Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

NOVEMBER/DECEMBER 2020

EDITOR'S NOTE: DEVELOPMENTS
Steven A. Meyerowitz

ARE WE ALL FIDUCIARIES NOW? CONSENT RIGHTS AFTER *PACE INDUSTRIES*—PART II
David S. Forsh, Corby J. Baumann, and Matthew J. Kerschner

IN THE WAKE OF COVID-19: PROTECTIVE ACTIONS RETAIL TENANTS SHOULD TAKE WHEN FACING A LANDLORD'S BANKRUPTCY
Monique D. Almy, Gregory D. Call, Thomas F. Koegel, and Randall L. Hagen

SUBORDINATION AGREEMENT IGNORED IN A CRAMDOWN—BUT WHAT'S SO UNFAIR ABOUT THAT?
Shmuel Vasser and Eric Hilmo

IN DESPERATE TIMES . . . TRAVELPORT PUTS $1.15 BILLION IN COLLATERAL VALUE BEYOND THE REACH OF ITS CREDITORS
David L. Ruediger, George Ticknor, Jason Ulezalka, Jonathan W. Young, and Stephen J. Humeniuk

COURT CONCLUDES FORCE MAJEURE CLAUSE IN LEASE EXCUSED 75 PERCENT OF TENANT'S RENT OBLIGATION BASED ON TENANT'S PERMITTED REDUCED USE DURING COVID-19 SHUTDOWN
Gregory D. Call, Tracy E. Reichmuth, and Ethan W. Simonowitz

NEW YORK COURT ADOPTS MAJORITY "TAINT TRAVELS" RULE
Matthew J. Gold, Dov R. Kleiner, and Michael S. Levine

DELAWARE BANKRUPTCY COURT DIVERGES FROM FIFTH CIRCUIT: MINORITY SHAREHOLDER'S BLOCKING RIGHT INVALIDATED AND FIDUCIARY DUTY IMPOSED
Shmuel Vasser and Casey Norman

CANNABIS INVESTORS AND PRODUCERS FACE NEED FOR DUE DILIGENCE
Benjamin P. Malerba and Stella Lellos

EXECUTORY CONTRACTS IN LATIN AMERICAN REORGANIZATIONS
Francisco L. Cestero and Gabriel Herscovici Junqueira

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 16 NUMBER 8 Nov./Dec. 2020

Editor's Note: Developments
Steven A. Meyerowitz 377

Are We All Fiduciaries Now? Consent Rights After *Pace Industries*—Part II
David S. Forsh, Corby J. Baumann, and Matthew J. Kerschner 380

In the Wake of COVID-19: Protective Actions Retail Tenants Should Take When Facing a Landlord's Bankruptcy
Monique D. Almy, Gregory D. Call, Thomas F. Koegel, and Randall L. Hagen 394

Subordination Agreement Ignored in a Cramdown—But What's So Unfair About That?
Shmuel Vasser and Eric Hilmo 400

In Desperate Times . . . Travelport Puts $1.15 Billion in Collateral Value Beyond the Reach of Its Creditors
David L. Ruediger, George Ticknor, Jason Ulezalka, Jonathan W. Young, and Stephen J. Humeniuk 404

Court Concludes Force Majeure Clause in Lease Excused 75 Percent of Tenant's Rent Obligation Based on Tenant's Permitted Reduced Use During COVID-19 Shutdown
Gregory D. Call, Tracy E. Reichmuth, and Ethan W. Simonowitz 408

New York Court Adopts Majority "Taint Travels" Rule
Matthew J. Gold, Dov R. Kleiner, and Michael S. Levine 412

Delaware Bankruptcy Court Diverges from Fifth Circuit: Minority Shareholder's Blocking Right Invalidated and Fiduciary Duty Imposed
Shmuel Vasser and Casey Norman 416

Cannabis Investors and Producers Face Need for Due Diligence
Benjamin P. Malerba and Stella Lellos 419

Executory Contracts in Latin American Reorganizations
Francisco L. Cestero and Gabriel Herscovici Junqueira 425

LexisNexis

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 415-908-3207
Email: .... kent.hanson@lexisnexis.com
Outside the United States and Canada, please call . . . . (973) 820-2000

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) 487-3385
Fax Number . . . . (800) 828-8341
Customer Service Website . . . . 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 . . . . (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: 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 (2014)

This publication is designed to provide authoritative information in regard to the subject matter covered. It 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 RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2020 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved.

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., 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.

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

(2020–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

Steven A. Meyerowitz

President, Meyerowitz Communications Inc.

EDITOR

Victoria Prussen Spears

Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Scott L. Baena

Bilzin Sumberg Baena Price & Axelrod LLP

Andrew P. Brozman

Clifford Chance US LLP

Michael L. Cook

Schulte Roth & Zabel LLP

Mark G. Douglas

Jones Day

Mark J. Friedman

DLA Piper

Stuart I. Gordon

Rivkin Radler LLP

Patrick E. Mears

Barnes & Thornburg LLP

Pratt's Journal of Bankruptcy Law is published eight times a year by Matthew Bender & Company, Inc. Copyright © 2020 Matthew Bender & Company, Inc., a member of LexisNexis. 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 customer support, please contact LexisNexis Matthew Bender, 9443 Springboro Pike, Miamisburg, OH 45342 or call Customer Support at 1-800-833-9844. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to lawyers and law firms, in-house counsel, government lawyers, senior business executives, and anyone interested in privacy and cybersecurity related issues and legal developments. 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, 230 Park Ave. 7th Floor, New York NY 10169.

New York Court Adopts Majority "Taint Travels" Rule

By Matthew J. Gold, Dov R. Kleiner, and Michael S. Levine*

Siding with the U.S. Court of Appeals for the Third Circuit, a New York bankruptcy court has held that a transferred claim can be disallowed or subordinated based on actions of the initial claim holder. The authors of this article discuss the decision, which provides uniformity in a disputed area of the law and raises due diligence questions for claims traders and lenders.

A New York bankruptcy court has adopted the majority rule in holding that a transferred claim can be disallowed or subordinated based on actions of the initial claim holder, siding with the U.S. Court of Appeals for the Third Circuit and rejecting a contrary decision of a New York district court. The decision, *In re Firestar Diamond, Inc.*,[1] provides uniformity in a disputed area of the law and raises interesting due diligence questions for claims traders and lenders.

BACKGROUND

Firestar Diamond was a wholesaler of finished jewelry that was accused by its bankers of being involved in what the bank called "the largest bank fraud in Indian history." Proofs of claim were submitted by or on behalf of four banks, based on financing arrangements with related non-debtor entities under which amounts owed by the debtor to those non-debtor entities had been pledged or factored to the banks. The trustee alleged that the non-debtor entities had each received millions of dollars in fraudulent transfers and preferences from the debtor, and objected to the banks' claims under Bankruptcy Code Section 502(d), which disallows claims of entities that have received avoidable transfers. The banks responded that the avoidable transfers had gone to the non-debtor

* Matthew J. Gold is a partner at Kleinberg, Kaplan, Wolff & Cohen, P.C., representing secured and unsecured creditors, creditors' committees, debtors, landlords, trustees and acquirers of assets in Chapter 11 reorganizations, Chapter 7 liquidations, voluntary and involuntary cases, SIPA proceedings, and out-of-court workouts and restructurings. Dov R. Kleiner is a partner at the firm advising clients on bankruptcy and workout issues, focusing on transactional and credit matters. Michael S. Levine is a partner at the firm advising trading desks of investment funds regarding purchases and sales of par and distressed assets including bank loans, equity interests, trade claims, and other instruments. The authors may be reached at mgold@kkwc.com, dkleiner@kkwc.com, and mlevine@kkwc.com, respectively.

[1] *In re Firestar Diamond, Inc.*, 615 B.R. 161 (Bankr. S.D.N.Y. 2020).

entities, not the banks, and cited to the 2007 district court decision in *In re Enron*,[2] which is described below.

"TAINT TRAVELS" CASES

In *Enron*, the debtor brought suit against several banks and the current holders of claims originally held by the banks, alleging pre-petition misconduct by the banks and seeking, among other things, to avoid pre-petition transfers made to the banks and, in the alternative, to disallow under Section 502(d) or to equitably subordinate the claims. The bankruptcy court reasoned that the claims were "tainted" by the alleged bad acts, and that subsequent holders of the claims acquired them subject to the taint. Accordingly, the bankruptcy court denied the defense that the claims were held by innocent transferees and held that the claims could be disallowed or equitably subordinated. The district court reversed and remanded, holding that whether a claim can be disallowed in such circumstances depends upon whether the claim was "sold" or "assigned," as well as whether the claim transferee had knowledge of the taint. The *Enron* litigation was settled before any determinations were made on remand.

The *Enron* district court's distinction between sales and assignments was not based on any express provision of the Bankruptcy Code and has been much criticized. No subsequent reported case has adopted the distinction or its result. In *In re KB Toys, Inc.*,[3] the Third Circuit termed the *Enron* sale/assignment distinction "problematic," and instead reached the same result as the *Enron* bankruptcy court.

FIRESTAR DIAMOND DECISION

The *Firestar Diamond* court first determined that it was not bound to follow *Enron*. It then surveyed the Taint Travels cases and adopted the reasoning and result of *KB Toys* and the *Enron* bankruptcy court. It rejected the banks' equitable argument that they were innocent victims of the Firestar Diamond fraud, holding that there is no equitable exception to the applicability of Section 502(d), and further determining that the banks' equities were not more compelling than those of the Firestar Diamond general unsecured creditors.

Analysis

While the *Enron* district court decision has not been formally overruled or rejected by a higher court, it increasingly appears to be a dead letter. The *Firestar*

---

[2] 379 B.R. 425 (S.D.N.Y. 2007), *reversing and remanding (In re Enron Corp.)*, 340 B.R. 180 (Bankr. S.D.N.Y. 2006).

[3] *In re KB Toys Inc.*, 736 F.3d 247 (3d Cir. 2013).

Diamond decision has the effect of bringing the law of the Southern District of New York into agreement with that of the District of Delaware, providing clear guidance to the secondary markets for bankruptcy claims as to the prevailing governing standard.

As purchasers of claims will likely be unable to assert a defense that they are innocent purchasers immune from the acts of their sellers, it is all the more important for them to consider how to minimize their exposure to the risk that acquired claims might be subordinated or disallowed under Section 502(d). Purchasers of trade claims can negotiate for recourse protection from sellers.

On the other hand, purchasers of bank debt should understand that the standard terms of bank debt trade documentation do not provide recourse against sellers or upstreams for claim objections that apply to all lenders under a syndicated loan (as opposed to claim objections that apply solely to the claim of a single lender but not to the claims of other lenders under such syndicated loan). Traders and analysts may wish to consider including the risk of Section 502(d) exposure as part of their due diligence and determination of an appropriate purchase price for a loan.

The risk of Section 502(d) Taint Travels exposure is not limited to claims purchasers. Indeed, the affected creditors in *Firestar Diamond* were not distressed debt purchasers but rather lenders whose collateral included pledges of receivables. Those who lend against receivables, especially receivables against entities that are related to the borrower, should consider robust diligence and possibly additional protections such as obtaining a guaranty or additional collateral or requiring a higher interest rate from the borrower.

While fraud was the cause of the "taint" in *Firestar Diamond*, a purchaser's exposure to Section 502(d) risk is not limited to fraud situations. For example, in *KB Toys* the "taint" was traceable not to bad acts or fraud but instead merely to alleged preferences received by the original claimants.

Consider a hypothetical situation in which a piece of a syndicated loan is purchased from a lender (not the agent) and in which the agent bank is accused of receiving a voidable preference with regard to a separate loan facility with the same borrower/debtor. The borrower/debtor could object under Section 502(d) to the syndicated loan claim. Because the Section 502(d) objection applies to the entire syndicated loan, the purchaser will not have recourse against its seller. Furthermore, depending upon the scope of the provisions of the credit agreement, the purchaser may not have recourse against the agent.

CONCLUSION

Purchasers of claims and interests in bank loans should consider, as part of standard due diligence review with respect to the purchase of claims and loans,

reviewing not only the credit agreement but also other background factors that could lead to Section 502(d) exposure, such as the relationships between agent lenders and the borrower and structure of the underlying claims and collateral securing the loans.