YOUNG CONAWAY STARGATT & TAYLOR, LLP

Case Alert: Third Circuit Year-End Bankruptcy Clearinghouse

Over the past few weeks, the Delaware Bankruptcy Court, the Delaware District Court and the Third Circuit Court of Appeals rendered decisions on several bankruptcy topics that may impact your practice. Set forth below are summaries of those opinions (with hyperlinks to the decisions available).

***Machne Menachem, Inc. v. Spritzer (In re Machne Menachem)*, No. 11-1496, 2012 U.S. App. LEXIS 33 (3d Cir. Jan. 3, 2012) (Restani, J.)**.

The Court of Appeals for the Third Circuit, applying the clearly-erroneous standard of appellate review, affirmed a bankruptcy court's decision that certain advances made by the appellant to the not-for-profit debtor were not loans. The bankruptcy court had looked to the intent of the parties as it existed at the time of the transaction, analyzed the parties' intent under *SubMicron Systems*, and held that the advances were donations. The Third Circuit held that the bankruptcy court's determination was not clearly erroneous because (1) "there [was] no written instrument for the court to analyze and determine whether the terms suggest an expectation of repayment," even though some of the checks had "loan" written on them, and (2) there was "no evidence of intent on behalf of [the debtor] to accept or authorize the purported loans, such as a resolution from the board of directors, or evidence that the board was aware of the loans."

***SemCrude L.P. v. Manchester Sec. Corp. (In re SemCrude L.P.)*, No. 11-1724, 2012 U.S. App. LEXIS 34 (3d Cir. Jan. 3, 2012) (Sloviter, J.).**

The Court of Appeals for the Third Circuit, applying an abuse of discretion standard to the application of the equitable mootness doctrine, affirmed a district court decision dismissing the appellant's bankruptcy appeal for being equitably moot. The district court found, and the Third Circuit concurred, that all of the five equitable mootness factors weighed in favor of finding the appeal equitably moot: (1) the plan of reorganization had been substantially consummated because a number of significant transactions were completed after the plan was approved and the relief the appellant sought would undermine the plan; (2) the appellant did not obtain a stay and did not even assert that it made any effort to ascertain the amount of the bond it might have been required to post; (3) the appeal would affect the rights of parties not before the court such as financial institutions that had extended lines of credit to the reorganized debtors, counterparties that had entered into executory contracts and leases, and holders of stocks and warrants issued as part of the consummation of the plan; (4) the appeal, if successful, would affect the success of the plan because the reorganized debtors could not part with the amount the appellant sought without undermining their financial health; and (5) the public policy of affording finality to bankruptcy judgments favored dismissing the appeal.

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Young Conaway Stargatt & Taylor, LLP, one of Delaware's largest law firms, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Young Conaway also guides regional businesses and individuals through a myriad of

***Nantahala Capital Partners, LP v. Wash. Mut., Inc. (In re Wash. Mut., Inc.)*, Ch. 11 Case No. 08-12229 (MFW), Adv. No. 10-50911 (MFW), 2012 Bankr. LEXIS 1 (Bankr. D. Del. Jan. 3, 2012) (Walrath, J.).**

The bankruptcy court granted judgment for Washington Mutual and against certain litigation–tracking warrantholders who had sought a determination that they held debt rather than equity. A bank had issued its stockholders warrants that entitled the holder to receive future stock in an amount proportional to any recovery received in certain ongoing litigation. The bank merged with Washington Mutual, which filed for bankruptcy, and the warrant holders filed suit, arguing that taken together, the warrant and merger agreements entitled them not simply to stock but to an election between stock and cash. The court disagreed and after trial was persuaded, largely on the basis of testimony by the creators of the warrants about their intent, that the warrants were true equity instruments. Also, the holders' claims for breach of the agreements were meritless and would be subordinated under § 510(b) in any event. Finally, the holders had no interest in the underlying litigation, which was estate property.

***In re Nortel Networks, Inc.*, No. 11-1895, 2011 U.S. App. LEXIS 25929 (3d Cir. Dec. 29, 2011) (Sloviter, J.).**

The Court of Appeals for the Third Circuit, exercising plenary review as to the legal precepts underlying section 362 of the Bankruptcy Code and applying the abuse of discretion standard as to the lower courts' decisions regarding comity, affirmed a district court decision holding that the appellants' participation in U.K. pension proceedings that would determine the U.S. debtors' liability in regards to the underfunding of Nortel U.K.'s pension plan did not fall within the police-power exception to the automatic stay contained in section 362(b)(4) and, therefore, the automatic stay applied. The Third Circuit held that neither of the appellants was a governmental unit within the scope of the police-power exception because first, the Trustee of Nortel Networks U.K. Pension Plan is a private party administering private benefits, and second, the U.K. Board of the Pension Protection Fund (the "PPF") is standing in the shoes of a private party at the current phase of the U.K. pension proceedings. The Third Circuit also held that the U.K. pension proceedings failed both the pecuniary purpose test and public policy test because (1) the UK pension proceedings are focused on the pecuniary interests of the PPF and the members of Nortel UK's pension scheme and (2) the proceedings do not relate to public health or safety.

***Zazzali v. Minert (In re DBSI, Inc.)*, Ch. 11 Case No. 08-12687 (PJW), Adv. No. 10-56163 (PJW), 2011 Bankr. LEXIS 5030 (Bankr. D. Del. Dec. 30, 2011) (Walsh, J.).**

In *Zazzali v. Minert*, the defendants moved to dismiss various claims. The interesting twist with this case involved Judge Walsh's ruling regarding the motion to dismiss the claim against certain defendants who were previous employees of and/or professionals for the debtors but who were representing certain investors/creditors in claims asserted by the plan trustee on behalf of the estate. The trustee argued that such defendants had breached their fiduciary duty to the debtors and the estates by subsequently representing an interest adverse to the estate. The court noted that "Idaho courts are silent on whether a duty [not to represent an interest adverse to a former client] exists between accountant and former client" and that "[o]ther jurisdictions have apparently never addressed the issue. . . ." However, instead of dismissing the cause of action because of the lack of authority supporting the claim, the court instead declined to dismiss and reserved judgment pending the development of further facts.

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