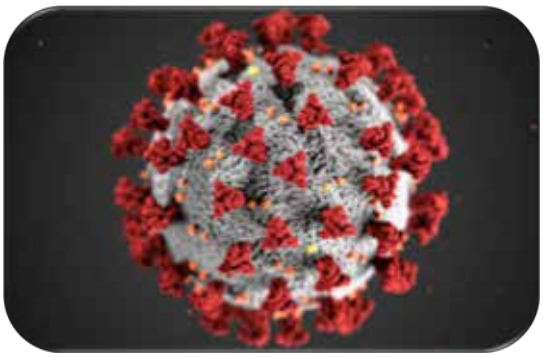
Force Majeure In Bankruptcy: 2020-21

- Force Majeure Generally
- Recent Cases
- Looking Forward

Force Majeure Generally



Black's Law Dictionary:
A force majeure clause is a "contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."

Is COVID-19 a "Force Majeure" Event?
Depends on the contract language and/or state law.

Keyword: Force Majeure.
Force majeure is a Latin phrase that means "**superior force**."

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EXAMPLE 1:

Landlord and Tenant **shall each be excused** from performing its obligations or undertakings provided in this Lease, in the event, but only so long as the performance of any of its obligations are prevented or delayed, retarded or hindered by … **laws, governmental action or inaction, orders of government**…. Lack of money shall not be grounds for Force Majeure.

In re Hitz Rest. Grp., 616 B.R. 374 (Bankr. N.D. Ill. 2020)

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In re Hitz Rest. Grp., 616 B.R. 374 (Bankr. N.D. Ill. 2020)

Force Majeure Partially Relieved Debtor from Duty to Pay Rent During Lockdown.

Force majeure clause partially relieved debtor of obligation to pay rent under force majeure clause in lease because government stay-at-home order prevented debtor from providing on-premises dining at its restaurant and limited it to takeout and curbside service.

Court Preliminarily Ordered a 75% Rent Reduction.

There was limited evidence as to how much rent should be abated. Ultimately, the Court held that Debtor could have used 25% of the premises to operate takeout services.

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EXAMPLE 2:

Beginning Construction; Delivery by Landlord: If the performance by Landlord or Tenant of any of its obligations under this Lease is delayed by reason of "Force Majeure", the period for the commencement or completion thereof shall be extended for a period equal to such delay.

Force Majeure definition includes: "acts of God" and "governmental restrictions" and, "any other act over which the performing party has no control, excluding financial ability of the performing party."

In re Cinemex USA Real Est. Holdings, Inc., 627 B.R. 693 (Bankr. S.D. Fla. 2021) Ballard Spahr LLP

In re Cinemex USA Real Est. Holdings, Inc.,
627 B.R. 693 (Bankr. S.D. Fla. 2021)

Force Majeure Clause Relieved Debtor from Duty to Pay Rent During Shutdown.

Force majeure clause in debtor's commercial leases served to relieve debtor of obligation to pay rent during time when its movie theaters could not operate

Debtor Had to Pay Rent After the Shutdown Order Was Lifted.

Doctrine of frustration of purpose did not apply to excuse debtor (the owner/operator of 41 movie theaters) of obligation to pay rent once the Governor lifted his shut down order and allowed movie theaters to reopen at 50% capacity during the COVID-19 pandemic

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EXAMPLE 3:

Subject to the casualty and condemnation provisions of this Lease, **if either party shall be prevented or delayed** from punctually performing any obligations or satisfying any condition under this Lease by any strike, lockout, labor dispute, inability to obtain labor or materials or reasonable substitutes therefor, act of God, **unusual governmental restriction, regulation or control**, enemy or hostile governmental action, civil commotion, insurrection, sabotage, fire or other casualty, or any other condition beyond the reasonable control of such party, or caused by the other party, then the time to perform such obligation or to satisfy such condition shall be extended on a day-for-day basis for the period of the delay caused by such event. The party claiming the benefit of this Section shall give notice to the other party in writing within ten (10) days of the incident specifying with particularity the nature thereof, the reason therefor, the date and time incurred and the reasonable length said incident will delay the fulfillment of obligation contained herein. *This Section shall not apply to the inability to pay any sum of money due hereunder or the failure to perform any other obligation due to the lack of money or inability to raise capital or borrow for any purpose*.

In re CEC Ent., Inc., 625 B.R. 344 (Bankr. S.D. Tex. 2020)

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In re CEC Ent., Inc., 625 B.R. 344 (Bankr. S.D. Tex. 2020)

Force Majeure Clauses Did Not Allow Debtor to Withhold or Abate Rent During Pandemic.

"The force majeure clause also does not apply to an inability to pay rent or a failure to perform due to lack of funds. That provision of the force majeure clause forecloses [debtor's] argument that the lease allows it to delay rent payments."

Debtor had to Pay Rent.

"The Court is sympathetic to the hardship which [debtor] has endured as a result of the global pandemic. However, neither the Bankruptcy Code, the force majeure clauses of the leases, nor the doctrine of frustration afford [debtor] the relief requested."

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Looking Forward
What to consider when drafting contracts post-COVID-19
American Bankruptcy Institute
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QUESTIONS?
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Update on Midstream Agreements in Bankruptcy: From *Sabine* to *Sanchez* and Beyond

Lydia R. Webb

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ATTORNEYS & COUNSELORS

Real Covenants—Elements

1. Intended to run with the land
2. Successor has notice
3. Writing sufficient to satisfy the statute of frauds
4. **Touch and concern**
   - The dedication must impact the use, enjoyment and/or value of the burdened real property
5. **Privity of Estate (Traditional View)**
   - Vertical Privity
   - Horizontal Privity

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Midstream Approach
In re Alta Mesa and *In re Badlands*

Touch & Concern Standard: The dedication must impact the use, value, or enjoyment of the real property interest **burdened** by the covenant.

- Dedication of oil and gas leases (or similar real property interest) is dispositive
- Focus on the benefits and burdens on leasehold estate

Privity of Estate Standard: Conveyance of surface easements and related rights were sufficient to satisfy privity.

- In *Badlands*, the gathering agreement granted gatherer a right of way and surface easement across producers' leases to install and operate the gathering system (i.e., a floating easement)
- In *Alta Mesa*, the leases contain implied surface easements for the exploration and production of oil and gas

Upstream Approach
In re Extraction and *In re Southland*

Touch & Concern Standard: The dedication must require the producer party to conduct some physical action on the mineral estate.

- Dedication language is not dispositive
- Focus on personal property nature of produced hydrocarbons
- Most midstream agreements considered mere service contracts

Privity of Estate Standard: The agreement must contain a conveyance of the mineral estate (i.e., leasehold estate).

- Conveyance of oil and gas lessee's implied lease easement is insufficient
- Conveyance of surface parcels is inadequate
- Dedication does not effect a conveyance

The Next Generation
In re Sanchez and *In re Nine Point Energy*

In re Sanchez Energy: Gathering agreement contained covenant running with the land under Texas law; however, covenants running with the land and executory contracts are not mutually exclusive

- Commercial terms of gathering agreement were rejected, but debtor was still bound by gatherer's dedication and surviving real property rights
- Parties commercially left in no man's land

In re Nine Point Energy**:** Midstream company successfully asserted secured liens against producer for unpaid prepetition services

- Under North Dakota law, Caliber Midstream held valid statutory well liens for amounts owed for gathering, processing and transporting Nine Point's oil and gas as part of its operations.
- Caliber's liens predated those held by Nine Point's lenders and were entitled to adequate protection.

I. Coercion

A. First-Day Motions & Prepacked Plans

1. Where a putative debtor solicits the votes of creditors in order to create sufficient plan prior to the filing of a bankruptcy petition so the solicitation prohibitions are inapplicable.

2. Deprives creditors of certain procedural protections.
    i. Such as the disclosure of "adequate information" by the debtor.

3. Also deprives creditors of the ability to organize opposition because of the expedited timeline—utilizes "hurry up" tactics where the debtor presents to the Judge that if the plan is not approved there will be a tremendous loss of capital
    i. The Code and Rules require at least 28 days' notice before disclosure statement adequacy hearing.
    ii. The creditors are supposedly offered a plan treatment superior to what they would receive if they wait to support the plan until the filing of the petition.
    iii. Example—Belk (in U.S. Bankruptcy Court, Southern District of Texas (Houston))
        a. On February 23, Belk solicited plan support, filed a prepackaged bankruptcy plan and that if the plan quickly set and approved, the debtor would have to liquidate.
        b. Despite little evidence that the creditors would have actually sought liquidation, Belk convinced the court to approve on 652 pages of motions and proposed orders within 24 hours, without allowing time for creditors to raise any objections.
            1. The court assumes that when a plan is pre-approved, the creditors will not have any objections to raise, however this isn't always true as the creditors may not have had all of the information when pre-approving this plan as explained above.
        c. On February 24, Belk was announcing to the media that it had reduced its funded debt and improved its liquidity all the while avoiding the significant expense and uncertainty of protracted bankruptcy proceedings.

    iv. Case example—Sunguard (in U.S. Bankruptcy Court, Southern District of New York (White Plains))

a. Just before 9pm on May 1, 2019, Sunguard filed its bankruptcy case; it received confirmation of its prepackaged plan less than 24 hours later just before 6pm on May 2nd.
b. In approving the plan, the Court overruled objections from UST.
    1. In overruling the objections, the Court relied on Sunguard's representation that it needed an expedited confirmation, as well as the fact that no creditor or other party-in-interest had objected and there were no impaired creditors voting against the plan (even though impaired creditors were not allowed to vote).

4. These plans may be convenient for courts but have serious due-process implications.

5. That said, these plans allow the debtor to avoid many major disruptions which may allow them to remain more competitive on the market which will allow for more capital in the long-run and prevent job-loss.

B. Asset Sales

1. Part of the "hurry up" nature of the process which can be coercive in nature by forcing the Court to make hasty decisions on the threat that something catastrophic will occur.
    i. Debtor will represent that it needs to sell assets rapidly because of their quickly depreciating value.
    ii. Debtor represents that a failure to assent will result in loss of the value of the bankruptcy estate.

2. The sale process can also be coercive with respect to future outcomes.
    i. Subrosa plan issue
    ii. Precludes real reorganization.
    iii. Precludes proper distribution to creditors.

3. Stalking-Horse Provisions
    i. Asset sales through auction processes which require "stalking horse" protections facilitating a starting offer but making competitive bidding difficult.
        a. A party identified as a potential buyer that negotiates the original terms; however those terms are subject to better offers at auction.

ii. "Stalking horses" often ask for certain protections to give them a leg-up in the auction since others are able to free-ride off of their initial negotiations.
    a. These can be very successful with 85% of stalking-horse bidders winning the auction.
iii. These provisions are almost always granted because of the "hurry up" nature of selling the assets.

C. DIP Financing

1. Businesses tend to avoid filing for bankruptcy until they face a liquidity crisis. At that point business are desperate for new financing usually prior to the day they file for bankruptcy.

2. "Debtor in Possession" financing offers a quick solution usually, in the form of a consensual priming lien, where the existing lienholders grant a new loan that "rolls up" the existing lien in a refinancing for an amount larger than the existing debt. Sometimes and altogether new lender makes a loan that will prime existing lien holders.

3. These DIP loans usually come with weighty terms that substantially alter a debtor's balance sheet and ability to propose a Chapter 11 plan. Most debtors are not in a negotiating position when they need a DIP loan.
    i. Any competitive market in DIP financing is narrow and oftentimes DIP lenders will have substantially greater negotiating power over their debtor.
    ii. Because of their necessity, DIP loans also have extremely high interest rates despite being some of the safest loans.
    iii. This necessity also allows DIP loans to also create expansive terms, many of which include:
        a. Detailed timelines requiring sale of certain assets;
        b. Restricting the use of the funds, including a prohibition for use on investigating or litigating against the DIP lender;
        c. Providing debtor must pay certain parties' legal expenses before paying other creditors; and
        d. Mandating the appointment of particular officers and operating benchmarks for the debtor.

4. If the debtor later decides that it wants to alter any of these terms, it risks triggering a default on the DIP loan.
    i. A DIP financing agreement thus often locks in the outcome of the bankruptcy.

II. Venue/Judge Shopping

A. 28 U.S.C § 1408

1. Allows companies to file bankruptcy in:
    i. The district in which the debtor has been headquartered for the previous 180 days;
    ii. The district in which the debtor's principal assets have been located for the previous 180 days;
        a. Any district in the state in which it or its general partner has been incorporated for the previous 180 days; or
    iii. Any district in which one of its affiliates has filed.

2. Statute allows for too much discretion in choosing where companies can file and permit gamesmanship in choosing a filing district.

3. Compared to the standard federal venue requirements—28 U.S.C § 1391
    i. Generally speaking, can only bring a suit in a district where a defendant resides, so long as all defendants are from that state, or a district where a substantial portion of the events occurred

4. Companies filing for bankruptcy should be allowed to have options, however § 1408 must be modified because the discretion it grants is too broad
        i. A debtor can easily pick venue by creating and then filing an affiliate,
        ii. Case example—Boy Scouts of America
            a. Headquartered in Texas, but filed for bankruptcy in Delaware by first filing an affiliate case
                1. Delaware BSA, LLC was incorporated only 222 days before filing for bankruptcy, had no more than $50,000 in assets, carried no business an employed no personnel
            b. Case example—National Rifle Association

1. Headquartered in Virginia, but filed in Texas via a subsidiary it created only 59 days before filing for bankruptcy

c. Case example—Winn-Dixie

1. Headquartered in Florida but filed for bankruptcy in the Southern District of New York via an affiliate created only 12 days before filing for bankruptcy

5. The venue statute has allowed for 60-70% of all business bankruptcy cases to be filed in just 2 out of the 94 districts—the District of Delaware and the Southern District of New York[1]

i. 80% of all bankruptcy "mega-cases" are also filed in those 2 districts.[2]

B. Local Rules Allow for Judge-Shopping

1. Some local case-assignment rules have been constructed to allow debtors to know with relative certainty which judge will handle their case depending on the division in which they file.

2. Create "complex-case" rules which provide that every complex case will be designated to a specific judge no matter the division in which the case is filed

i. The Southern District of Texas specifically set up the complex case system to attract big cases

3. These rules have provided almost 100% certainty which judge will handle a case

4. In 2018, one particular judge in the Southern District of New York began receiving 63% of the SDNY mega-cases—up from 9% when he started in 2008.

[1] Nat'l Conf. of Bankr. J., *Special Comm. on Venue, Report on Proposal for Revision of the Venue Statute in Commercial Bankruptcy Cases*, 24 (Nov. 27, 2018), https://cdn.ymaws.com/www.ncbj.org/resource/resmgr/docspublic/Venue_White_Paper_-_Final.pdf.

[2] *Id.* at 28.

C. Repercussions of the Current Venue Statute and Local Assignment Rules

1. Venue/Judge shopping negatively impacts judicial legitimacy.

2. Creates a "competitive market" where judges compete for "business" by increasingly becoming more debtor friendly
    i. In turn results in creditors rights being pushed to the side[3]

3. The concentration of bankruptcy cases in so few districts also inhibits the development of bankruptcy law.

4. "Repeat Players" are held captive
    i. Given the venue rules, an attorney with a large case bankruptcy practice has a high likelihood of ending up before the same judge or judges
    ii. Feel even more pressured to stay in the judges' good graces
    iii. Attorneys will tolerate bad judicial behavior and are unlikely to raise the question of proper venue.
    iv. Result is bankruptcy attorneys may advocate less zealously

5. A reform of the venue and local assignment rules would promote access to justice by eliminating the need to "compete" for cases and the incentives to cater to debtors

6. Case example—Purdue Pharma
    i. Perdue Pharma, a Delaware Limited Partnership, established Purdue Pharma, Inc., a New York corporation.
    ii. The New York subsidiary had no equity in the parent company or in any other subsidiaries.
    iii. Just 198 days before filing their bankruptcy claim, the New York subsidiary changed its official corporate address for service of process to White Plains, New York; though it never actually conducted business at the address and listed its principal place of business as Stamford, Connecticut.
    iv. The subsidiary used this address to file for bankruptcy in SDNY at 11:16pm on Sept. 15, 2019—just over an hour later it filed for join administration of all its affiliates at 12:28am on Sept. 16, 2019, even before all of the affiliates listed on the motion had filed their petitions

[3] "The unspoken but implicit message in a filing across the country from home base is that nobody counts but the lenders and the debtor's management." *Id.* at 32-33.

v. Perdue knew with 100% certainty that by changing the address of the subsidiary it would be assigned one particular judge in the SDNY.

D. Arguments Against Reforming the System

1. Even among the largest corporate debtors, only a minority avail themselves of the option to file where they are incorporated.[4]

2. "[F]orum shopping is a legitimate, expressly authorized action when more than one forum satisfies the requisite legal criteria," and "we should not be surprised or dismayed at the fact that forum shopping has thrived."[5]

3. Predictability[6]
   i. Was the biggest driving force behind venue choice
   ii. Not even necessary that the predictable outcome be favorable because predictability reduces costs for everyone in the long-term

4. "Empirical evidence that cases assigned to more experienced judges spend less time in bankruptcy, are more likely to be reorganized rather than liquidated, and are less likely to refile for bankruptcy after emergence."[7]
   i. Evidence also suggests that cases filed in districts that cater to "mega-cases" cost significantly less[8]

5. Finally, eliminating venue choice may not actually benefit creditors
   i. Eliminates the reduced cost and time that benefits creditors
      ii. "No empirical evidence supports the proposition that filing where the debtor's headquarters or principal assets are located results in a better outcome for small creditors, employees, retirees, or other parties in interest who ostensibly would benefit from being nearer to the presiding court."[9]

[4] Nat'l Conf. of Bankr. J., *supra* note 1 at 66.
[5] *Id.* at 67.
[6] *Id.* at 69-70.
[7] Nat'l Conf. of Bankr. J., *supra* note 1 at 75.
[8] *Id.* at 76.
[9] *Id.* at 80.

III. Illusory Appellate Review

A. The "Final Order"

1. Appeal cannot be taken unless it is of a "final order," however, there is a lack of clarity as to what qualifies as a final order.

2. This confusion can be deadly as a part only has 14 days to file an appeal from a final order

B. Statutory Mootness

1. Section 363(m)
    i. Section 363 provides for the trustee to use, sell, or lease property of the bankruptcy estate outside of the ordinary course of business upon bankruptcy court approval.
    ii. However, this section also provides that, on appeal, the sale or lease or a property cannot be overturned.
    iii. "The reversal or modification on appeal of an authorization under [Section 363(b) or (c)] of the sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal."
        a. Essentially makes the power to appeal useless.
        b. While stays can allow a sale of property to be reversed they are expensive and almost never financially practical.

2. Section 364(e)
    i. This section provides that the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business.
    ii. However, like section 363, once the credit or debt is incurred it cannot be reversed on appeal.
    iii. "The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or 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."

a. Again, removes power from an appeal

C. Equitable Mootness

1. Even if a portion of a confirmed plan does not fall under a statute causing the issue to be moot, the court might still find the issue to be "equitably moot."

2. "Equitable mootness is a prudential doctrine that is invoked to avoid disturbing a reorganization plan once implemented."

3. A live dispute between the parties might still remain but, once money starts flowing under a plan, courts are reluctant to reverse anything in order to protect parties relying on the plan

4. Renders the ability to appeal largely meaningless

5. Arguments that some courts are expanding this doctrine too far
    i. Case example – In re Nuverra Envtl. Sols. No. 18-3084, (3d Cir. Jan. 6, 2021)
        a. Decided that an appeal was still equitably moot despite the fact the court admitted the limited relief the creditor sought would not have "fatally scrambled" the confirmed plan
        b. In the concurring opinion, Judge Krause wrote forcefully against the continuing expansion of the equitable mootness doctrine, however ultimately agreeing with the result
            1. In another concurrence (In re One2One Communc'ns) Judge Krause called equitable mootness a "legally ungrounded and practically unadministrable 'judge-made abstention doctrine."

D. Reasons for Statutory and Equitable Mootness

1. It is generally imperative that large financial transactions close quickly and delays such as an appeal poses expensive risks that market condition may change.
    i. Therefore it is beneficial to allow deals to close without the worry that they will overturned later

2. Also protects third parties which are relying on the plan.

3. Finally, lets creditors “get on” with business.

Faculty

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Craig S. Ganz is a partner with Ballard Spahr LLP in Phoenix and Los Angeles, and co-leads its Non-Bank Lending Team in the firm's Banking and Financial Services Industry Group. He is focused primarily in the areas of real property, restaurant/hospitality, and finance/banking law. His experience also encompasses significant trial work on both the state and federal levels. Recently, Mr. Ganz has focused his efforts on assisting clients with (COVID-19-related) distressed asset workouts on the banking and real estate side. As it relates to his real estate and finance practice, he frequently counsels clients on strategies ranging from asset acquisition and dispositions to leveraged transactions on both the buy and sell side. He often consults with private-equity groups, REITs, hotel operators and family offices to establish internal and external strategies in order to implement a formal protocol to manage the transactional-side acquisition and disposition processes. He also handles pre-litigation workouts for financial institutions and various real estate entities as it relates to distressed-asset scenarios. On the litigation front, Mr. Ganz defends and prosecutes actions on behalf of corporate clients, including hotels, REITs, private-equity groups and commercial real estate entities, along with balance-sheet and nontraditional lenders and borrowers. These litigation matters typically involve distressed assets, lender-liability claims, fraud actions, securities law violations, RICO actions, enforcement of real estate leases, broker commissions, enforcement of real property purchase agreements, enforcement of commercial contract guarantees, deficiency actions, loan default actions, garnishments, judgment enforcement proceedings and fraudulent transfer actions. In his reorganization practice, he guides clients in prominent retail bankruptcy proceedings. He also represents corporate creditors and debtors, advising clients on debtor financing issues, § 363 asset purchases, avoidance and preference actions, stay proceedings and claim analysis. In addition, he

actively manages the national bankruptcy portfolios of several publicly traded clients and conducts in-house training for finance departments in order to eliminate or reduce insolvency risk. Mr. Ganz regularly represents creditors' committees and counsels clients on receivership-related issues. He received his B.A. in 1997 from the University of Arizona and his J.D. in 2001 from Southwestern Law School.

Hon. Harlin DeWayne Hale is Chief U.S. Bankruptcy Judge for the Northern District of Texas in Dallas, appointed in November 2002. He previously worked at Strasburger & Price before opening a boutique firm, where he became well versed in bankruptcy law. Two years before his judicial appointment, Judge Hale was a regional partner in charge of the bankruptcy practice at Baker & McKenzie in Dallas. He is a member of the Texas, Louisiana, American and Dallas Bar Associations, the Dallas Bankruptcy Bar Association, and the National Conference of Bankruptcy Judges. Judge Hale received his undergraduate degree and J.D. from Louisiana State University, where he was a member of the Order of the Coif and an editor of its law review.

Lydia R. Webb is a partner with Gray Reed & McGraw LLP in Dallas, where she focuses her practice on representing and advising debtors, creditors, committees and post-confirmation trustees in bankruptcy cases and other insolvency or restructuring scenarios. She has guided clients to successful results in complex cases before courts throughout Texas and many other states, including Oklahoma, Delaware and New York. Ms. Webb's cases span the oil and gas, health care, retail, manufacturing and restaurant businesses. She has been listed in *The Best Lawyers in America* in the fields of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law since 2021 and in Bankruptcy Litigation for 2022, was selected to participate in the National Conference of Bankruptcy Judges Next Generation program in 2019, and has been named a "Rising Star" by *Texas Super Lawyers* since 2018 -Ms. Webb is an ABI member and is social chair of the DFW Association of Young Bankruptcy Lawyers. She is also a member of the Dallas Bar Association's Bankruptcy Section, The Hon. John C. Ford American Inn of Court and the International Women's Insolvency & Restructuring Confederation. Ms. Webb received her B.B.A. *cum laude* in finance and economics from Baylor University in 2009 and her J.D. *cum laude* from Baylor University School of Law in 2012.