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Second Circuit Reverses District Court in *Marblegate*, Making It Easier to Restructure Bonds Outside of a Chapter 11 Case

By Alan R. Glickman, David M. Hillman, Ronald B. Risdon and Minji Reem

On Jan. 17, 2017, in a closely watched dispute surrounding Section 316(b) of the Trust Indenture Act of 1939, the U.S. Court of Appeals for the Second Circuit issued its long-anticipated decision in *Marblegate Asset Management, LLC v. Education Management Finance Corp.*, No. 15-2124-CV(L), 2017 WL 164318 (2d Cir. Jan. 17, 2017) (the "Decision"). In a 2-1 ruling reversing the district court, the court of appeals construed Section 316(b) narrowly, holding that it only prohibits "non-consensual amendments to an indenture's core payment terms" and does not protect noteholders' practical ability to receive payment. Decision at *1.

In so ruling, the Second Circuit considered the issue arising in the recent Southern District of New York District Court decisions in *Marblegate* (*Marblegate Asset Management v. Education Management Corp.*, 75 F.Supp.3d 592 (S.D.N.Y. 2014) (*Marblegate I*); *Marblegate Asset Management, LLC v. Education Management Corp.*, 111 F.Supp.3d 542 (S.D.N.Y. 2015) (*Marblegate II*)), and two cases relating to Caesars Entertainment (*BOKF, N.A. v. Caesars Entertainment Corp.*, 144 F.Supp.3d 459 (S.D.N.Y. 2015); *MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp.*, 80 F.Supp.3d 507 (S.D.N.Y. 2015) (collectively, *BOKF/MeenhanCombs*)), as to when an out-of-court debt restructuring may violate Section 316(b) of the TIA.

Some, but not all, of the cases before and after them that have dealt with the issue have treated Section 316(b) as providing a narrow and specific protection for noteholders: requiring noteholder unanimity to alter the legal right to repayment under the terms of an indenture and the right to sue to enforce that right, but not protecting the practical right to receive payment.

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What Constitutes 'Proper' Notice?

By Bruce Buechler

Proper notice is a hallmark of all bankruptcy proceedings. If a creditor or party-in-interest has no notice of a particular matter, many courts have ruled that the creditor or party-in-interest will not be bound by a particular court's determination. The Fifth Amendment to the Constitution provides that "no person shall … be deprived of life, liberty, or property, without due process of law … ."

Thus, without providing creditors and parties-in-interest with adequate notice of, say, the bar date or the deadline to file a proof of claim, those creditors and parties-in-interest may not be bound by the bar date and their rights will not be cut off. Similarly, in connection with a sale of assets under section 363 of the Bankruptcy Code, if creditors, including lienholders, were not provided sufficient notice of a sale motion, such creditors may not be bound by the sale approval order.

Known vs Unknown Creditors

The requirements for constitutional notice to creditors in a bankruptcy case may be satisfied in several distinct ways, depending on whether a particular creditor is known or unknown. With respect to known creditors, courts have held that a creditor's constitutional right to due process is not violated if

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The *Marblegate* and *BOKF/MeenhanCombs* district court decisions, however, construed Section 316(b) as a broad protection of noteholders' practical ability to receive payment. The potential implications of those decisions were not insignificant — under those holdings, any out-of-court restructuring that deprived dissenting noteholders of assets against which to recover could violate Section 316(b), even absent any formal amendments to the indenture's payment terms. According to counsel for EDMC and its secured creditors, more noteholder actions for Section 316(b) violations were filed in the wake of the district court decision in *Marblegate* than in the preceding 70 years since the enactment of the TIA, despite a significant decrease in the number of out-of-court restructurings.

The Second Circuit in *Marblegate* rejected the district court's broad reading of Section 316(b), construing it as prohibiting only the actual amendment of an indenture's payment terms or right to sue for payment.

WHAT HAPPENED IN *MARBLEGATE*

Marblegate involved a dispute between Education Management Corp., a for-profit education company, and its affiliates (EDMC), and one of its noteholders, Marblegate Asset Management LLC (Marblegate), regarding an out-of-court restructuring designed to incentivize all of EDMC's creditors to accept an exchange offer by the company.

The transaction contemplated two scenarios: 1) if all noteholders consented to the proposed restructuring, then the notes would be converted into equity of the issuer's parent guarantor; however, 2) if there were any dissenting noteholders, then there would be an alternative transaction under which the secured lenders would foreclose on substantially all of EDMC's assets and release the EDMC parent guarantee of the notes.

Although the transaction did not formally amend the actual terms of the unsecured notes, it was structured to ensure that dissenting noteholders would be left only with claims against a subsidiary with no assets. Despite that, because EDMC was able to reduce its debt burden through the very transaction to which Marblegate objected, EDMC apparently now actually has the assets to pay on Marblegate's notes. Decision at *4. However, that did not play any role in the court's decision. Marblegate, the sole dissenting noteholder, sued to enjoin the restructuring transaction on the ground that it violated TIA Section 316(b).

THE DISTRICT COURT PROCEEDINGS: *MARBLEGATE I* AND *II*

The core issue in *Marblegate* was whether the "right ... to receive payment" is to be read narrowly, as a legal entitlement to demand payment, or broadly, as a substantive right to actually obtain such payment.

EDMC argued the former — that Section 316(b) only prohibits nonconsensual amendments to an indenture's core payment terms, and that the transaction was outside the purview of Section 316(b) because it did not amend any terms of the indentures. Marblegate, on the other hand, argued the latter — that Section 316(b) should be broadly construed as a protection against any impairment to a noteholder's practical ability to receive payment, even absent any formal amendments to the indenture's payment terms. According to Marblegate, the transaction violated Section 316(b), since it stripped the issuers of their assets and removed the parent guarantee, effectively preventing payments to the dissenting noteholders.

The district court adopted Marblegate's broader reading and

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Client Data in the Age of Digital Technologies and Cyber Warfare

By Tinamarie Feil

Ubiquitous news of law firm data breaches, even among BigLaw, spotlights a treasure trove of trade secrets, confidential and strategic transactions, and sensitive client information — all of which might be stolen from law firms for ransom, sale, insider trading, blackmail or hacktivist purposes. No wonder law firms are perceived to be attractive targets of cyber-attacks. Attractive? You can't help that. Easy? Not so fast. Don't let your firm be an attractive AND easy target!

With developing and aggressive governmental policies to combat cyber warfare alongside ethical and legal obligations to protect clients' technical, private and privileged information, lawyers must be competent and reasonable in their practice. For example, among the last things you need is an inadvertent electronic disclosure of confidential client data such as a customer list when working on a 363 sale. Your technical competence and the reasonableness of your efforts to thwart such a leak could lead to questioning by a governmental agency as well as to suffering punitive consequences.

What was seen to be reasonable at any given point is likely to change quickly with a new ruling or the enactment of a law. In fact, while technological competency was addressed back in 2012 with an amendment to MRPC 1.1, Florida, as of Jan. 1, 2017, was the first state to require technology related CLE courses. In adopting the bar association's proposal for mandatory technology CLEs, the Florida Supreme Court opined that competent representation may involve a lawyer's association with, or retention of, a non-lawyer adviser with established technological competence in the relevant field. Additionally, the court said, in order to maintain the requisite knowledge and skill, a lawyer should engage in continuing study and education, including an understanding of the risks and benefits associated with the use of technology.

In what areas should a bankruptcy practitioner be vigilant regarding the risks and benefits of using technology?

Security Basics

Some valuable examples of bankruptcy-specific issues are discussed further below. But first, here are some excellent basics extracted from a publication of the Federal Trade Commission (FTC) that describes lessons learned from 50+ FTC data security settlements.

Start with Security. Make conscious choices about the kind of information you collect, how long you keep it, and who can access it. There is a plethora of personally identifiable information (PII), as defined at § 101(41A), together with other sensitive client data, that is collected in the bankruptcy and restructuring process. Consider also whether your data destruction policy can eliminate unnecessary maintenance or possession of sensitive client data.

Sensibly Control Access to Data. Not everyone in the firm needs access to the confidential data you collect. Implement proper user authorization controls and train personnel on proper treatment of confidential data. Restrict administrative rights so that changes to your network can only be made by those tasked to do so.

Require Secure Passwords and Authentication. Too many firms allow common dictionary words as administrative passwords, as well as passwords already in use for other accounts. Hackers use password-guessing tools and try passwords stolen from other services. Best to require complex passwords and avoid using the same or similar passwords for multiple and both business and personal accounts. Implement a policy to suspend or disable accounts after repeated login attempts.

Store Sensitive Information Securely and Protect It During Transmission. Assuming you have secured your own network, keep the sensitive information secure throughout its lifecycle. Use industry-tested and accepted methods. Often, data is encrypted in its initial transmission but once received the security feature is removed and then shared both in and outside of the firm. Ensure proper configuration. Encryption — even strong methods — won't protect your users if you don't configure it properly. (Turning off a critical process known as SSL certificate validation without implementing other compensating security measures is a common example.)

Segment Your Network and Monitor Who's Trying to Get In and Out. Firewalls should be set up to segment your network, thereby limiting access between computers on your network and between your computers and the Internet. Another useful safeguard: intrusion detection and prevention tools to monitor your network for malicious activity.

Secure Remote Access to Your Network. Most firms allow remote access and mobile access, which can pose new security challenges. If you give employees, clients or service providers remote access to your network, have you taken steps to secure those access points? You need to ensure endpoint security. Just as a chain is only as strong as its weakest link, your network security is only as strong as the weakest security on a device with remote access to it (*e.g.*, ensure there's antivirus protection on outside computers accessing the firm's network and clients or service providers with remote access should have basic security measures, like firewalls and updated antivirus software).

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Make Sure Service Providers Implement Reasonable Security Measures. Before hiring someone, be candid about your security expectations. Take reasonable steps to select providers able to implement appropriate security measures and monitor that they're meeting your requirements. Put it in writing. Insist that appropriate security standards are part of your contracts. Verify compliance. Security can't be a "take our word for it" thing. Including security expectations in contracts with service providers is an important first step, but it's also important to build oversight into the process.

Put Procedures in Place to Keep Your Security Current and Address Vulnerabilities That May Arise. If you use third-party software on your network, or you include third-party software libraries in your applications, don't ignore updates, implement them as they're issued. Outdated software undermines security. The solution is to update it regularly and implement third-party patches. Heed credible security warnings and move quickly to fix them.

Secure Paper, Physical Media and Devices. Just as you lock your office or filing cabinet, your server should be in a locked rack. Media and devices should be password protected. Dispose of sensitive data securely by shredding, burning, or pulverizing documents to make them unreadable and by using available technology to wipe devices that are lost or aren't in use.

Avoid Unencrypted Emails, Mobile Transport of Confidential Data. Attention is certainly given to PII when selling or transferring same and when disclosed in court filings. Note, though, that PII such as customer and creditor lists, together with confidential data anticipating a client merger, acquisition or filing for Chapter 11 relief and asset and liability data, is often carried on thumb-drives or laptops, or transmitted via unencrypted email.

At a very minimum, password protect emails with attachments containing sensitive information. There is risk that the information may either be captured "en route," or provided to the wrong party (either by mistake or on purpose). Once password protected data is received, don't compromise it by removing the security. To safeguard confidential data transmissions, explore using a Secure Virtual Data Room (VDR). It is more likely that confidential data emerges not as the result of a hack, but due to security lapses. Today, more and more of our critical data safely resides in the cloud, accessible via the Internet, anywhere in the world.

Top-tier virtual data rooms have proven to be a secure, encrypted alternative to the unencrypted, insecure email systems that many law firms and advisers currently use. The user authorization requirements and global accessibility of VDRs really obviate the need to ever physically carry confidential data. Using VDRs to share confidential data and ease collaboration is standard practice in North America. Use of project names/aliases, rather than actual client names, is likewise a standard practice. Not taking such simple and effective steps to protect confidential data would likely be considered negligent by most courts in evaluating the culpability of a law firm.

ECF Submissions

Bankruptcy Rule 9037 addresses privacy concerns resulting from public access to electronic case files. It instructs filers to only include the last four digits of the Social Security number and taxpayer identification number, the year of the individual's birth, only the initials of minors and the last four digits of any financial account numbers.

In the court's effort to ensure compliance, filers must indicate that they are aware of this requirement by clicking acknowledgment when entering the court's ECF website. Making this acknowledgment should be done with a conscious awareness, not casually. Per the Rule's advisory committee notes, the Clerk of Court is not required to review documents filed with the court for compliance with this rule. Under subdivision (a) of the Rule, the responsibility to redact filings rests with counsel, creditor parties, and others who make filings with the court.

A particularly relevant example of unintentional submission of PII was the failure of several banks to exclude or redact underlying bower PII from the supporting documentation of thousands of claims. A debtor's counsel may wish to reconsider the relevant definition of PII, particularly when representing healthcare and consumer-facing clients.

The Rule fails to contemplate relief in the event of prohibited disclosures. However, as in the case of bank-filed proofs of claim that included borrower PII, we have already seen quite serious consequences, including punitive damages. Regardless of the apparent scarceness of other enforcement actions surrounding Rule 9037, the increased attention being directed at rights regarding data privacy will likely lead to additional activity in the bankruptcy courts as well.

Changing Laws

There's no question that changes to data privacy laws are on the rise and becoming of increased public interest. It will be critical to keep abreast. Of note at the February 2017 LegalWeek conference held in New York was a session titled "The Data Privacy Landscape: Emerging Laws Affecting Cross-Border Discovery." Natascha Gerlach, a Brussels-based senior attorney at Cleary Gottlieb Steen & Hamilton, was quoted, "In the EU, which is currently still governed by the EU data protection directive from 1995, the premise is that the processing of data is prohibited unless it is explicitly allowed by law. In the U.S., it's the opposite: You can do whatever you like unless it's prohibited." Although the session was not specifically directed to bankruptcy practice, the alert is relevant to cross-border bankruptcies where the reports and filings that are usually public in U.S. cases may not be public in non-U.S. jurisdictions.

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When a Data Breach Occurs

Data breach is not a matter of if, but of when. Breaches most commonly occur as a result of motive, opportunity, weak security and/or weak policies. Do you have breach insurance that covers notice and remediation? There are numerous changes being made in cybersecurity insurance offerings. Do you even know what constitutes a breach?

All too often, firms and companies aren't aware until a governmental agency is investigating and advising a firm of its security lapse, aka data breach. Typical manifestations include hacks, theft, phishing and malware. Regulatory compliance in the event of a breach is also changing. Learn what the requirements are in your state, but at a minimum have an incident response plan, a plan for execution of quick and proper notification, and rules for preservation of evidence.

Being informed, educated and proactive in implementing a system of data security policies and procedures to protect client data, can prove vital. Persistently protect confidential data — when it is collected, stored, used, and shared in databases and applications, as well as when it is e-mailed or otherwise transmitted inside or outside the firm. Such precautions will likely reduce the occurrences of data breaches and may serve to mitigate some of the costs.

Conclusion

In summary, data security continues to be an issue for many law firms. More and more clients assess security measures of potential vendors as a key to vendor selection. Failure to take the simple steps referenced earlier in this article is not likely to be viewed as acceptable considering the trends with laws, regulation and expectations. Cybersecurity expectations are moving quickly and it is time law firms catch up.

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construed Section 316(b) as a broad protection of noteholders' practical ability to receive payment. *See Marblegate I*, 75 F.Supp.3d at 614. In the district court's view, Section 316(b) may be violated whenever a transaction "effect[s] an involuntary debt restructuring" — even where the payment terms of an indenture are not explicitly amended by the transaction. *Id*.

Because the transaction at issue, while not directly amending the indenture's payment terms, impaired dissenting noteholders' ability to be repaid, the district court held that it violated Section 316(b). Although it so held, the district court denied the preliminary injunction sought by Marblegate because it concluded there was no irreparable harm.

Thereafter, EDMC proceeded with the restructuring, but refrained from releasing the parent guarantees of Marblegate's notes, in light of the *Marblegate I* decision. Instead, EDMC filed a counterclaim, seeking a declaration that the parent guarantees of Marblegate's notes could be released without violating Section 316(b). The district court rejected EDMC's claims and, abiding by its earlier decision in *Marblegate I*, permanently enjoined EDMC from releasing the parent guarantees. *See Marblegate II*, 111 F.Supp.3d at 556-57. EDMC appealed the judgment.

The Second Circuit Decision

In a decision written by Judge Raymond Lohier Jr., in which Judge José Cabranes joined, the Second Circuit vacated and remanded the district court's judgment, rejecting the district court's broad reading of Section 316(b). The court adopted a narrow reading of Section 316(b), holding that Section 316(b) only prohibits "non-consensual amendments to an indenture's core payment terms" and not the practical ability to receive payment. Decision at *1. As such, the court concluded that the transaction at issue, which "did not amend any terms of the Indenture" or "prevent any dissenting bondholders from initiating suit to collect payments due on the dates specified by the Indenture," did not violate Section 316(b). *Id*. at *12.

The court began by reviewing the language of Section 316(b), which is entitled "Prohibition of impairment of holder's right to payment" and provides as follows:

> Notwithstanding any other provision of the indenture to be qualified, *the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder*, except as to a postponement of an interest payment consented to as provided in paragraph (2) of subsection (a) of this section, and except that such indenture may contain provisions limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of judgment therein would, under applicable law, result in the surrender, impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien.

15 U.S.C. § 77ppp(b) (emphasis added). Focusing on the terms "right," "impaired" and "affected," the court — like the district court — concluded they were ambiguous, and did not resolve the question of whether they prohibited only the amendment of an indenture's terms or a more broadly proscribed interference with an issuer's ability to pay. *Id*. at *4-5. The court also concluded that the structure of the TIA did not provide the answer either. *Id*. at *5.

Despite finding Section 316(b) ambiguous, the court noted what

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it believed were the "improbable results and interpretive problems" that would result from a broad interpretation of the relevant terms." *Id*. "Among other things," the court observed, "interpreting 'impaired or affected' [in Section 316(b)] to mean any *possible* effect would transform a single provision of the TIA into a broad prohibition on any conduct that could influence the value of a note or a bondholder's practical ability to collect payment." *Id*. (emphasis in original). The court also said that if the "right … to receive payment" meant "a bondholder's practical ability to collect payment," it would embrace — and therefore render superfluous — the "right … to institute suit for the enforcement of any such payment," which Section 316(b) also expressly protects. *Id*.

The court then turned to the legislative history of Section 316(b). Reviewing the testimony and reports leading up to and immediately following the enactment of the TIA, the court determined that "Congress sought to prohibit formal modifications to indentures without the consent of all bondholders, but did not intend to go further by banning other well-known forms of reorganization like foreclosures." Decision at *10. Specifically, the court noted that, contrary to the district court's contention that Congress did not contemplate the use of foreclosures as a method of reorganization at the time that Section 316(b) was drafted, "[t]he authors of the 1936 SEC Report (and by inference the drafters of the TIA) were [ ] clearly aware that corporate reorganizations could be achieved through foreclosure." *Id*. at *8.

Notwithstanding such awareness, however, the reports leading up to and immediately following the enactment of Section 316(b) "exclusively addressed *formal* amendments and indenture provisions like collective-action and no-action clauses," but did not prohibit foreclosure-based reorganizations, even if they may affect a bondholder's ability to receive full payment. *Id*. at *7 (emphasis in original). As such, the court concluded that it was Congress' intent that Section 316(b) would only be directed at "reorganization by contract" and would only prohibit amendments to core payment terms. *Id*. at *8.

The court also relied on previous testimony of the drafters of Section 316(b), the House and Senate Reports on the final version of the TIA, a subsequent report by the SEC, and certain textual changes to Section 316(b) through its enactment in 1939 — all of which the court found to support a narrow construction of the provision. *See id*. at *8-11.

Judge Lohier then discussed what he viewed as the unworkability of the district court's broad interpretation of Section 316(b). According to the court, the broad interpretation would "require[ ] that courts determine in each case whether a challenged transaction constitutes an 'out-of-court debt restructuring … designed to eliminate a non-consenting holder's ability to receive payment'," and thus, under that interpretation, liability under Section 316(b) would "turn[ ] on the subjective intent of the issuer or majority bondholders, not the transactional techniques used." *Id*. at *11 (citation omitted). That, the court believed, would "undermine uniformity in interpretation" by requiring courts to "interpret[ ] boilerplate indenture provisions based on the relationship of particular borrowers and lenders or the particularized intentions of the parties to an indenture" — an approach that the Second Circuit has "expressed a particular distaste for." *Id*. (quoting *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1048 (2d Cir. 1982)) (internal quotation marks omitted).

Finally, the court said that its narrow interpretation of Section 316(b) "will not leave dissenting bondholders at the mercy of bondholder majorities" because such holders still could "pursue available State and federal law remedies" and/or "insist on credit agreements that forbid transactions" like the one at issue. Decision at *12.

The Dissenting Opinion

Judge Chester Straub, in a dissenting opinion, focused on the text of Section 316(b). *See id*. at *12-16. Contrary to the majority panel and the district court, however, he did not find the provision to be ambiguous. Relying on the "plain text of the statute," he concluded that "an out-of-court debt restructuring 'impairs' or 'affects' a non-consenting noteholder's 'right to receive payment' when it is designed to eliminate a non-consenting noteholder's ability to receive payment, and when it leaves bondholders no choice but to accept a modification of the terms of their bonds." *Id*. at *15.

Judge Straub was "cognizant of the parade of horrors that Appellants predict will result from interpreting the TIA" as he did. *Id*. at *16. However, he concluded that "threatening dire commercial consequences" did not provide a sufficient basis to "override the correct interpretation of the law" by reading the statute in a manner inconsistent with its plain meaning, inasmuch as "making law is the job of the legislature and not of the courts." *Id*. Therefore, he concluded that even though "[c]ertain undesirable consequences might well arise from the fact that Section 316(b) prohibits actions such as those taken by EDMC in this case," the resolution of such consequences is for Congress and not the courts. *Id*.

Further Proceedings

It appears that the appellees next intend to seek en banc review of the Second Circuit panel's decision by the entire court. *See* Order, *Marblegate*, No. 15-2124, Dkt. No. 213 (2d Cir. Jan. 23, 2017). Such review is generally granted only in particularly significant cases, which *Marblegate* is, but even in such instances it is the exception rather than the rule.

Conclusion

The Second Circuit's ruling is of significant import, as it provides guidance — at least in the Second Circuit — on the scope of Section 316(b), holding that out-of-court

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debt restructurings, even if they may impair noteholders' practical ability to receive payment, do not fall within the purview of Section 316(b).

Assuming the Second Circuit's decision stands and is either affirmed by the Supreme Court or is otherwise followed in other circuits, the decision will make it far easier for companies with TIA registered bonds (or "private for life" bonds that include a clause comparable to Section 316(b)) to implement an out-of-court restructuring with the support of a majority of the bondholders, such as debt exchanges with coercive features, like releasing guarantees and stripping covenants, designed to induce minority hold-outs to participate. So long as the restructuring does not violate the express terms of the applicable indenture or result in nonconsensual modifications to the indenture's "core payment terms," minority hold-outs would lose their leverage under the TIA to block the restructuring with the threat of litigation.

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'Proper' Notice

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the creditor received actual notice of the action to be taken. Additionally, due process may be satisfied by providing "notice reasonably calculated under all of the circumstances, to apprise the interested parties of the pendency of the action and afford them an opportunity to present their objections." *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 272 (2010). The courts have made clear that "process that may be constitutionally sufficient in one setting may be insufficient in another." *SLW Capital LLC v. Mansaray-Ruffin* (*in re Mansaray-Ruffin*), 530 F.3d 230, 239 (3rd Cir. 2008). This article discusses what "notice reasonably calculated" means.

The foregoing applies to known creditors, for example where the debtor knows the identity and mailing address of the creditors. Conversely, unknown creditors are those with claims that are "not readily ascertainable" or are merely "conceivable, conjectural or speculative." *In re BGI, Inc.*, 476 B.R. 812, 823 (Bankr. S.D.N.Y. 2012), appeal dismissed as equitably moot, 772 F.3d 102 (2d Cir. 2014). If creditors are unknown, a court can authorize alternative forms of constructive notice such as publication of the relevant relief sought, deadline, and/or hearing date in newspapers, on web pages or via social media. *See* Fed. R. Bankr. Pro. 2001(l) and 9008. Constructive publication notice has been held to be constitutionally permissible for unknown creditors. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 317-18 (1950).

The Bankruptcy Rules

Bankruptcy Rule 9014(b) requires that notice of motions seeking various forms of relief under the Bankruptcy Code must be provided in the same manner as service of a summons and complaint provided for in Bankruptcy Rule 7004. Bankruptcy Rule 7004(b)(1) requires service upon an individual to be made by first-class mail postage prepaid to the individual's dwelling house or usual place of abode, or to the place where the individual regularly conducts business or a profession. Concerning a domestic or foreign corporation, Bankruptcy Rule 7004(b)(3) requires service to be sent by first-class mail postage prepaid "to the attention of an officer, a managing or general agent, or to another agent authorized … by law to receive service of process … ." Thus, although a creditor has a due process right to receive notice of a bankruptcy proceeding that would for example, implicate such creditor's property interest in a lien, a "[v]iolation of the Bankruptcy Rules does not … automatically create a due process violation." *Jacoby v. BAC Home Loans Servicing LP*, 477 B.R. 533, 541 (D.N.J. 2012).

While best practice is to provide notice of the relief being sought to the President or Chief Legal Officer of a corporation impacted by such relief, and to list such person's name (where known) and not just his or her title, some courts have held that if the package does not contain the officer's name, service is still valid because such notice was reasonably calculated to advise the creditor of the relief sought. *See, e.g., In re Braden*, 516 B.R. 672, 676 (Bankr. S.D. Ga. 2014).

A related issue arises when an attorney appears on behalf of a client in a bankruptcy case — the question in such a scenario is whether service on just the attorney sufficient. The answer to date from courts is "it depends." If the attorney appears through the bankruptcy court's electronic service system known as ECF, some courts have held it is adequate to serve only the attorney, and indeed some bankruptcy courts have enacted local rules that describe (but limit) the circumstances in which service on the attorney alone is adequate and instances where the client must also be served (in addition to the attorney) in accordance with Bankruptcy Rule 7004(b).

For instance, in *In re C.P. Hall Company*, 513 B.R. 546 (Bankr. N.D. Ill. 2014), the court held that "[i]n bankruptcy, an attorney's authority to accept service in an adversary proceeding can be implied from the level of his participation in the underlying bankruptcy case. Courts have held repeatedly that an attorney who has actively represented a party in the bankruptcy case is implicitly authorized to receive service for that party in a related adversary proceeding." *Id.* at 552 (citation omitted).

A Recent Case

In a recent decision, *In re Robert Alan Maizus and Beverly Rachel Porway*, 2016 WL 7013462 (D.N.J.

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'Proper' Notice

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Nov. 30, 2016), Green Tree Servicing LLC (Green Tree) asserted that the debtors owed it in excess of $600,000. This debt was evidenced by a note secured by a mortgage executed in favor of Green Tree's predecessor. During the course of the bankruptcy case, Green Tree filed two separate proofs of claim, each designating that notice regarding the claim should be sent to a specific post-office box. Each proof of claim was also signed by an individual named Kara Taylor as Green Tree's "Bankruptcy Representative." *Id*. at *1-2. Subsequently, an attorney appeared on behalf of Green Tree by filing a response to the debtor's objection to Green Tree's proof of claim. *Id*. at *2.

Several years later, the debtor filed a motion seeking to sell the underlying real property. Debtor's counsel filed a certification of service stating that Green Tree was served at both P.O. Boxes listed on its proofs of claim, as well as the P.O. Box set forth in the debtor's original schedules. *Id*. Green Tree's counsel also received electronic notice of the motion through the court's ECF system. *Id*. Green Tree failed to oppose the debtor's motion to sell the real estate and a subsequent motion filed by the debtor concerning how the proceeds from the sale should be distributed. *Id*. In connection with the second motion, debtor's counsel not only served Green Tree at the two P.O. Boxes identified in Green Tree's proofs of claim, but also sent the motion to Green Tree's counsel by email and facsimile. *Id*. Subsequently, Green Tree's counsel advised debtor's counsel that she no longer represented Green Tree in the matter, yet that attorney remained counsel of record and had never filed a substitution of counsel or a withdrawal of appearance as counsel for Green Tree in the debtor's bankruptcy proceedings. *Id*.

After the closing on the sale of the real property to unrelated good-faith purchasers, Green Tree filed a motion seeking to vacate the sale order, and asserted that because Green Tree's constitutional due process rights were violated by Green Tree failing to receive reasonable notice from the debtor of the relief sought, the sale order should be vacated. *Id*. at *4.

The bankruptcy court held that the debtor's efforts to serve Green Tree "while arguably not in compliance with Bankruptcy Rule 7004, were reasonably calculated to give Green Tree notice at two or more P.O. Box addresses that Green Tree provided to the Court and to counsel for the Debtor." The bankruptcy court also noted that counsel of record for Green Tree was served. *Id*. at *3. The court also expressed real concern for the impact of Green Tree on the bona fide purchasers, and thus denied its motion. *Id*.

District Court Ruling

On appeal, the purchasers argued that the appeal was moot under Bankruptcy Code Section 363(m) because they were good-faith purchasers who had relied on the sale order, and Green Tree failed to request or seek a stay pending appeal. The district court held that Green Tree's appeal was in fact statutorily moot, but noted that because Green Tree collaterally attacked the sale order and argued that "constitutionally mandated due process requirements for notice and an opportunity to be heard" trumped the Bankruptcy Code's interest in finality, it would nevertheless address the merits of Green Tree's argument. *Id*. at *5.

The district court rejected Green Tree's arguments and affirmed the bankruptcy court's decision denying Green Tree's motion to vacate the sale order. The district court held that Green Tree was provided with proper service of process pursuant to Bankruptcy Rule 7004(b)(3) because the debtor mailed the notices to the address which the creditor voluntarily designated as the address upon which it was to be served. *Id*. at *6-7.

While those notices were not mailed to the attention of an "officer" or "agent" or a specific person by name on the package, the court held that in light of: 1) the notices mailed; and 2) Green Tree's counsel's receipt of the ECF notice of the filing of the motion, notice was reasonably calculated under all of the circumstances of the case to give Green Tree notice of the pendency of the motion and an opportunity to present any objections to the motion. *Id*. at *6.

Thus, the district court determined that the debtor's efforts to serve Green Tree with notice of the motion on distribution of the sale proceeds were reasonably calculated to provide Green Tree with notice of the pendency of the motion and, therefore, passed muster under applicable law and the Constitution. *Id*. *7-8.

Conclusion

The take-away from this decision is that when a creditor files a proof of claim listing its address for service, it needs to ensure that it promptly and effectively reviews all bankruptcy and other court-related notices received at the address (including P.O. boxes) listed in order to respond promptly. Likewise, the creditor and its counsel must be sure that counsel promptly provides its client with all notices of motions or other pleadings that may affect a creditor's property interests or other rights. Failure to provide such notice could result in the irreparable loss of potentially value rights and/or property interests.

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