The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION JUNE 2023

Editor's Note: Yes, the Law Is Still Continuing to Develop
Victoria Prussen Spears

U.S. Supreme Court Clarifies Scope of Nondischargeable Debt in Favor of Victims of Fraud
Lawrence J. Kotler and Drew S. McGehrin

U.S. Supreme Court Rules that FBAR Penalties Are Per-FBAR Form, Rejecting IRS's Per-Account Position
Susan Combs

U.S. Court of Appeals for the Second Circuit Rules That the Funding Structure for the Consumer Financial Protection Bureau Is Constitutional
Diana M. Eng, Louise Bowes Marencik and Jonathan K. Moore

Decision by New York's Highest Court Results in Account Debtor Owing Its Counterparty's Debts
Deborah J. Enea and Steven Soffer

Royalty Rights as Unsecured Claims: The Relevance of *Mallinckrodt* to M&A, Revenue or Royalty Interest Financings, and Other Transactions Involving Future Payment Streams
Martin E. Beeler, Dianne F. Coffino and Peter A. Schwartz

Denial of Assumption of Pre-Bankruptcy Workout Agreement Demonstrates How Settlement Value Can Change with Time and Circumstances
Patrick E. Fitzmaurice and Claire K. Wu

New York's "Small Business" Commercial Financing Disclosure Law
Leonard A. Bernstein, Bob Jaworski and Richard Smith

Subscription Credit Facilities: Continuation Funds
Kiel A. Bowen and McKay S. Harline

Lenders May Be the Next Government Focus for PPP Fraud
Christopher L. Nasson, Hayley Trahan-Liptak, Robert M. Tammero, Jr and Christopher F. Warner

LexisNexis

THE BANKING LAW JOURNAL

VOLUME 140 NUMBER 6 June 2023

Editor's Note: Yes, the Law Is Still Continuing to Develop
Victoria Prussen Spears 275

U.S. Supreme Court Clarifies Scope of Nondischargeable Debt in Favor of Victims of Fraud
Lawrence J. Kotler and Drew S. McGehrin 278

U.S. Supreme Court Rules that FBAR Penalties Are Per-FBAR Form, Rejecting IRS's Per-Account Position
Susan Combs 281

U.S. Court of Appeals for the Second Circuit Rules That the Funding Structure for the Consumer Financial Protection Bureau Is Constitutional
Diana M. Eng, Louise Bowes Marencik and Jonathan K. Moore 284

Decision by New York's Highest Court Results in Account Debtor Owing Its Counterparty's Debts
Deborah J. Enea and Steven Soffer 289

Royalty Rights as Unsecured Claims: The Relevance of *Mallinckrodt* to M&A, Revenue or Royalty Interest Financings, and Other Transactions Involving Future Payment Streams
Martin E. Beeler, Dianne F. Coffino and Peter A. Schwartz 292

Denial of Assumption of Pre-Bankruptcy Workout Agreement Demonstrates How Settlement Value Can Change with Time and Circumstances
Patrick E. Fitzmaurice and Claire K. Wu 298

New York's "Small Business" Commercial Financing Disclosure Law
Leonard A. Bernstein, Bob Jaworski and Richard Smith 302

Subscription Credit Facilities: Continuation Funds
Kiel A. Bowen and McKay S. Harline 316

Lenders May Be the Next Government Focus for PPP Fraud
Christopher L. Nasson, Hayley Trahan-Liptak, Robert M. Tammero, Jr and Christopher F. Warner 321

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call or email:
Matthew T. Burke at .... (800) 252-9257
Email: .... matthew.t.burke@lexisnexis.com

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

ISBN: 978-0-7698-7878-2 (print)
ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

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 © 2023 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

(2023–Pub.4815)

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
BARKLEY CLARK
Partner, Stinson Leonard Street LLP

CARLETON GOSS
Counsel, Hunton Andrews Kurth LLP

MICHAEL J. HELLER
Partner, Rivkin Radler LLP

SATISH M. KINI
Partner, Debevoise & Plimpton LLP

DOUGLAS LANDY
White & Case LLP

PAUL L. LEE
Of Counsel, Debevoise & Plimpton LLP

TIMOTHY D. NAEGELE
Partner, Timothy D. Naegele & Associates

STEPHEN J. NEWMAN
Partner, Stroock & Stroock & Lavan LLP

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright 2023 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. 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, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. 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 THE BANKING LAW JOURNAL, LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW, Third Floor, Washington, DC 20005-2207.

Denial of Assumption of Pre-Bankruptcy Workout Agreement Demonstrates How Settlement Value Can Change with Time and Circumstances

By Patrick E. Fitzmaurice and Claire K. Wu*

In this article, the authors discuss a bankruptcy court decision that provides a path forward for potentially increased creditor recoveries.

A recent bankruptcy court ruling answers the question of whether a garden-variety discounted payment agreement to release a large debt contingent on prior full payment of an agreed smaller sum is an "executory contract" that may be assumed and assigned under Section 365 of the Bankruptcy Code over a creditor's objection.

In *In re Svenhard's Swedish Bakery*,[1] the U.S. Bankruptcy Court for the Eastern District of California concluded that such an agreement was not assumable either because it was not executory for lack of mutuality or because contracts to extend financial accommodations are excluded from assumption under the Bankruptcy Code. The bankruptcy court therefore denied the debtor's motion to assume the pre-petition discounted payment agreement and the related settlement between the debtor and its successor-in-interest.

BACKGROUND

In a series of transactions, US Bakery acquired Svenhard's Swedish Bakery's business and caused Svenhard's operations to move locations. This move triggered termination of a collective bargaining agreement with the union representing Svenhard's workers and that termination caused Svenhard's to become obligated for certain pension contributions that the court categorized as the "withdrawal liability."

Several years later, Svenhard's and the pension fund agreed to settle the $43 million withdrawal liability for a payment of $3 million, payable in monthly installments over 20 years. The agreement provided for releases to Svenhard's upon full payment of the discounted amount.

Svenhard's made the first six payments due under the discounted payment agreement, then defaulted because US Bakery took control of Svenhard's

---

[*] The authors, attorneys with Pillsbury Winthrop Shaw Pittman LLP, may be contacted at patrick.fitzmaurice@pillsburylaw.com and claire.wu@pillsburylaw.com, respectively.

[1] In re Svenhard's Swedish Bakery, Nos. 19-15277-C-11, DT-61, 62 (Bankr. E.D. Cal. Dec. 19, 2022).

operations and facilities such that Svenhard's abruptly lacked the revenue to make the required payments to the pension fund. The pension fund gave notice of default and five business days in which to cure the default. Svenhard's filed its Chapter 11 case on December 19, 2019, one day before the cure period expired.

Several years into Svenhard's Chapter 11 case, and after a mediation between Svenhard's and US Bakery (the pension fund was excluded from the mediation), Svenhard's and US Bakery agreed, among other things, that (1) Svenhard's would assume the defaulted discounted payment agreement with the pension fund, and (2) the agreement would be assigned to US Bakery and US Bakery would make the payments. Thus, Svenhard's filed a motion to assume the agreement under Section 365 of the Bankruptcy Code, and a related motion under Federal Rule of Bankruptcy Procedure 9019 to approve its settlement with US Bakery.

Notably, when Svenhard's filed these motions, the pension fund already had a successor liability action against US Bakery pending. The agreement assumption strategy embodied in the Svenhard's/US Bakery settlement was designed in part as an effort by US Bakery to cut off those claims, which strategy may have played a role in or otherwise impacted the court's decision. The pension fund opposed Svenhard's motion to assume the discounted payment agreement, believing its successor claims against US Bakery had real merit and that it could collect the full amount of the withdrawal liability from US Bakery as a successor-in-interest to Svenhard's business.

EXECUTORY CONTRACTS

Section 365(a) of the Bankruptcy Code provides that a trustee or debtor in possession, subject to the court's approval, may assume or reject any executory contract. The Bankruptcy Code, however, does not define the term "executory contract" and over time, two general approaches to the definition have emerged: (1) the traditional *Countryman* test, which describes an executory contract as "[a] contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other," and (2) the more result-oriented "functional" test, which focuses on whether the bankruptcy estate will benefit from the assumption or rejection of a contract.

The *Svenhard's* bankruptcy court noted that the Ninth Circuit follows the *Countryman* test and focuses on mutuality of obligation. In concluding that the discounted payment agreement was not executory, the court reasoned that:

(1) As of the date of the bankruptcy filing, both sides had "nominal"

obligations remaining;

(2) The pension fund's obligation was contingent on prior full performance by Svenhard's and therefore the pension fund had no obligation to perform and "needed to do nothing to avoid being in breach," and

(3) Under the Restatement (Second) of Contracts, "performance of a duty subject to a condition cannot come due unless the condition occurs or is excused."

For these reasons, the court determined as a matter of fact that the discounted payment agreement was not an executory contract and could not be assumed and assigned pursuant to Section 365 of the Bankruptcy Code.

FINANCIAL ACCOMMODATIONS

To the extent the discounted payment agreement was executory, the court also analyzed the issue of whether it was nevertheless not assumable under Section 365(c) of the Bankruptcy Code. As relevant here, that provision limits a trustee or debtor in possession's right to assume a contract to make a financial accommodation, to or for the benefit of the debtor.

The bankruptcy court described "financial accommodations" as "extensions of money or credit for the benefit of the debtor" and noted prior cases holding that a pre-petition workout agreement may constitute a "financial accommodation" for purposes of Section 365(c)(2). Analyzing this issue, the court held that because the discounted payment agreement allowed Svenhard's to pay a sum of money over time that was a fraction of its total liability, the agreement benefited Svenhard's by allowing it to discharge a much larger liability and was, therefore, a financial accommodation and not assumable.

CONCLUSION

This decision demonstrates that a lender or other creditor may not be forced to perform under a discounted or deferred settlement (or similar agreement) where the other party defaults and subsequently files for bankruptcy protection. Indeed, where collateral value (or the debtor's business generally) has improved, or where, as in this case, a non-debtor may be liable, a lender or creditor may understandably not want to give up that potential additional value. The bankruptcy court's decision in *Svenhard's* provides a path forward for those potentially increased creditor recoveries.

Conversely, an objection to assumption may not make economic sense and the debtor (with the creditor's support) may want to assume the agreement and pay the discounted amount in full. Under this court's analysis, however, the parties may not be able to guarantee themselves the benefit of a pre-petition

workout agreement. In such cases, all hope is not lost. A lender or other creditor could potentially protect their interests by filing a claim in the bankruptcy case or by entering into the same agreement post-petition and submitting that agreement to the court for approval under Bankruptcy Rule 9019, although this path has the same risks as any other settlement that could be challenged.

SUMMARY

- To assume an agreement under Section 365, the agreement must be an "executory contract," which generally requires that the parties have mutual obligations and that those obligations are so far unperformed that the failure by either party to complete performance would constitute a material breach excusing performance of the other.
- Lenders and other creditors should not be quick to conclude that they are stuck with the terms of a pre-petition workout agreement if the borrower later seeks to assume the agreement in bankruptcy due to improved (for the borrower) asset values.
- Even if both the creditor and the obligor have the incentive to enforce the pre-petition discounted payment agreement, under one bankruptcy court's analysis applying Ninth Circuit law, there is some risk that the discounted settlement may not be honored.