

BANKRUPTCY UPDATE

Expert Analysis

Detroit's Historic Filing; Developments In American Airlines, Dewey, Kodak

Today's column updates readers on major events that transpired in the high-profile bankruptcy cases of American Airlines, Dewey & LeBoeuf, City of Detroit, Kodak and Interfaith Medical Center. The column discusses American Airlines and Kodak's recently confirmed plans of reorganization and the impact of recent antitrust litigation on American Airlines' ability to emerge from bankruptcy. The column also focuses on litigation developments in Dewey & LeBoeuf's bankruptcy case and Detroit's "eligibility" battle. Finally, the column discusses the closure threat faced by Brooklyn's Interfaith Medical Center.

'AMR'

American Airlines, together with parent company AMR Corporation, sought bankruptcy protection on Nov. 29, 2011, under Chapter 11 of the Bankruptcy Code. As discussed in prior columns, the bankruptcy was precipitated by American Airlines' rising organized labor costs and an imbalanced competitive field.

As previously discussed, American Airlines secured bankruptcy court approval of an \$11 billion merger with U.S. Airways Group, to form the world's largest airline. The merger enjoyed the support of key bankruptcy constituencies including the official committee of unsecured creditors (committee appointed by the U.S. Trustee comprised of large unsecured creditors representing the interests of general unsecured creditors) and the airline's major unions.

On Sept. 12, 2013, the Bankruptcy Court approved American Airlines' plan of reorganization which incorporates and depends upon the consummation of the merger between American Airlines and US Airways.

However, American Airlines' exit from bank-

By
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ruptcy is still far from certain. The U.S. Department of Justice, together with attorneys general from six states and the District of Columbia, commenced an antitrust suit in the district court for the District of Columbia against American Airlines and US Airways seeking to block the merger.

The Justice Department argued that the \$11 billion merger will have a profoundly negative impact on consumers in a market that is already significantly consolidated as a result of the recent mergers of Delta Airlines with Northwest Airlines and United Airlines with Continental Airlines. American Airlines and US Airways countered that the combined airline will be more competitive and provide consumers with more options as the two airlines operate primarily out of different hub cities.

American Airlines' exit from bankruptcy is still far from certain.

A trial in the district court antitrust action is scheduled for Nov. 25, 2013. The current deadline under the merger agreement to consummate the merger is Jan. 18, 2014, or, if the airlines win at trial, within two weeks of the court's ruling. If the Justice Department succeeds at trial, the merger agreement can be mutually terminated by the airlines within five days.

In the event the merger is blocked, the plan of reorganization will not go into effect and American Airlines will be forced to return to the drawing board to work toward a new plan in bankruptcy court.

AMR (Bankr. S.D.N.Y. Case No. 11-15463).

'Dewey & LeBoeuf'

International law firm Dewey & LeBoeuf filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code on May 29, 2012. Dewey suffered from reduced revenues and significant partner defections.

As discussed in prior columns, following the bankruptcy filing, the firm reached a \$71 million settlement of potential "clawback" claims with approximately 400 former partners.

The bankruptcy court approved Dewey's "liquidation plan" earlier this year and established a liquidating trust for the benefit of Dewey's creditors. A liquidating plan, as opposed to a plan of reorganization, provides for the liquidation of estate assets and claims for the benefit of creditors. The liquidating trust was tasked with pursuing certain litigation on behalf of the firm's creditors.

The liquidating trustee recently commenced "preference actions" under Bankruptcy Code section 547 against many of Dewey's former vendors, including companies that provided legal, real estate brokerage, collection, billing, data and other similar services to the law firm. Bankruptcy Code section 547 allows a trustee or debtor in possession to avoid a transfer made by a debtor while insolvent to or for the benefit of a creditor on account of an antecedent debt within 90 days (or one year in the case of an "insider") of the petition date, where such transfer enables the creditor to receive more than it would have received in a Chapter 7 liquidation. The rationale for the statute is that the company was likely insolvent 90 days before the bankruptcy filing, and it was unfair that some creditors were "preferred" and paid in full while others were not. The monies recovered in a preference action are evenly redistributed among the unsecured creditors.

According to a report filed by the liquidating trustee, as of August 2013, the liquidating trustee recovered approximately \$99.6 million (inclusive of \$17.5 million received in trust funding) through

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settlements and/or judgments.

Dewey & LeBoeuf (Bankr. S.D.N.Y. Case No. 12-12321).

'City of Detroit'

The City of Detroit made history when it filed for bankruptcy protection under Chapter 9 of the Bankruptcy Code on July 18, 2013. As the largest municipality to seek bankruptcy protection thus far, Detroit listed approximately \$18 billion in debt, including \$11.9 billion of unsecured obligations owed to lenders and retirees.

Chapter 9 of the Bankruptcy Code provides for voluntary bankruptcy proceedings by municipalities. While it shares many similarities with Chapter 11 proceedings, there are also some important distinctions. One significant difference is a requirement to negotiate with creditors prior to the commencement of a Chapter 9 proceeding. Another significant difference between Chapter 11 and Chapter 9 is the limitation on bankruptcy court powers to affect the governance of the municipality.

The city's employees and retirees whose benefits are threatened by the bankruptcy filing sought to enjoin the bankruptcy in state court arguing, among other things, that the bankruptcy filing violated the state constitution because it jeopardizes accrued benefits of retirees. The city immediately and successfully moved in bankruptcy court to halt this litigation arguing that it violated the "automatic stay." The bankruptcy automatic stay is invoked as soon as a debtor files a bankruptcy petition and acts as a stay of all actions against a debtor or property of a debtor's estate.

While the state court litigation is stayed, Detroit faces a significant fight in bankruptcy court over its eligibility to commence a Chapter 9 bankruptcy case. Over 100 objections to Detroit's eligibility were filed by parties in interest, including unions and retirees. In order to be eligible for protection under Chapter 9 of the Bankruptcy Code a debtor must (i) be a municipality, (ii) be authorized by state law to be a debtor, (iii) be insolvent, (iv) desire to effect a plan to adjust its debts and (v) (a) have either reached a deal with the majority (in dollar amount) of its creditors, (b) negotiated with its creditors in good faith but failed to reach agreement, (c) be unable to negotiate with its creditors because negotiation would be impracticable, or (d) reasonably believe that a creditor may attempt to obtain an avoidable transfer from the municipality.

Detroit filed a consolidated response to the objections arguing that it satisfied the criteria for obtaining Chapter 9 relief. It cited a Michigan state statute that authorizes an emergency manager to file bankruptcy for an insolvent municipality. The city also argued that while Chapter 9 requires a debtor municipality to negotiate with creditors prior to commencing a case, such negotiations could not be meaningful in this case in light of the number of creditors involved. A hearing on objections addressing legal (as opposed to

factual) issues will take place on Oct. 15 and 16, 2013. A further evidentiary hearing is scheduled for Oct. 23, 2013.

Eligibility disputes are not uncommon in Chapter 9 proceedings and often take a significant amount of time to resolve. Notably, San Bernardino, Calif., recently won an eligibility fight in its Chapter 9 proceeding after over a year of litigation. San Bernardino sought bankruptcy protection under Chapter 9 of the Bankruptcy Code in August 2012 to address unsustainable pension costs and a \$46 million budget shortfall. Opponents of the Chapter 9 proceeding, including the California state pension fund, argued that San Bernardino was not eligible for Chapter 9 protection because the city did not have a plan to reorganize and did not negotiate with creditors prior to the bankruptcy filing. San Bernardino countered that it desires to effectuate a plan of reorganization and could not negotiate with its creditors in advance because such negotiations would be impracticable.

The Bankruptcy Court agreed with San Bernardino and noted that the Chapter 9 proceeding was the city's only chance to reorganize.

City of Detroit, Mich. (Bankr. E.D. Mich. Case No. 13-53846).

Kodak's unsecured creditors will receive 15 percent of the equity in the reorganized company, warrants to purchase 10 percent of the company, and interest in a litigation trust empowered to pursue litigation with the aim of recovering money for the trust's beneficiaries. Kodak's shareholders will receive no distribution under the plan.

'Eastman Kodak'

Photography pioneer Eastman Kodak Company commenced its Chapter 11 bankruptcy proceeding on Jan. 19, 2012, to trim and streamline its business after failing to raise sufficient operating cash through sales of digital patents.

As discussed in a prior column, in an effort to cut its expenses, Kodak first reached agreements with retired Kodak employees to significantly reduce Kodak's future exposure for medical, dental, life insurance and survivor income benefits.

Kodak also streamlined its operations by selling its personalized and document imaging business for \$650 million to its U.K. pension plan.

In August of this year, Kodak secured bankruptcy court approval of its plan of reorganization over shareholder opposition. The plan of reorganization provides for the transfer of 85 percent of the company's stock to certain creditors through rights offerings totaling \$406 million. The funds raised will be utilized to fund distributions to creditors and pay a portion of the claims

in cash upon confirmation of the plan. Kodak's unsecured creditors will receive 15 percent of the equity in the reorganized company, warrants to purchase 10 percent of the company, and interest in a litigation trust empowered to pursue litigation with the aim of recovering money for the trust's beneficiaries. Kodak's shareholders will receive no distribution under the plan.

The reorganized company intends to focus its business on commercial printing.

Eastman Kodak (Bankr. S.D.N.Y. Case No. 12-10202).

'Interfaith Medical Center'

Interfaith Medical Center, a central Brooklyn hospital and clinic operator serving 250,000 patients annually, filed a petition for relief under Chapter 11 of the Bankruptcy Code on Dec. 2, 2012. The bankruptcy filing was precipitated by continuing Medicaid reimbursement cuts and an inability to effectuate a business combination with another hospital outside of bankruptcy.

Following the bankruptcy filing, Interfaith continued to pursue a merger with another hospital and engaged in significant discussions with Brooklyn Hospital Center. The parties entered into a memorandum of understanding approved by the bankruptcy court to allow Brooklyn Hospital to conduct due diligence in connection with the potential merger. However, a transaction with Brooklyn Hospital was never consummated.

In July 2013, at the direction of the New York State Department of Health and Interfaith's secured lender, the Dormitory Authority of the State of New York, Interfaith filed a motion seeking court approval of a closure plan for the hospital. Several key creditor groups and parties in interest, including the IM Foundation (a foundation dedicated to preserving medical care access in central Brooklyn), New York State Nurses Association and New York City Public Advocate Bill de Blasio opposed the closure. The public advocate also sought relief from the automatic stay in order to commence an action in New York state court to enjoin the Department of Health from approving the closure plan. The IM Foundation also proposed an alternative operational restructuring that would preserve a streamlined medical center and sought bankruptcy court permission to file its own plan of reorganization.

The hearing on the closure motion was adjourned several times as the Department of Health acknowledged that the closure plan filed with the bankruptcy court is not acceptable in its present form and discussions among the parties continue. The hearing on the closure and other motions is currently scheduled for Oct. 15, 2013.

Interfaith Medical Center (Bankr. E.D.N.Y. Case No. 12-48226).