Our Group Is Rolling Into 2018, But Looking Back, We Had A Great 2017, To Heighten A Few, We:

- Negotiated stay relief for the single largest secured creditor, and vendor, of an energy company in Chapter 7. Subsequently defended against preference, fraudulent conveyance, fraud, insider, good faith and fair dealing, and subordination claims by Trustee. In a defense aided by pre-action discovery under *Rule* 2004, we obtained partial dismissal of the complaint on motion, and then successfully resolved remaining claims.
- Settled for *de minimis* value complex preference and unauthorized post-petition transfer action involving pre and post-petition emergency service provider to Chapter 11 debtor. Provider had been retained on eve of bankruptcy, and had functioned under a contract and advance deposit.
- Represented secured creditor on negotiations, *Section* 363 and successful auction sale of Staten Island commercial facility.
- Represented a land owner in successfully obtaining dismissal of a bankruptcy initiated by a developer who was seeking to preserve a failed development project on the owner's farmland.
- Represented the Chapter 11 trustee of an individual debtor in obtaining bankruptcy court approval of a $12 million sale of a former gas station and car wash property in New York City. This matter included substantial negotiations with the real estate developer – purchaser. It also require application of Bankruptcy Code §363(h) to sell the interest of a co-owner of the property.

Equitable Subordination and the Separate Doctrine of Recharacterization of Debt to Equity in Bankruptcy – Be Leary of "Good Money after Bad"

Owners, shareholders (including parents and subsidiaries) in closely held businesses, lenders and investors, and the professionals who represent them, must be concerned with equitable subordination of advances, loans and investments, and the recharacterization of debt to equity, in bankruptcy. The Federal statutory rubric for equitable subordination, and the separate judge made doctrine of recharacterization, are similar, often confused and frequently pled in tandem – despite distinctions between the two. In simple terms, equitable subordination of a claim can occur after a bankruptcy filing, where a principal, shareholder or insider, (and in some instances even an angel investor, trade creditor or lender), has advanced funds to the company prior to the bankruptcy. A bankruptcy court may subsequently determine that the advances were an equity contribution, and therefore subordinate to all unsecured creditors.

Equitable subordination claims arise under 11 *U.S.C.* § 510(c) of the Bankruptcy Code. Recharacterization, on the other hand, is an equitable, judge made doctrine that does not arise under a specific provision of the Bankruptcy Code. Equitable subordination is applied when a creditor's pre-petition acts are in question – but there is little question about the documentary foundation of the claim. Debt recharacterization focuses on whether or not a debt actually exists – as opposed to whether the debt is a disguised equity contribution.

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Equitable Subordination and the Separate Doctrine… ***Cont'd…/***

In 2016, the U.S. Supreme Court granted Certiori in the case of *PEM Entities LLC v. Levin, et als*. to resolve a split of the circuits as to whether bankruptcy courts should employ state or federal law in recharacterizing debt to equity. Ultimately, the grant of Certiori was dismissed as improvidently granted, thus the Supreme Court has not ruled on the issue. The Third Circuit, has long been in the majority in holding that recharacterization is governed by federal common law. There is no body of common law emanating from the state courts of New Jersey directly regarding the recharacterization of debt equity.

All circuits agree that bankruptcy courts as courts of equity have the power to recharacterize debt as equity. Despite varying tests, the Third, Fourth, Sixth, Tenth and Eleventh Circuits employ federal common law in reliance upon the Bankruptcy Court's equitable powers pursuant to 11 *U.S.C* § 105(a). The Fifth and Ninth Circuits defer to state law and Section 502 of the Bankruptcy Code, under *Butner vs. United States.* Presently, within the Third Circuit, New Jersey Bankruptcy Courts must follow the test set forth in *Submicron.* Were the Supreme Court ever to decide to visit the split, and were it to rule in favor of the minority position, recharacterization claims might be quite different, and perhaps much more difficult if not impossible, given the paucity of New Jersey state court decisions directly addressing the equitable doctrine of recharacterization of debt.

Both equitable subordination and recharacterization often pose "all or nothing" stakes for owners, investors and lenders. The cost of successfully defending a principal, shareholder, investor, lender or the like as to these fact sensitive claims can be very high. Extreme care in the drafting and execution of transactions which may be subject to these claims, and extreme caution in the parties' behavior regarding these transactions, is absolutely critical to avoid later bankruptcy litigation and to maintain a solid defenses.

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About Becker LLC

Becker LLC is a premier mid-market firm serving the New York, New Jersey, Philadelphia and California corridor. The firm provides the complete spectrum of legal services from litigation, transactional, labor and employment, and bankruptcy law counseling, to intellectual property, real estate and construction law-related advice. Our size and regional footprint allows us to provide sophisticated services in a manner not only focused on results, but also on our client's return on their investment. For more information, call (973) 422-1100, or visit www.becker.legal