A TALE OF TWO DEBTORS: LEHMAN BROTHERS AND THE AVAILABILITY OF EQUITABLE SUBORDINATION IN THE "DUELING DEBTOR" CONTEXT

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This article suggests that the generally accepted "offensive/defensive" standard used by bankruptcy courts to determine whether a debtor may equitably subordinate a claim asserted by another debtor should not necessarily be extended to disputes with a debtor subject to a foreign insolvency proceeding. At the outset, this article surveys the history of caselaw in this "dueling debtor" context and concludes that bankruptcy courts have generally deemed equitable subordination of a secured claim under section 510(c) of the Bankruptcy Code to be an "offensive" remedy unavailable to a debtor when the claimant is itself a chapter 11 debtor. Next, this article summarizes two recent disputes in the Lehman Brothers chapter 11 cases that bear on the availability of equitable subordination in the "dueling debtor" context. Lastly, this article analyzes the legacy of the Lehman Brothers cases in the "dueling debtor" context before concluding that while the "offensive/defensive" standard remains viable for bankruptcy court disputes within the United States, it may be inappropriate in "dueling debtor" disputes where one debtor is subject to a foreign insolvency proceeding.

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I. INTRODUCTION

This article addresses two recent developments within the *Lehman Brothers* chapter 11 cases that impact the ability of a debtor to equitably subordinate a claim asserted by an entity that is itself a debtor in a separate reorganization proceeding. This "dueling debtor" scenario seemingly brings two hallmark provisions of the United States Bankruptcy Code into potential antagonism—the automatic stay of section 362(a)[1] and equitable subordination under section 510(c).[2]

In a typical chapter 11 case, sections 362(a) and 510(c) operate in a complementary fashion: section 362(a) preserves the assets of a debtor's estate for the benefit of its creditors, while in certain circumstances section 510(c) entitles that debtor to equitably subordinate an asserted claim and effectively enlarge the pool of estate assets available for distribution to higher-priority allowed creditors. In the "dueling debtor" context, however, the usually complementary provisions of sections 362(a) and 510(c) are aligned against each other. In this scenario, one debtor's right under section 510(c) to effectively expand its pool of distributable assets runs headlong into a second debtor's right under section 362(a) to shield its distributable assets from its creditors.

Not surprisingly given that the "dueling debtor" context is itself rare, few cases have analyzed the interplay of these two bankruptcy provisions in the context of this unique fact pattern. Nonetheless, a review of relevant caselaw reveals that courts have looked to an unpublished decision handed down in the *Enron* chapter 11 case for guidance on the issue.[3] In that

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1. 11 U.S.C. § 362(a) (2006) ("[A] petition . . . operates as a stay applicable to all entities.").

2. *Id.* § 510(c) ("[A]fter notice and a hearing, the court may – (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest or all or part of another allowed interest.").

3. *In re* Enron Corp., No. 01-16034 (AJG), 2003 Bankr. LEXIS 2261 (Bankr. S.D.N.Y. 2003 Jan. 13, 2003).

case, former Chief Judge for the Bankruptcy Court of the Southern District of New York Arthur Gonzales set forth what may be deemed the leading operative legal standard for analyzing the interplay of sections 362(a) and 510(c) in the "dueling debtor" context. This standard dictates that courts, when determining whether an action by one debtor violates the automatic stay of another debtor, should analyze whether the conduct at issue is "offensive" or "defensive" in nature.[4] According to *Enron*, the pursuit of equitable subordination by one debtor is an "offensive" action that violated the automatic stay of the other debtor.[5]

Two recent decisions relating to the Lehman Brothers chapter 11 cases[6] shed new light on the continued viability of the Enron standard. In the first decision, *In re Palmdale Hills Property, LLC*,[7] the Ninth Circuit Court of Appeals affirmed a Bankruptcy Appellate Panel's reversal[8] of a bankruptcy court's adjudication of a dispute between one of the *Lehman* debtors, Lehman Commercial Paper Inc. ("LCPI"), and one of the *SunCal* debtors, Palmdale Hills Property, LLC.[9] The *SunCal* debtors consisted of several real estate ventures subject to chapter 11 proceedings in the United States Bankruptcy Court for the Central District of California. LCPI asserted a secured claim against the *SunCal* debtors based on its status as one of the *SunCal* debtors' largest pre-petition secured creditors.[10]

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4. *Id.* at *23.

5. *Id.*

6. *In re* Lehman Brothers Holdings, Inc. ("LBHI"), No. 08-13555 (JMP) (Bankr. S.D.N.Y. filed Sept. 15, 2008). The filing for chapter 11 of LBHI and several of its affiliates early Monday morning on September 15, 2008 is considered a watershed moment of the so-called credit crisis of Fall 2008. *See generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL (Viking Adult, 1st ed. 2009). Lehman Brothers remains "the only true icon to fall" as a result of that tumultuous period. Transcript of Hearing at 248, *In re LBHI*, No. 08-13555 (JMP) (Sept. 19, 2008), ECF No. 318.

7. 654 F.3d 868 (9th Cir. 2011) [hereinafter SunCal III].

8. LCPI v. Palmdale Hills Prop., LLC (*In re* Palmdale Hills), 423 B.R. 655 (B.A.P. 9th Cir. 2009) [hereinafter SunCal II].

9. *In re* Palmdale Hills Prop., LLC, No. 08-17206 (ES) (Bankr. C.D. Cal. filed Nov. 8, 2008) [hereinafter SunCal I].

10. *See* Motion for Relief from the Automatic Stay as to Real and Personal Property, *SunCal I*, No. 08-17206 (ES) (Jan. 23, 2009), ECF No. 61; Memorandum of Points and Authorities in Support of Motions of LCPI and Lehman ALI, Inc. for Relief from the Automatic Stay under 11 U.S.C. § 362, *SunCal I*, No. 08-17206 (ES) (Jan. 23, 2009), ECF No. 69.

LCPI and one of its non-debtor affiliates filed a motion before the *SunCal* bankruptcy court requesting relief from the automatic stay to foreclose on secured property.[11] According to LCPI, this relief was appropriate given that a successful chapter 11 plan was not feasible in light of the *SunCal* debtors' intent to file a plan premised on the equitable subordination of LCPI's claims, which were subject to LCPI's automatic stay.[12] The SunCal bankruptcy court denied LCPI's motion, concluding, *inter alia*, that the stay relief motion filed by LCPI constituted the equivalent of filing an informal proof of claim and that, as a result, the *SunCal* debtors could "object to the claim of Lehman Commercial, seek to subordinate the claim of Lehman Commercial . . . , and/or seek to transfer a lien securing a subordinated claim to the estate . . . via an adversary proceeding or plan, without violating Lehman Commercial's automatic stay."[13] LCPI thereafter appealed the order by the *SunCal* bankruptcy court.[14] On appeal, the Bankruptcy Appellate Panel reversed the bankruptcy court's decision, holding that *SunCal's* equitable subordination actions were "offensive" in nature and violated LCPI's automatic stay absent prior specific relief from stay granted by LCPI's home court.[15] The Ninth Circuit upheld this judgment on appeal in a memorandum decision issued on August 3, 2011.[16]

The second decision, a bench ruling on October 14, 2009 by Judge Peck of the United States Bankruptcy Court for the Southern District of New York,[17] concerned a dispute between another *Lehman* debtor, LBHI, and Shinsei Bank Ltd. ("Shinsei"), a major creditor of Sunrise Finance Co. Ltd. ("Sunrise"), an indirect subsidiary of LBHI and one of LBHI's Japanese affiliates. On September 19, 2008, the Tokyo District Court

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11. Motion for Relief from the Automatic Stay, *supra* note 10; Memorandum of Points and Authorities in Support of Motion for Relief from Automatic Stay, *supra* note 10.

12. Memorandum of Points and Authorities in Support of Motion for Relief from Automatic Stay, *supra* note 10, at 4-5, 18-21.

13. Order Denying Motion for Relief from the Automatic Stay, *SunCal I*, No. 08-17206 (ES) (Mar. 10, 2009), ECF No. 149-156.

14. Notice of Appeal, *SunCal I*, No. 08-17206 (ES) (Mar. 20, 2009), ECF No. 178-185.

15. *See* SunCal II, 423 B.R. 655 (B.A.P. 9th Cir. 2009).

16. SunCal III, 654 F.3d 868 (9th Cir. 2011).

17. Order Denying Debtors' Motion, *In re* LBHI, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Oct. 27, 2009), ECF No. 5634.

commenced civil rehabilitation proceedings for Sunrise in accordance with Japanese insolvency law.[18] LBHI possessed large pre-petition intercompany claims against Sunrise and was one of its largest creditors.[19] Shinsei, a competing claimant in Sunrise's rehabilitation proceeding, filed a proposed plan of rehabilitation before the Tokyo District Court that would have effectively subordinated LBHI's claims against Sunrise.[20] In response, LBHI filed a motion in its chapter 11 cases seeking a declaration that Shinsei's submission of its proposed plan violated LBHI's automatic stay.[21] The *Lehman* bankruptcy court denied LBHI's motion, concluding that, under Japanese law, Shinsei's submission of its competing rehabilitation plan did not constitute a "commencement of litigation" against LBHI in violation of LBHI's automatic stay.[22]

Viewed together, these decisions imply that *Enron*'s "offensive/defensive" construct remains the dominant paradigm for analyzing equitable subordination pursued by one debtor against another debtor within the United States, but they leave unresolved the viability of this doctrine when analyzing conduct taken by dueling debtors in a foreign jurisdiction. Accordingly, these decisions provide useful guidance to courts and practitioners seeking to ascertain the availability of equitable subordination in the "dueling debtor" context within the United States and in foreign jurisdictions.

II.
Enron and the Historical Interplay Between the Automatic Stay and Equitable Subordination in the "Dueling Debtor" Context

The automatic stay is a fundamental feature of chapter 11.[23] It arises automatically upon the filing of a chapter 11 pe-

18. LBHI Motion to Enforce Automatic Stay at ¶ 17, *In re LBHI*, No. 08-13555 (JMP) (Aug. 11, 2009), ECF No. 4764.

19. *Id.* at ¶ 1.

20. *Id.* at ¶ 23.

21. *Id.*

22. Transcript of Hearing at 25, 28, *In re LBHI*, No. 08-13555 (JMP) (Oct. 14, 2009), ECF No. 5558 [hereinafter Oct. 14 2009 Shinsei Hearing Tr.].

23. *See, e.g.*, AP Indus., Inc. v. SN Phelps & Co. (*In re* AP Indus.), 117 B.R. 789, 798 (Bankr. S.D.N.Y. 1990) ("Congress intended that the scope of the automatic stay be broad in order to effectuate its protective purposes on behalf of both debtors and creditors.").

tition[24] to shield all property of a debtor's estate, wherever located, against attack from creditors.[25] In chapter 11 cases, the:

> Automatic stay is particularly important in maintaining the status quo and permitting the debtor in possession or trustee to formulate a plan of reorganization. Without the stay, the debtor's assets might well be dismembered, and its business destroyed, before the debtor has an opportunity to put forward a plan for future operations. Secured creditors and judgment creditors might race to seize and sell the debtor's assets in order to obtain satisfaction of their claims, without regard to the interests of other creditors or the value of keeping assets together in an operating business. The stay prevents this piecemeal liquidation, offering the chance to maximize the value of the business.[26]

The automatic stay protects a debtor's worldwide estate from actions against estate property and, by extension, actions against the debtor itself that could in turn impact estate property. This simultaneous protection from actions against the estate property and against the debtor itself is codified in sections 362(a)(1)[27] and 362(a)(3)[28] of the Bankruptcy Code, respectively.

In straightforward cases, creditor actions may be readily identified as violations of these restrictive Bankruptcy Code provisions. For example, the commencement of litigation against a debtor plainly violates its automatic stay under section 362(a)(1).[29] Likewise, a creditor's confiscation of estate

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24. 11 U.S.C. § 362(a) (2006) ("[A] petition . . . operates as a stay applicable to all entities.").

25. *Id.* § 541(a)(1) (Estate property includes "all legal or equitable interests of the debtor in property as of the commencement of the case.").

26. ALAN N. RESNICK & FRANK J. SOMMER, COLLIER ON BANKRUPTCY § 362.03[2] (15th ed. rev. 2002).

27. 11 USC § 362(a)(1) (A petition stays "the commencement or continuation of a judicial . . . proceeding against the debtor.").

28. *Id.* § 362(a)(3) (A petition stays "acts to obtain possession of property of the estate or to exercise control over property of the estate.").

29. *See, e.g.*, Koolik v. Markowitz, 40 F.3d 567 (2d Cir. 1994) (per curium) (holding that debtor's filing of chapter 11 petition automatically stayed litigation pending appeal); Borman v. Raymark Indus., Inc., 946 F.2d 1031 (3d Cir. 1991) (holding that appeal of judgment of product liability lawsuit was stayed by debtor's chapter 11 filing, even when debtor had previously stayed

property violates that debtor's automatic stay under section 362(a)(3).[30]

Occasionally, however, creditor conduct is not so plainly identifiable as a clear violation of sections 362(a)(1) and 362(a)(3). When a creditor's conduct resides in this gray area, a bankruptcy court must determine whether such conduct is sufficiently similar to the clearly proscribed conduct to constitute a violation of sections 362(a)(1) or (3).

This uncertainty typically characterizes the "dueling debtor" context, where two different entities with claims against each other each file for bankruptcy protection.[31] Faced with these competing claims, bankruptcy courts typically focus on whether the potentially offending behavior at issue is "defensive" (such as a debtor's objection to a proof of claim filed by a debtor in another bankruptcy case in its capacity as a creditor) or "offensive" in nature. Conduct deemed "defensive" in nature has generally not been found to violate section 362(a)(1) because it does not constitute the equivalent of the commencement of litigation "against" the first debtor.[32]

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execution of judgment by posting a bond); Eisinger v. Way (*In re* Way), 229 B.R. 11, 14 (B.A.P. 9th Cir. 1998) (finding that a counterclaim is subject to the automatic stay).

30. *See, e.g.*, Underwood v. Hilliard (*In re* Rimsat), 98 F.3d 956, 961 (7th Cir. 1996) (holding that director and shareholder of the debtor violated the stay when he sought an order from a court in the foreign country in which debtor was incorporated to enhance his power to "exercise control" over the company's operations); 48th Street Steakhouse, Inc. v. Rockefeller Group Inc. (*In re* 48th St. Steakhouse), 835 F.2d 427, 431 (2d Cir. 1987) (holding that landlord violated the stay when it attempted to extinguish a debtor property interest by sending a lease termination notice to a third-party lessee of property of which the debtor was a sublessee); Lykes Bros. Steamship Co. v. Hanseatic Marine Serv. (*In re* Lykes), 207 B.R. 282, 287-88 (Bankr. M.D. Fl. 1997) (finding that creditor violated the stay when it arrested one of the debtors' vessels to enforce payment of its claims); LTV Steel Co. v. David Graham Co. (*In re* Chateaugay), 78 B.R. 713 (Bankr. S.D.N.Y. 1987) (holding that shipping carrier violated the stay when it collected unpaid freight charges owing to the debtors from the debtors' consignee).

31. *See, e.g.*, *In re* Enron Corp., No. 01-16034 (AJG), 2003 Bankr. LEXIS 2261 (Bankr. S.D.N.Y. Jan. 13, 2003).

32. *See, e.g.*, Martin-Trigona v. Champion Fed. Sav. & Loan Ass'n, 892 F.2d 575, 577 (7th Cir. 1989) (creditor did not violate automatic stay because its motion to dismiss plaintiff's state court action was defensive in nature); Gordon v. Whitmore (*In re* Merrick), 175 B.R. 333, 337 (B.A.P. 9th Cir. 1994) (creditor did not violate automatic stay when it defended lawsuit commenced by debtor); Justus v. Fin. News Network, Inc. (*In re* Fin. News

Within the gray area of this "dueling debtor" context, bankruptcy courts have also encountered particular difficulty determining whether one particular type of action—a claim by a debtor to equitably subordinate a dueling debtor's claim—violates the automatic stay.[33] Section 510(c) of the Bankruptcy Code empowers a bankruptcy court to subordinate claims asserted against a debtor under principles of equitable subordination.[34] Historically, courts have equitably subordinated a creditor's claim when three preconditions are satisfied: (i) the claimant engaged in inequitable conduct; (ii) the inequitable conduct injured other creditors of the debtor or conferred an unfair advantage on the claimant; and (iii) equitable subordination must not be inconsistent with other provisions of the Bankruptcy Code.[35] Procedurally, a request to equitably subordinate a creditor's claim must be asserted by the filing of

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Network), 158 B.R. 570, 573 (S.D.N.Y. 1993) (creditor did not violate automatic stay when it objected to the debtor's proof of claim because section 362(a)(1)'s prohibition on the commencement of litigation "does not prevent entities against whom a debtor proceeds in an offensive posture . . . from protecting their legal rights"); *In re* BI-LO, LLC, No. 09-02140 (HB), 2010 Bankr. LEXIS 2462, at *19 (Bankr. D.S.C. Aug. 13, 2010) ("[I]f each of the parties raises its claims in the other bankruptcy case as defenses to the claims filed in its own case, there is no law preventing them from doing so . . . ."); Logan v. Credit General Ins. Co. (*In re* PRS Ins. Group), 331 B.R. 580, 584 (Bankr. D. Del. 2005) ("[T]he Trustee is not seeking any affirmative' recovery, but merely raises the action as a defense under section 502(d) to the allowance of [creditor's] claim.") (internal quotation marks omitted); *In re* Metiom, Inc., 301 B.R. 634, 638-39 (Bankr. S.D.N.Y. 2003) (creditor did not violate automatic stay when it objected to debtor's proof of claim).

33. *See, e.g.*, *In re* Enron, 2003 Bankr. LEXIS 2261.

34. 11 U.S.C. § 510(c) (2006) ("[A]fter notice and a hearing, the court may – (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest or all or part of another allowed interest.").

35. *See* Benjamin v. Diamond (*In re* Mobile Steel), 563 F.2d 692, 699 (5th Cir. 1977); *see also, e.g.*, Shubert v. Lucent Techs. Inc. (*In re* Winstar Commc'ns), 554 F.3d 382, 411 (3d Cir. 2009) (adopting the *Mobile Steel* test). Recently, however, at least one Court of Appeals has eschewed *Mobile Steel*'s three-prong test in favor of an examination of "the totality of the circumstances in the individual case." Merrimac Paper Co. v. Harrison (*In re* Merrimac Paper), 420 F.3d 53, 63 (1st Cir. 2005).

a complaint commencing an adversary proceeding, or pursuant to a chapter 11 plan.[36]

A. Enron *in Detail*

The paradigmatic case applying the "offensive/defensive" distinction in the context of an equitable subordination dispute between dueling debtors is Judge Gonzales' decision in the *In re Enron Corp.* chapter 11 case.[37] That case involved a dispute between Enron Corp. and its affiliated debtors before the United States Bankruptcy Court for the Southern District of New York, and Heartland Steel, Inc., ("HSI"), a chapter 11 debtor in a case pending in the United States Bankruptcy Court for the Southern District of Indiana.[38] Enron was a prepetition creditor of HSI and filed a proof of claim in HSI's chapter 11 cases.[39] The bankruptcy court overseeing HSI's reorganization entered an order allowing Enron's claim and later confirmed HSI's reorganization plan.[40] Thereafter, the Official Committee of Unsecured Creditors ("HSI Committee") filed an adversary complaint in the HSI bankruptcy court seeking in part to equitably subordinate Enron's claim against HSI.[41] The HSI Committee subsequently filed a motion before the *Enron* court seeking determination that Enron's automatic stay "did not enjoin the commencement" and continued prosecution of the HSI Committee's equitable subordination adversary proceeding.[42]

At the outset, the *Enron* court recognized a conceptual distinction between an objection to a proof of claim and the commencement of an adversary proceeding seeking equitable subordination. It observed that "[w]hereas equitable subordination concerns the distribution and classification of an al-

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36. *See* Fed. R. Bankr. P. 7001 ("The followings are adversary proceedings: . . . (8) a proceeding to subordinate any allowed claim or interest, except when a . . . chapter 11 . . . plan provides for subordination.").

37. 2003 Bankr. LEXIS 2261.

38. *In re* Heartland Steel Inc., No. 01-80081 (FJO) (Bankr. S.D. Ind. filed Jan. 24, 2001).

39. *In re Enron*, 2003 Bankr. LEXIS 2261, at *4.

40. *Id.* at *5 (indicating that HSI's confirmation order was entered on Nov. 20, 2001); Order Confirming Chapter 11 Plan, *In re Heartland Steel Inc.*, No. 01-80081 (FJO) (Nov. 20, 2001), ECF No. 440.

41. *In re Enron Corp.*, 2003 Bankr. LEXIS 2261, at *4-5.

42. *Id.* at *3.

lowed claim based upon equitable principles, an objection to claim . . . concerns the allowance of such claim."[43] In other words, "equitable subordination . . . is qualitatively different than an objection to a proof of claim False because it 'can only be used to reorder priorities, not to disallow claims.' "[44] Unlike an objection to a proof of claim, an equitable subordination action "does not focus upon the validity of the underlying debt at all" because "this fact is presumed, or otherwise admitted."[45]

In light of this distinction, the *Enron* court concluded that an equitable subordination action in the "dueling debtor" context, unlike an objection to a proof of claim, seeks "offensive" relief that violates the claimant-debtor's automatic stay.[46] Thus, the *Enron* court concluded that the HSI Committee's attempt to equitably subordinate Enron's claim "was intended as an offensive use of federally created rights to alter the priority of [Enron's] proof of claim only," and that the automatic stay therefore prohibited the effort.[47] The *Enron* court also noted that the HSI Committee had filed its equitable subordination action "months after Enron's bankruptcy petition" and that, at the very least, their complaint "should have identified [itself as] an objection to Enron's proof of claim and that the relief requested was defensive."[48] According to Enron, the fact that the HSI Committee's action did not even purport to be an objection or defense to Enron's proof of claim justified finding that it was "merely an attempt by the HSI Committee to circumvent the automatic stay in Enron's bankruptcy case," and that "[f]rom a policy perspective, there is no reason . . . to conclude that by prosecuting the [equitable subordination action] . . . the HSI Committee is not attempting to procure a benefit not otherwise available to Debtors' [sic] other creditors in violation of the automatic stay."[49]

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43. *Id.* at *26-27 (citations omitted).

44. *Id.* at *27-29 (quoting Official Comm. of Unsecured Creditors of Sunbeam Corp. v. Morgan Stanley & Co. (*In re* Sunbeam), 284 B.R. 355, 363 (Bankr. S.D.N.Y. 2002)).

45. *Id.* at *27-28 (quoting *In re* County of Orange, 219 B.R. 553, 559-60 (Bankr. C.D. Cal. 1997)).

46. *Id.* at *28-30.

47. *Id.*

48. *Id.* at *25-26.

49. *Id.* at *26.

B. *Other Relevant Case Precedents*

The "offensive/defensive" distinction was also utilized by the court in *In re Metiom, Inc.*[50] In that case, the creditor trustee for the liquidating debtor Metiom, Inc. ("Metiom") objected to an unsecured claim asserted against Metiom by a creditor named Divine Acquisition, Inc. ("Divine"). Divine had itself been subject to a chapter 11 proceeding in the United States Bankruptcy Court for the District of Massachusetts.[51] Metiom's objection primarily sought to disallow Divine's claim under section 502(d)[52] of the Bankruptcy Code on the grounds that Divine had received unrelated pre-petition and post-petition preference payments. In the alternative, however, Metiom argued that even if the bankruptcy court allowed Divine's claim, it should be equitably subordinated to other unsecured claims under section 510(c) of the Bankruptcy Code.[53] In response, Divine argued that Metiom's assertion of equitable subordination violated the automatic stay in Divine's chapter 11 case because it threatened to impact property of Divine's estate by subordinating Divine's claim against Metiom.[54]

The court disagreed with Divine, holding that Metiom's assertion of equitable subordination did not violate the automatic stay in Divine's chapter 11 proceeding because it was in the context of a "defensive" objection to Divine's proof of claim, and did not seek offensive, affirmative relief to exercise control over Divine property.[55] The court's divergence from *Enron* is perhaps attributable to the fact that, unlike in *Enron*,

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50. 301 BR 634 (Bankr. S.D.N.Y. 2003).

51. *Id.* at 637.

52. 11 U.S.C. § 502(d) (2006) ("[T]he court shall disallow any claim of any entity from which property is recoverable under section . . . 550 . . . or that is a transferee of a transfer avoidable under section . . . 547 . . . .").

53. *In re Metiom*, 301 B.R. at 637.

54. *Id.* at 638.

55. Although the court then proceeded to deem Metiom's claim objection to constitute the functional equivalent of the commencement of an adversary proceeding, it did not speak to whether a debtor's assertion of equitable subordination by adversary proceeding would be sufficiently "offensive" behavior in violation of the automatic stay. *See id.* at 640 ("When one of the types of relief specified in Bankruptcy Rule 7001 is raised in a claim objection, the objection automatically becomes more than a contested matter under Bankruptcy Rule 9014; the parties automatically become subject to the adversary proceeding rules . . . .").

the claim to be subordinated was a general unsecured claim rather than a secured claim. As a result, the subordination of any such unsecured claim did not necessarily involve "offensive" relief such as the transfer of a corresponding lien from the creditor to the debtor's estate.

More recently, the case of *In re BI-LO, LLC* applied the "offensive/defensive" doctrine to analyze an action brought by a debtor to equitably subordinate claims asserted by another debtor.[56] That case involved a conflict between the liquidating estate of Bruno's Supermarkets, LLC ("Bruno"), a chapter 11 debtor in the United States Bankruptcy Court for the Northern District of Alabama, and BI-LO, LLC ("BI-LO") and its debtor affiliates, subject to chapter 11 proceedings in the United States Bankruptcy Court for the District of South Carolina.[57] Each debtor asserted several large claims in the other's respective chapter 11 proceedings. Included among Bruno's claims against BI-LO was a claim for equitable subordination.[58] The liquidating trustee for the Bruno estate filed a motion before the *BI-LO* court, seeking relief from BI-LO's automatic stay to liquidate all of its claims against BI-LO before the *Bruno* court, including its claim for equitable subordination.[59] The *BI-LO* court denied the liquidating trustee's motion for stay relief with respect to all claims other than equitable subordination, concluding that each party remained free to properly assert its defenses to claims before their respective bankruptcy courts.[60] With respect to Bruno's claim for equitable subordination against BI-LO, the court concluded that the automatic stay did indeed prohibit the claim absent prior stay relief from BI-LO's home court, because such a claim was "offensive" in nature.[61]

Two recent cases decided in the context of the *Lehman* chapter 11 cases illustrate the challenges confronted by bankruptcy courts in applying the "offensive/defensive" distinction to equitable subordination actions in the "dueling debtor" context.

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56. No. 09-02140 (HB), 2010 Bankr. LEXIS 2462, at *20-22 (Bankr. D.S.C. Aug. 13, 2010).
57. *Id.* at *1-2.
58. *Id.* at *7 n.10.
59. *Id.* at *1-2
60. *Id.* at *23.
61. *See id.* at *22-23.

III.
Recent Development 1: LCPI and the SunCal Debtors

The first recent development with respect to this issue involves a conflict between LCPI and the SunCal debtors. The SunCal debtors sought to equitably subordinate the secured claims of LCPI, one of SunCal's largest secured creditors. On appeal, the Ninth Circuit deemed the equitable subordination attempts to constitute "offensive" conduct under the Enron standard that violated the automatic stay of LCPI.

A lengthy procedural history surrounds the dispute. The SunCal debtors were formed as part of a joint venture with affiliates of LBHI, including LCPI, to develop a series of large residential real estate projects. LCPI, one of the Lehman debtors, was a leading pre-petition secured lender to the SunCal debtors.[62] The SunCal debtors commenced their chapter 11 cases on November 6, 2008.[63] LCPI, as one of the SunCal debtors' principal pre-petition lenders, was positioned to be a large claimant against SunCal. On November 10, 2008, the SunCal debtors filed a motion for relief from stay before the *Lehman* bankruptcy court.[64] In the stay relief motion, the SunCal debtors sought broad relief from LCPI's automatic stay to permit the SunCal debtors to take future, to-be-identified actions in the SunCal chapter 11 cases that could potentially impact LCPI's rights.[65] After extensive briefing and oral argument, the *Lehman* bankruptcy court denied[66] the SunCal debtors' broad stay relief motion without prejudice to the ability of the

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62. Together, the loans to SunCal from LCPI and one of its non-debtor affiliates totaled approximately $1.5 billion. *See* Debtors' Response to SunCal Debtors' Motion and Memorandum of Law Pursuant to Fed. R. Bankr. P. 8005 for Stay Pending Appeal of Order Approving Debtors' Motion Pursuant to Bankruptcy Rule 9019 for Authority to Compromise Controversy in Connection with a Repurchase Transaction with Fenway Capital LLC, *In re* LBHI, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Oct. 27, 2009), ECF No. 9428.

63. Chapter 11 Voluntary Petition, SunCal I, No. 08-17206 (ES) (Bankr. C.D. Cal. Nov. 6, 2008), ECF No. 1.

64. Motion of the SCC Entities for an Order Granting Relief from the Automatic Stay, *In re LBHI*, No. 08-13555 (JMP) (Nov. 10, 2008), ECF No. 1439.

65. *Id.* at *7-8.

66. Order Denying SCC Entities' Motion for Relief from the Automatic Stay, *In re LBHI*, No. 08-13555 (JMP) (Nov. 21, 2008), ECF No. 1647.

SunCal debtors to subsequently renew their motion for specific relief at a later date.[67]

Instead of returning to the *Lehman* bankruptcy court to request specific stay relief, the SunCal debtors proceeded to take action against LCPI in the *SunCal* bankruptcy court. On January 23, 2009, LCPI filed a motion for relief from stay in the *SunCal* cases to foreclose on collateral, alleging in part that any plan of reorganization was not feasible because it would be premised on the equitable subordination of LCPI's secured claims which were subject to LCPI's automatic stay.[68] Thereafter, the SunCal debtors filed a proposed chapter 11 plan that, *inter alia*, sought to equitably subordinate the claims asserted

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67. Ultimately, on April 7, 2010, the SunCal Debtors returned to the *Lehman* court objecting to a proposed settlement agreement entered into between LCPI, LBHI, Fenway Capital, LLC, and Fenway Funding LLC. Debtors' Joint Opposition to Motion Pursuant to Bankruptcy Rule 9019 for Authority to Compromise Controversy in Connection with a Repurchase Transaction with Fenway Capital LLC and a Commercial Paper Program with Fenway Funding LLC, *In re LBHI*, No. 08-13555 (JMP) (Apr. 7, 2010), ECF No. 8105. Separately, on April 21, 2010, the SunCal Debtors filed a motion before the *Lehman* court requesting a determination that LCPI's automatic stay did not apply to prevent the SunCal Debtors from proceeding with the equitable subordination action before the *SunCal* court in California, or, in the alternative, requesting relief from LCPI's stay. Debtors' Motion for Relief from Stay Notice and Motion of SunCal Debtors for an Order Determining that the Automatic Stay Does Not Apply; or in the Alternative, Granting Relief from Stay, *In re LBHI*, No. 08-13555 (JMP) (Apr. 21, 2010), ECF No. 8539.

The *Lehman* bankruptcy court approved the compromise motion and denied SunCal's motion for relief from the automatic stay. Transcript of Hearing, *In re* LBHI, No. 08-13555 (JMP) (May 12, 2010), ECF No. 9351 [hereinafter May 12, 2010 SunCal Hearing Tr.]. The Court deemed it inappropriate to rule on the extent of LCPI's automatic stay while the *SunCal* bankruptcy court's decision on the same issue remained subject to pending appeal before the Ninth Circuit. *See id.* at 57, 73 ("I couldn't have been clearer in January of 2009 that this was the Court that you needed to come to for purposes of getting stay relief . . . . But it's now May of 2010. It's quite a long while after that. . . . The SunCal Debtors have scrupulously avoided coming into this court from November of 2008 until today . . . . Having gone to the Ninth Circuit, I believe the Ninth Circuit is the place for this question to be decided."). The *Lehman* bankruptcy court's ruling was affirmed on appeal. *In re* LBHI., 435 B.R. 122 (S.D.N.Y.), *aff'd sub nom.* SunCal Cmtys. I LLC v. Lehman Commercial Paper, 402 F. App'x 634 (2d Cir. 2010).

68. Motion for Relief from the Automatic Stay, *supra* note 10; Memorandum of Points and Authorities in Support of Motion for Relief from the Automatic, *supra* note 10.

by the LCPI.[69] In response to LCPI's stay relief motion, the SunCal debtors relied on *Metiom* to argue that the equitable subordination actions against LCPI constituted merely an objection to LCPI's informal proof of claim and therefore were permissible "defensive" actions that did not violate LCPI's automatic stay.[70]

On March 10, 2009, after extensive pleadings and oral argument, the *SunCal* bankruptcy court denied LCPI's stay relief motion.[71] The bankruptcy court deemed LCPI's stay relief motion to constitute an "informal proof of claim" and deemed the SunCal debtors' equitable subordination action to be a permissible defense to such a proof of claim.[72] Accordingly, the bankruptcy court concluded that "[t]he automatic stay arising from the bankruptcy case of [LCPI] does not apply to any objection to the claim of [LCPI], [or] any proceeding to subordinate the claim of [LCPI] pursuant to 11 U.S.C. § 510(c)(1) . . . ."[73] As a result, the *SunCal* bankruptcy court permitted the SunCal debtors to pursue equitable subordination of the claims of the LCPI "via an adversary proceeding or plan" without having to first seek relief from the automatic stay in LCPI's chapter 11 case.[74]

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69. SunCal Debtors' Proposed Plan of Reorganization, SunCal I, No. 08-17206 (ES) (Bankr. C.D. Cal. Feb. 4, 2009), ECF No. 93. The Plan was premised on (i) equitably subordinating the claims of LCPI and its non-debtor affiliate lenders (Lehman ALI, Inc., Northlake Holdings LLC, and OVC Holdings LLC) to all of the SunCal debtors' allowed unsecured claims; (ii) transferring the liens of the Lehman lenders to the SunCal debtors' estates; (iii) selling the real property that constituted the Lehman lenders' collateral; and (iv) using the proceeds of the sale of the properties to satisfy the claims of the SunCal debtors' unsecured creditors. *Id.*

70. Debtors' Omnibus Opposition to Motions for Relief from the Automatic Stay, *SunCal I*, No. 08-17206 (ES) (Feb. 6, 2009), ECF No. 98.

71. Order Denying Motion for Relief from the Automatic Stay, *supra* note 13.

72. *Id.* at ¶ 5.

73. *Id.*

74. *Id.* After the Bankruptcy Court for the Central District of California's ruling, the SunCal debtors added LCPI as a defendant to an earlier filed-complaint, asserting five claims against LCPI: (i) equitable subordination; (ii) fraudulent transfer; (iii) lien avoidance; (iv) disallowance of claims and liens; and (v) preservation of claims and liens for the SunCal debtors' estates. *See* Amended Complaint (Third), SCC Acquisitions, Inc. v. Lehman ALI, Inc. (*In re* Palm Hills Prop. LLC), No. 09-01005 (ES) (Bankr. C.D. Cal. July 10, 2009), ECF No. 44. The SunCal debtors had initially filed the complaint against LCPI's non-debtor affiliates on January 6, 2009. Complaint,

On appeal, however, the United States Bankruptcy Appellate Panel for the Ninth Circuit ("BAP") reversed the bankruptcy court's decision.[75] The BAP concluded that "[s]imply because LCPI filed a proof of claim (whether formally or informally) does not mean that the [SunCal] debtors may take *any* action against LCPI without violating LCPI's automatic stay."[76] The BAP recognized that *Enron*'s "offensive/defensive" distinction was an appropriate construct and concluded that the SunCal debtors' equitable subordination action was an "offensive" action, noting that "the adjudication of the Palmdale debtors' equitable subordination action seeks affirmative relief, and therefore violates [LCPI's] automatic stay."[77] According to the BAP, equitable subordination is an "offensive" action, as opposed to a merely "defensive" objection to the allowance of a claim, because "unlike in claim disallowance, in the situation of equitable subordination, a creditor *has* the right to payment on its claim, but that property right may be modified by the bankruptcy court based upon equitable principles."[78]

In relying on *Enron*, the BAP distinguished *Metiom*.[79] It distinguished *Metiom* from the *SunCal* dispute on the grounds that the conduct in *Metiom* involved an attempt to equitably subordinate an unsecured claim:

> The facts of this case differ from *Metiom* because, here, [LCPI's] claims are secured and Debtors are seeking to transfer the liens to the estate. Such affirmative relief was not part of the *Metiom* case where the equitable subordination, along with § 547 and § 549, were included as alternatives in debtor's claim objection and the bankruptcy trustee expressly

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SCC Acquisitions, No. 09-01005 (ES) (Jan. 6, 2009), ECF No. 1. Thereafter, the SunCal debtors amended the complaint to include, *inter alia*, equitable subordination claims against LCPI. Notice of Lodging and Lodging of Second Amended Complaint, at ex. A, *SCC Acquisition*, No. 09-01005 (ES) (Mar. 11, 2009), ECF No. 19.

75. SunCal II, 423 B.R. 655 (B.A.P. 9th Cir. 2009).

76. *Id.* at 667 (alteration added).

77. *Id.* at 665 (alteration added).

78. *Id.* at 666.

79. *Id.* at 667 (citing *In re* Metiom, 301 B.R. 634, 637 (Bankr. S.D.N.Y. 2003)).

> waived any affirmative relief or damages resulting from the creditor's postpetition conduct.[80]

Lastly, the BAP dealt with the issue of concurrent jurisdiction over the extent and applicability of LCPI's automatic stay. The BAP recognized that the *SunCal* bankruptcy court had "concurrent" jurisdiction to determine the applicability and scope of LCPI's automatic stay, but concluded that "the New York bankruptcy court must have the final say as to whether the automatic stay applies to the bankruptcy case before it."[81] The SunCal debtors appealed the BAP's decision to the Ninth Circuit on January 8, 2010.

On further appeal, the Ninth Circuit upheld the BAP's decision and concluded that the SunCal debtors' attempts to equitably subordinate LCPI's claim were "offensive" actions in violation of LCPI's automatic stay.[82] According to the Ninth Circuit, if one debtor "wants to equitably subordinate the creditor claims of the first debtor, it must seek relief from stay from the first debtor's home bankruptcy court."[83] As with the BAP, the Court of Appeals distinguished *Metiom* on the grounds that *Metiom* involved equitable subordination of an unsecured claim, "and so could not involve the transfer of a lien to the estate of the 'defending' debtor."[84] In the context of a secured claim, equitable subordination was an inherently "offensive" remedy: "[t]he bankruptcy court's ability, in equitably subordinating a secured claim, to transfer property from the bankruptcy estate, means that a claim for equitable subordination of a secured claim is an 'act to exercise control over property of the estate.'"[85]

IV.
Recent Development 2: Lehman Brothers Holdings, Inc. and Shinsei Bank

The second recent development with respect to this issue arose from a dispute between LBHI and its Japanese affiliate, Sunrise. This conflict implicated a new issue missing from

80. *Id.* (alteration added).
81. *Id.* at 668.
82. SunCal III, 654 F.3d 868, 871, 76 (9th Cir. 2011).
83. *Id.* at 871.
84. *Id.* at 876.
85. *Id.* (citations omitted).

each of the *Enron*, *Metiom*, and *SunCal* disputes – the boundary between one debtor's automatic stay and another debtor's claim for equitable subordination when the dueling debtors are subject to reorganization proceedings in different countries.

On September 15, 2008, Sunrise filed a petition for civil reorganization proceeding before the Tokyo District Court (the "Sunrise Proceeding").[86] The Sunrise Proceeding was filed in accordance with, and governed by, the Japanese Civil Rehabilitation Law (the "CRL").[87] The next day, on September 16, 2008, the Tokyo District Court entered a provisional order precluding Sunrise from paying its debts.[88] That same day, in accordance with the CRL, the Tokyo District Court appointed a supervisor (the "Supervisor") to facilitate the administration of the Sunrise Proceeding.[89] On September 19, 2008, the Tokyo District Court entered an order of commencement that commenced the civil proceedings for Sunrise, a Japanese affiliate of LBHI.[90]

In accordance with a timetable set forth by the Tokyo District Court, LBHI timely filed a proof of claim against Sunrise in the amount of ¥1.4 billion (approximately $15 million).[91] One of LBHI's non-debtor affiliates, LB Asia, submitted a proof of claim against Sunrise in the amount of ¥229 billion (approximately $2.44 billion).[92] LBHI, as the indirect parent of LB Asia, would be the ultimate beneficiary of any recovery by LB Asia on its claim against Sunrise.[93] Shinsei, a large unsecured creditor of the Lehman debtors and a member of the Lehman debtors' official committee of unsecured creditors,[94]

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86. Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion at ¶ 12, *In re* LBHI, No. 08-13555 (JMP) (Sept. 17, 2009), ECF No. 5205.

87. *Id.* at ¶ 7.

88. *Id.* at ¶¶ 17-18.

89. *Id.* at ¶ 14.

90. LBHI Motion to Enforce Automatic Stay, *supra* note 18, at ¶ 17; Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion, *supra* note 86, at ¶ 17.

91. Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion, *supra* note 86, at ¶ 18.

92. LBHI Motion to Enforce Automatic Stay, *supra* note 18, at ¶ 18.

93. *See id.* at ¶ 1.

94. *Id.*

timely submitted a proof of claim against Sunrise in the amount of ¥25 billion (approximately $266 million).[95]

Pursuant to the CRL, Sunrise was required to submit a statement of its approval or disapproval with respect to the content and voting rights of filed proof of claims by November 18, 2008.[96] In accordance with the CRL, on November 18, 2008 Sunrise submitted its statement.[97] That statement approved of the amount of LB Asia's claim against Sunrise.[98] Although the statement disputed the amount of LBHI's claim against Sunrise, Sunrise and LBHI subsequently resolved the dispute and agreed to a reduced amount of LBHI's claim.[99] Thereafter, in accordance with the CRL, creditors of Sunrise (such as Shinsei) had the opportunity to object to any other creditor's claims by December 2, 2008.[100] Shinsei did not object to LB Asia or LBHI's claim during this period.[101]

On May 15, 2009, Sunrise and Shinsei each submitted a proposed rehabilitation plan to the Supervisor and the Tokyo District Court.[102] The proposed plan submitted by Sunrise (the "Sunrise Plan") provided for the distribution to creditors of amounts equal to 20% of their claims on a pro rata basis.[103] Under this proposed plan, LBHI would recover ¥2.8 million (approximately $30,000), LB Asia would recover ¥46 billion (approximately $490 million), and Shinsei would recover ¥5 billion (approximately $52 million).[104]

The proposed plan submitted by Shinsei (the "Shinsei Plan"), on the other hand, sought to reclassify the claims of

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95. *Id.* at ¶ 22.

96. Reply Declaration of Junya Naito at ¶ 3, *In re* LBHI, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Aug. 25, 2009), ECF No. 4919.

97. *See* Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion, *supra* note 86, at ¶ 21.

98. Reply Declaration of Junya Naito, *supra* note 96, at ¶ 3.

99. *Id.*

100. *Id.* ¶ 4.

101. *Id.*

102. *See* Declaration of Junya Naito in Support of LBHI's Motion at ex. 1-2, *In re* LBHI, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Aug. 11, 2009), ECF No. 4768 (the Sunrise and Shinsei Plans as submitted to the Tokyo District Court); Declaration of Richard L. Levine in Support of LBHI's Motion at ex. A-B, *In re LBHI*, No. 08-13555 (JMP) (Aug. 11, 2009), ECF No. 4766 (English translations of the Sunrise and Shinsei Plans).

103. LBHI Motion to Enforce Automatic Stay, *supra* note 18, at ¶ 21.

104. *Id.* at ¶¶ 21-22.

LBHI and LB Asia on the grounds that under Japanese law LBHI and LB Asia's claims against Sunrise should be treated as equity contributions rather than debt obligations.[105] Under such a plan, then, Shinsei would recover the full amount of its claim against Sunrise, while LBHI and LB Asia would recover nothing.[106]

On August 11, 2009, LBHI filed a motion before the Lehman court arguing that Shinsei's submission of the Shinsei Plan violated LBHI's automatic stay.[107] In the motion, LBHI requested an order directing Shinsei to comply with the automatic stay by withdrawing its filing of the Shinsei Plan with the Tokyo District Court.[108] In support of the motion, the Lehman debtors argued that Shinsei's submission of the Shinsei Plan requested in effect the equitable subordination of LBHI's claims and therefore constituted "offensive" conduct under the Enron standard and violated LBHI's automatic stay.[109]

After extensive briefing and oral argument, including the filing of supplemental declarations by specialists in Japanese law detailing the context and nature of the Shinsei Plan under relevant Japanese law,[110] the *Lehman* court issued a bench ruling in favor of Shinsei and denying the motion of LBHI.[111] First, the *Lehman* bankruptcy court declined to apply *Enron*'s "offensive/defensive" distinction given that the Shinsei Plan was submitted pursuant to Japanese law in a Japanese court: "[t]he offensive/defensive dichotomy used in *Enron* to identify conduct functionally equivalent to the commencement of litigation is inappropriate, in my view, in the context of the present dispute, given the central role in this case of another juris-

105. *Id.* at ¶ 23; Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion, *supra* note 86, at ¶¶ 40-45; Declaration of Isomi Suzuki at ¶ 37, *In re* LBHI, No. 08-13555 (JMP) (Sept. 17, 2009), ECF No. 5206.

106. LBHI Motion to Enforce Automatic Stay, *supra* note 18, at ¶ 23.

107. *Id.*

108. *Id.* at ¶ 44.

109. *Id.*; Debtor's Reply to Objections to the Debtor's Motion, As Supplemented, for an Order Enforcing the Automatic Stay and Holding Shinsei Bank in Contempt for Violating the Automatic Stay at ¶¶ 11-15, *In re* LBHI, No. 08-13555 (JMP) (Aug. 25, 2009), ECF No. 4920.

110. *See, e.g.*, Supplemental Declaration of Shigeaki Momo-o in Support of LBHI's Motion, *supra* note 86; Declaration of Isomi Suzuki, *supra* note 105.

111. Oct. 14, 2009 Shinsei Hearing Tr., *supra* note 22, at 21:5-6 ("Succinctly put, I believe that Lehman loses this motion.").

diction's legal procedures and substantive law."[112] In so ruling, the court grounded its analysis in its understanding of Shinsei's conduct in light of "what I have been told in the affidavit submitted is the practice in the Tokyo District Court[.]"[113] Specifically, the court noted:

> The eight-day period which was applicable to the objection procedure in Tokyo, a very, very abbreviated period which, according to one of the affidavits that I read, frequently is not meaningful because so much information is held by third parties. The distinction between being able to permissibly object to a claim within that eight-day period but impermissibly file a competing plan is not, in my view, a meaningful distinction, at least for purposes of the Tokyo bankruptcy case.[114]

Having declined to apply *Enron*'s "offensive/defensive" distinction, the *Lehman* court instead identified the "appropriate inquiry" as "whether under Japanese law the submission of the Shinsei Plan constituted conduct explicitly prohibited by the Bankruptcy Code."[115] In particular, the bankruptcy court focused on whether Shinsei's submission of the Shinsei Plan constituted the commencement of litigation "against a debtor" under section 362(a)(1).[116] After reviewing the submissions on Japanese law, the *Lehman* court noted that although "the appropriate legislation in Japan delineates a procedure for discrete litigation akin to adversary proceedings . . . the law there does not deem a creditor's submission of rehabilitation plan to be such an action."[117] Instead, "the submission of competing rehabilitation plans appears to be merely the first step in a somewhat drawn-out and protracted procedure whereby the supervisor and, in turn, the Tokyo District Court both evaluate the fairness and reasonableness of competing distribution schemes."[118]

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112. *Id.* at 23:12-25.
113. *Id.* at 23:21-23.
114. *Id.* at 24:1-9.
115. *Id.* at 24:10-14.
116. *See id.* at 24-25.
117. *Id.* at 25:2-7.
118. *Id.* at 25:7-11.

Similarly, the *Lehman* court rejected LBHI's characterization of Shinsei's submission of the Shinsei Plan as the functional equivalent of a seizure of estate property prohibited under section 362(a)(3), noting that "Shinsei's submission of the Shinsei Plan is markedly different from the flagrant confiscation of debtor property by creditors."[119] The *Lehman* court recognized that the Shinsei Plan, if ultimately deemed legal by the Supervisor and the Tokyo District Court and ratified by creditor vote, would cause LBHI to recover less on its claim against Sunrise.[120] Nonetheless, the *Lehman* court declined to deem this potentially negative impact on LBHI recovery to be the equivalent of a seizure of estate property: "LBHI's right to collect on its claim against Sunrise depends on that claim's amount and priority being valid under relevant Japanese law. Case law is replete with examples of permissible creditor actions with actual or potential negative consequences for debtor property."[121]

V.
The Future of the *Enron* "Offensive/Defensive" Distinction in the Aftermath of *Shinsei* and *SunCal*

While *Shinsei* and *SunCal* affirm the applicability of *Enron*'s "offensive/defensive" distinction for equitable subordination disputes between dueling debtors within the United States, the two recent cases leave open whether the doctrine remains the appropriate construct for "dueling debtor" constructs involving a foreign debtor.

The recent decision by the Ninth Circuit in *SunCal* leaves no doubt that, in the "dueling debtor" context within the United States, a debtor seeking to equitably subordinate another debtor's secured claim must first obtain stay relief from the debtor-claimant's home bankruptcy court. In fact, this appears to have been implicitly contemplated by the *Lehman* court at the time that it denied without prejudice the SunCal debtors' initial motion for stay relief while simultaneously preserving the right of the SunCal debtors to later return seeking specific, individualized relief from LCPI's automatic stay. As the BAP made clear, "the [SunCal debtors] are not without

119. *Id.* at 26:13-19.
120. *Id.* at 26:23-27:2.
121. *Id.* at 27:6-11.

remedy. They can seek relief from stay in LCPI's case where their earlier motion was denied without prejudice."[122] In fact, the *Lehman* court reaffirmed the validity of the *Enron* distinction in dicta on the record at a hearing on May 12, 2010: "And let me be really clear, the law in the Southern District of New York as stated by Judge Gonzales in the *Enron* case, and I choose to follow his reasoning, is that litigation brought by a party against a debtor seeking to equitably subordinate claims of that debtor constitutes a violation of the automatic stay."[123]

The applicability of *Enron*'s "offensive/defensive" construct is less clear, however, when, as in *Shinsei*, one of the dueling debtors is a foreign debtor subject to an insolvency proceeding in a foreign jurisdiction. Indeed, in declining to apply *Enron*'s "offensive/defensive" distinction to the *Shinsei* dispute, the *Lehman* court appeared to implicitly recognize the limited usefulness of this paradigm when evaluating questionable creditor conduct taken in accordance with foreign substantive and procedural law.[124]

Nonetheless, it is not apparent just how much precedential value should be afforded to the *Shinsei* decision in light of the extent to which the *Lehman* court narrowly tailored its analysis to the unique facts underlying that dispute. For one thing, the *Lehman* court expressly grounded its holding on the role played by Shinsei's conduct within the broader context of Japanese insolvency law: "the [plan] submission . . . appears to be merely the first step" in an otherwise complex procedural structure governing the submission and approval of rehabilitation schemes in the Tokyo District Court.[125] Moreover, the *Lehman* court later cautioned on the record at an omnibus hearing on the *Lehman* cases on May 12, 2010 that the *Shinsei* decision is of limited precedential value:

> And then just so it's clear what my view is of the *Shinsei* case because that has been liberally misquoted in papers, my ruling with respect to the *Shinsei* case speaks for itself. But I view actions taken pursuant to principles of Japanese bankruptcy law which would have the effect of subordinating claims, not to be cov-

122. SunCal II, 423 B.R. 655, 666 n.8 (B.A.P. 9th Cir. 2009).
123. May 12, 2010 SunCal Hearing Tr., *supra* note 67, at 75:19-25.
124. *See* Oct. 14, 2009 Shinsei Hearing Tr., *supra* note 22, at 23:18-25.
125. *Id.* at 25:2-15.

> ered by the principal announced by Judge Gonzales in the *Enron* case because under Japanese law active litigation comparable to an adversary proceeding is not involved. And in that case the action taken by Shinsei Bank was not self-executing and involved actions to be taken by a quasi-judicial figure, a supervisor, who would be determining whether and when a competing plan would be circulated to creditors. It was incredibly fact specific, and is not subject to broad application in the U.S.[126]

Notwithstanding such limitations, however, the position adopted by the *Lehman* court in addressing the *Shinsei* dispute appears to be the most appropriate way to resolve equitable subordination disputes between dueling debtors when one debtor is subject to a foreign insolvency proceeding. Bankruptcy courts confronting this issue in the future should decline to apply *Enron*'s "offensive/defensive" distinction when examining actions taken in a foreign jurisdiction. The "offensive/defensive" dichotomy used in *Enron* and *SunCal* to identify conduct functionally equivalent to conduct explicitly prohibited by the United States Bankruptcy Code seems inappropriate in the context of disputes involving another country's procedural and substantive law. This is so because *Enron*'s "offensive/defensive" distinction is, at bottom, an implicit attempt by United States bankruptcy courts to balance the competing policy concerns that underpin the automatic stay of section 362, i.e., the need to preserve estate property while simultaneously protecting creditor rights.[127]

But the balance between these policies sought by United States bankruptcy courts may not be identical to the balance

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126. *Id.* at 76:9-23.

127. *See* Justus v. Fin. News Network, Inc. (*In re* Fin. News Network), 158 B.R. 570, 572-73 (S.D.N.Y. 1993) (noting that the distinction between offensive and defensive actions of a party which affect the debtor's estate is a useful tool for balancing the need to protect estate property with the rights of creditors to legal protections); *In re* Enron Corp., No. 01-16034 (AJG), 2003 Bankr. LEXIS 2261, at *11-14 (Bankr. S.D.N.Y. Jan. 13, 2003) (quoting Martin-Trigona v. Champion Fed. Sav. & Loan Ass'n, 892 F.2d 575, 577 (7th Cir. 1989) ("The fundamental purpose of bankruptcy, from a creditor's standpoint, is to prevent creditors from trying to steal a march on each other . . . [t]here is, in contrast, no policy of preventing persons whom the bankrupt has sued from protecting their legal rights.")).

sought by other foreign legal insolvency regimes. For example, it is certainly possible to imagine a hypothetical foreign insolvency regime that would emphasize the protection of creditor rights above and beyond the preservation of debtor property. It hardly seems appropriate to replace this policy choice with the policy balance sought by the United States Bankruptcy Code, prohibiting a creditor from duly exercising its rights under the foreign legal regime in a foreign court. Moreover, different bodies of substantive and procedural law mean that the characterization of certain American procedures or remedies as "offensive" or "defensive"—already a subjective and context-driven assessment—will have limited applicability to conduct in foreign legal systems.

Declining to adopt the *Enron* distinction in the international context would honor the principle of comity underlying any dispute between foreign legal jurisdictions. It is axiomatic that U.S. courts have long recognized the need to respect the sovereignty of proceedings in other nations.[128] Declining to adopt *Enron* in the international context honors the sovereignty of foreign legal proceedings by ensuring that, as in *Shinsei*, foreign legal authorities will not be forestalled from determining the propriety of a creditor's actions in accordance with their jurisdiction's unique set of policy preferences. For example, in *Shinsei*, the CRL contemplated that the Supervisor, and ultimately the Tokyo District Court, determine whether the submission of the Shinsei Plan was the appropriate procedural vehicle through which Shinsei could equitably reclassify LBHI's claims. Had the *Lehman* court granted LBHI's motion and deemed the submission of the Shinsei Plan "offensive" behavior in violation of LBHI's automatic stay, the supervisor's role would have been usurped and the foreign legal procedure eclipsed.

Lastly, extending *Enron*'s "offensive/defensive" distinction to creditor actions abroad could prove administratively unworkable, as the amorphous categories would force creditors

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128. *See* J.P. Morgan Chase Bank v. Altos Hornos de Mexico, S.A. de C.V., 412 F.3d 418, 424 (2d Cir. 2005) ("[The Second Circuit] ha[s] repeatedly held that U.S. courts should ordinarily decline to adjudicate creditor claims that are the subject of a foreign bankruptcy."); Victrix S.S. Co., S.A. v. Salen Dry Cargo A.B., 825 F.2d 709, 714 (2d Cir. 1987) ("Under general principles of comity . . . federal courts will recognize foreign bankruptcy proceedings.").

participating in foreign insolvency proceedings related to a chapter 11 debtor to seek guidance in the chapter 11 court before exercising rights abroad. This would, in essence, convert the chapter 11 debtor's main bankruptcy case into a "bankruptcy clearinghouse" of sorts, whereby creditors from all over the world must first appear to vet their conduct before exercising their appropriate legal remedies abroad.