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Business Bankruptcy Legal Update

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The Small Business Reorganization Act of 2018

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A. Recommendations of the ABI Commission as to "SMEs"

In response to what appeared to be a general consensus among restructuring professionals was that the time had come once again to evaluate U.S. business reorganization laws, in 2012, the ABI established the Commission to Study the Reform of Chapter 11 (the "Commission"). Specifically in regard to Small & Medium-Sized Enterprises ("SMEs"), anecdotal evidence suggested, even before the Commission's work, that chapter 11 has become too expensive and is no longer capable of achieving certain policy objectives such as stimulating economic growth, preserving jobs and tax bases at both the state and federal level, or helping to rehabilitate viable companies that cannot afford a chapter 11 reorganization. Many professionals suggested that more companies are liquidating or simply closing their doors without trying to rehabilitate under the federal bankruptcy laws. Commentators and professionals also suggested that companies are waiting too long to invoke the federal bankruptcy laws, which limits companies' restructuring alternatives and may lead to premature sales or liquidations.

To launch its study, the Commission identified 13 broad study topics to facilitate a detailed analysis of the various components of chapter 11. The Commission then enlisted the volunteer service of more than 150 of the insolvency profession's expert judges, lawyers, financial advisors, academics, and consultants to serve on advisory committees for each of these study topics.[1] Ultimately, the Commission submitted a proposal aimed at reinstate reorganization under the Bankruptcy Code as a viable option for SMEs.

i. What businesses should constitute SMEs?

The Commission's proposed reforms would apply to approximately 90% of all business filers by number. The Commission proposed that an SME be defined as a business debtor with:

i. No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor's case; and

[1] The Commission's study culminated in a comprehensive report, which can be found here: http://commission.abi.org/full-report. The subsection relating to small businesses can be found here: https://abiworld.app.box.com/s/uzc6yo7dr8lt1g2m4uxs.

ii. Less than \$10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the petition date.[2]

A single asset real estate case could not qualify as an SME. The current "small business case" and "small business debtor" definitions and provisions of the code would be deleted.

A debtor purporting to qualify as an SME under this definition must file a balance sheet reflecting a good faith estimate of its assets and liabilities as of the petition date with its chapter 11 petition. The Court, a creditor or the trustee would be permitted to object to qualification as an SME within 14 days of filing the petition, but only on the basis that one of the two requirements were not satisfied (not on the basis that the debtor should nevertheless not be treated as an SME).

In addition, if a business debtor satisfies subsection (i) above and has more than \$10 million but less than \$50 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates, the debtor may file a motion seeking to be treated as an SME in its chapter 11 case. Such motion must be filed with the debtor's voluntary petition or within seven days after the entry of the order for relief in an involuntary case. The court should grant such motion and classify the debtor as an SME only if the motion is timely filed and the court determines based on evidence presented at the hearing that treating the debtor as an SME in the chapter 11 case is in the best interest of the estate. Any objection to such motion should be filed on or before 14 days after the filing of the motion, and the motion and any objections should be heard on an expedited basis.

ii. Summary of Proposed Bankruptcy Code Revisions for SMEs

The key Commission recommendations on SMEs would change the Bankruptcy Code to:

(a) Remove the unrealistic and artificial deadlines and allow SMEs to work with the court and their stakeholders to establish a sensible restructuring timeline.

(b) Reduce the amount, and limit the kinds, of information that a SME debtor must provide when filing a chapter 11 case.

(c) Reduce the reporting requirements imposed on SMEs.

(d) Not require the U.S. trustee to appoint a committee of unsecured creditors in a SME case, unless requested by a creditor or needed for other reasons.

(e) Allow a SME debtor or other stakeholder in the case to request the appointment of a professional with skills tailored to the particular problems facing that debtor—e.g., an accountant, financial advisor, operational expert in the debtor's industry,

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2 Note that this prong does not specify that the liabilities be noncontingent and liquidated, which could have the effect of excluding small businesses with large asserted tort claims. The Commission Report does suggest that the court should have the discretion to grant SME treatment in such cases, but this could lead to costly wrangling at the beginning of a case.

etc. The Commission called this professional an "estate neutral," which would be a new and valuable resource for debtors operating under the Bankruptcy Code.

(f) Include provisions that encourage the parties, and allow the court, to reduce or control the costs of a chapter 11 case by, for example, streamlining the plan of reorganization process, providing clear rules for the SME debtor's reorganization (thereby reducing litigation), and structuring fees in the case (for example, fees of the estate neutral) to fit the size and resources of the particular SME debtor.

(g) Provide a plan of reorganization option (as a default if a deal is not reached) that allows a SME owner to maintain some ownership interest in the company while preserving the rights of secured creditors and seeking to repay unsecured creditors in full within a period of four years or less. The Commission's plan proposal also provides protections for creditors in the event that the SME debtor defaults under such a reorganization plan.

iii. Detail for Proposed Bankruptcy Code Revisions for SMEs

(a) Plan Timeline

Within 60 days of the entry of the order for relief, the SME debtor should develop and file with the court a timeline for filing and soliciting acceptances of its plan. If an estate neutral or a committee is appointed, the SME debtor should consult with such estate neutral or committee in developing its timeline. After the SME debtor files its timeline for filing and soliciting acceptances of its plan, the court should enter an order setting the deadlines for the SME debtor's plan process. The SME debtor should be subject to the exclusivity periods provided in Bankruptcy Code section 1121.

(b) Plan Content and Confirmation

A chapter 11 plan in an SME case should provide for the following treatment of allowed claims and interests in the case:

- Payment of all administrative and priority claims in accordance with Bankruptcy Code section 1129(a)(9).
- Bifurcation of each undersecured claim into an allowed secured claim in accordance with section 506 and a general unsecured claim for any deficiency claim; neither section 1111(b) nor section 1129(a)(7)(B) should apply in an SME case.
- Distributions to secured creditors (i) as provided in the plan and accepted by each class of secured creditors; or (ii) in accordance with section 1129(b)(2)(A).
- Distributions to unsecured creditors (i) as provided in the plan and accepted by each class of unsecured creditors; (ii) in accordance with section 1129(b)(2)(B) (subject to the

recommended principles in the Report codifying the new value corollary[3]); or (iii) as provided below for an SME Equity Retention Plan.

- Prepetition equity interests may receive voting common stock or ownership units in the reorganized debtor, provided that (i) all impaired classes have accepted the plan; (ii) the plan complies with section 1129(b) (subject to the recommended principles in the Report codifying the new value corollary); or (iii) the plan complies with section 1129(b)(2)(A) and provides impaired classes of unsecured creditors that have rejected the plan with preferred stock, or similar economic interests, in the reorganized debtor as described below (an "SME Equity Retention Plan").

In short, the SME Equity Retention Plan concept world work as follows: secured creditors would need to be paid the value of their collateral; unsecured creditors would be given preferred stock entitling them to 85% of any dividends or distributions; old equity would retain 100% of the common stock, on the condition that they continue to assist in the management of the debtor; after 4 years, the preferred stock would "mature" and would convert to 85% of the equity of the company, unless the unsecured creditors had been "redeemed" at the then-remaining value of their claims.

Specifically, the Commission recommended that the court should confirm an SME Equity Retention Plan that is not accepted by any class of unsecured claims only if all of the following are true:

- (i) The prepetition equity security holders will continue to support the debtor's successful emergence from chapter 11 by remaining involved, on a basis reasonably comparable to their prepetition involvement, in the ongoing operations of the reorganized debtor; and (ii) the reorganized debtor will pay to the holders of unsecured claims, no less often than annually, its **excess cash flow** calculated in a manner reasonable in relation to the company's operating cash flow for each of the three full fiscal years following the effective date of the chapter 11 plan. The debtor should file a budget with its disclosure statement and chapter 11 plan that describes the excess cash flow calculation method and includes projections of excess cash flow for the three fiscal years following the effective date of the plan.
- The prepetition equity security holders receive or retain 100 percent of the common stock, or similar ownership interests, issued or outstanding as of the effective date entitling the holders as a class to receive **15 percent of any economic distributions** from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.
- The prepetition unsecured creditors as a class receive **100 percent of a class of preferred stock**, similar preferred interests, or payment obligations issued by the reorganized debtor on the effective date in accordance with the chapter 11 plan with the following features (referred to as the "creditors' preferred interests"): (i) pro rata voting

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[3] *See* explanation of the Commission's recommendation on this point at page 224-26 of https://abiworld.app.box.com/s/1dele68lfs6uxzm5hkwt.

rights, limited to voting only on the extraordinary transactions identified in these principles; and (ii) entitlement as a class to receive **85 percent of any economic distributions** from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.

- The creditors' preferred interests **mature on the fourth anniversary of the effective date**, at which time the interests should **convert into 85 percent of the common stock**, or similar ownership interests, of the reorganized debtor, **unless redeemed in cash** on or before the maturity date for their full face amount. The face amount of the creditors' preferred interests should equal the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order. Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to the maturity date should **reduce the redemption or conversion value** of such interests.
- The following kinds of post-effective date transactions are deemed "extraordinary transactions" subject to the vote of holders of creditors' preferred interests:

  (i) any change to the compensation of, or payments to, insiders of the reorganized debtor as set forth in the chapter 11 plan, including any compensation or payments to or for the benefit of relatives or affiliates of such insiders;

  (ii) dividends or other distributions of value to equity security holders of the reorganized debtor;

  (iii) decisions to forego or roll over any dividends or other distributions of value required to be paid under the organizational documents on account of the economic ownership interests held by holders of creditors' preferred interests;

  (iv) the sale of all or substantially all of the assets of the reorganized debtor, dissolution of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and

  (v) any amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors' preferred interests.

  An extraordinary transaction should require at least an absolute majority vote of the holders of creditors' preferred interest, but the chapter 11 plan may require a higher level of approval. Whether an extraordinary transaction has been approved by the requisite majority vote (or such higher level as required by the plan) should be determined in accordance with applicable state entity governance law.

- The consummation of an extraordinary transaction without the requisite approval should constitute a default under the chapter 11 plan, and holders of creditors' preferred interests should have the ability to request appropriate relief for such breach from the court that confirmed the plan. In addition, upon any such default, the creditors' preferred interests should be entitled to a liquidation preference over the common stock in the full face amount of the creditors' preferred interests, reduced by any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to liquidation.

- The general recommended principles proposed in the Report for chapter 11 plans apply to SME cases, unless the principles expressly exclude SME cases or would otherwise conflict with the SME principles.[4]

B. March 2018 Congressional Hearing

On March 7, 2018, Bob Keach, Co-Chair of the ABI Commission, Craig Goldblatt, partner at WilmerHale,[5] and Edward Janger, Professor of Law at Brooklyn Law School each testified before the Senate Committee on the Judiciary Subcommittee on Oversight, Agency Action, Federal Rights and Federal Courts at a hearing entitled "Small Business Bankruptcy: Assessing the System."[6]

Mr. Keach testified in support of the Commission's recommendations for SMEs summarized above. Mr. Keach included with his written testimony a 5-page bill drafted to implement the Commission's recommendations by supporters of the Commission's approach (appended hereto as Exhibit A).

Mr. Goldblatt advocated for adoption of Subchapter V to chapter 11, as proposed by the National Bankruptcy Conference (that proposal is appended hereto as Exhibit B). That proposal drew in large part from individual debtor cases under chapter 13 and from family farm cases under chapter 12: (i) it would apply to businesses with less than $7.5 million in liquidated, non-contingent debt; (ii) it proposed to permit small businesses to retain ownership while crafting a plan of repaying their debts over a short number of years; (iii) it leaned on standing trustees to help administer these cases; and (iv) it eliminated formation of a creditor's committee.

Professor Janger advocated for revisions to the Bankruptcy Code for small businesses that would have three general attributes (though he did not propose a specific statutory mechanism for implementing these attributes): (i) clear rules about which debtors qualified for the special treatment so as to prevent fights at the beginning of a case as to which rules applied; (ii) an alternative to creditors' committees (which are expensive and often ineffective in small cases) to supervise the debtor-in-possession; and (iii) as in Chapter 13, an "off the shelf" formula for a plan that can be confirmed without going through the costly process of obtaining class

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4 Including, e.g., the recommendation of eliminating the 1129(a)(10) requirement of having an impaired consenting class.

5 Mr. Goldblatt was a Conferee of the National Bankruptcy Conference and counsel to the Loan Syndications Trading Association, but was not testifying in such capacities.

6 A video of the testimony as well as links to the witnesses' statements and responses to questions received at the hearing can be found at https://www.judiciary.senate.gov/meetings/small-business-bankruptcy-assessing-the-system.

acceptances.[7] Professor Janger lauded the inexpensive feature of the NBC's "standing trustee" proposal, but also the flexibility—both in whether appointed at all and in degree of control over the debtor and its operations—afforded by the ABI's "estate neutral" proposal.

C. Introduction of the Small Business Reorganization Act of 2018

In late November 2018, Senate Judiciary Chairman Charles Grassley (R-Iowa) and Sen. Sheldon Whitehouse (D-R.I.) and Reps. Doug Collins (R-Ga.), Tom Marino (R-Pa.) and David Cicilline (D-R.I.) introduced the Small Business Reorganization Act ("SBRA") (S. 3689 and H.R. 7190; S. 3689 is appended hereto as Exhibit C). The SBRA would add a new subchapter V to chapter 11 in an attempt to achieve more successful restructurings for small businesses, reduce the numbers of their liquidations, and increase recoveries to their creditors. It would preserve the current definition of a "small business debtor,"[8] and otherwise appears to track more closely with chapter 13 and 12, as opposed to the more nuanced revisions proposed by the Commission. Key provisions include:

i. Increasing the Debtor's Ability to Negotiate a Successful Reorganization and Retain Control of the Business.

(a) Only the small business debtor may file a plan under subchapter V of the SBRA (no other entities may file competing plans).

(b) The owner of the small business debtor may retain a stake in the company so long as the plan does not discriminate unfairly and is fair and equitable with respect to each class of claims or interests.

(c) If a trustee or a holder of an unsecured claim objects to the plan, the court cannot approve the plan unless the plan provides that all of the small business debtor's projected disposable income to be received during the plan will be applied to make payments under the plan for a period of three to five years.

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7 Professor Janger also addressed various issues related to student loans.

8 11 U.S.C. 101(51D) defines "small business debtor" as:

> (A) subject to subparagraph (B), [ ] a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,566,050 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and
>
> (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $2,566,050 (excluding debt owed to 1 or more affiliates or insiders).

ii. Reducing Unnecessary Procedural Burdens and Costs.

(a) Unless the court for cause orders otherwise, an official committee of unsecured creditors will not be appointed and a disclosure statement will not be required.

iii. Increasing Oversight and Ensuring Quick Reorganization.

(a) A standing trustee would be appointed in every small business debtor case to perform duties similar to those performed by a chapter 12 or chapter 13 trustee to help ensure the reorganization stays on track.

(b) The small business debtor must file a plan within 90 days of commencement, which may be extended under limited circumstances.

(c) An initial status conference would be required in every case within 60 days of commencement "to further the expeditious and economical resolution" of an SBRA case.

The SBRA will be reintroduced this term.

115th Congress
2nd Session

A BILL

To amend the Bankruptcy Code to establish a separate chapter to reorganize small and medium-sized enterprises, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.-This Act may be cited as the Small and Medium-Sized Enterprise Bankruptcy Amendments Act.

(b) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

[to be inserted]

SEC. 2. EFFECTIVE DATE.

(a) IN GENERAL.—This Act shall take effect on the date of the enactment of this Act with respect to cases filed under chapter 10 of title 11, United States Code, on or after the date of enactment of this Act.

SEC. 3. Establishment of Chapter 10 of the Bankruptcy Code.

Title 11, United States Code, is amended by inserting after chapter 9 and before chapter 11 the following new chapter:

Chapter 10—Small and Medium-Sized Enterprise Reorganization

SUBCHAPTER I—General Provisions

§ 1001. Applicability of other sections of this title

(a) Except to the extent provided in subsection (b), subchapters I, II, and III of chapter 11 apply in a case under this chapter.

(b) Sections 1102, 1111(b), and 1129(a)(7)(B) do not apply under this chapter.

§ 1002. Definitions for this chapter

In this chapter—

- (1) The term "small or medium-sized enterprise" means a business debtor with—

(A)(i) no publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor's case; and

(ii) except as provided in subparagraph (C), less than $10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the date of the filing of the petition; but

(B) excluding a business debtor that owns or operates "single asset real estate" as defined by section 101(51B) of this title; or

(C) more than $10 million but less than $50 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates, which meets the requirements of subparagraph (A)(i) and has obtained a court order granting a motion by the debtor seeking to be treated as a small or medium-sized enterprise under this chapter.

(2) The term "creditors' preferred interests" means preferred stock, similar preferred interests, or other payment obligations issued by the reorganized debtor with the following features: (i) *pro rata* voting rights, limited to voting only on extraordinary transactions; and (ii) entitlement as a class to receive 85 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to any of the economic owners of the reorganized debtor. (3) The term "extraordinary transactions" means any of the following post-effective date transactions: (i) any change to the compensation of, or payments to, insiders of the reorganized debtor as set forth in the chapter 10 plan, including any compensation or payments to or for the benefit of relatives or affiliates of such insiders; (ii) dividends or other distributions of value to equity security holders of the reorganized debtor; (iii) decisions to forgo or roll over any dividends or other distributions of value required to be paid under the organizational documents on account of the economic ownership interests held by holders of creditors' preferred interests; (iv) sale of all or substantially all of the assets of the reorganized debtor, dissolution or winding-up of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and (v) any amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors' preferred interests.

SUBCHAPTER II—Officers and Administration

§ 1021. Petition and proceedings related to petition

(a) (1) A debtor purporting to qualify as a small or medium-sized enterprise under this chapter must file with its chapter 10 petition a balance sheet reflecting audited financial statements, or, if such statements are unavailable, a good faith estimate of its assets and liabilities as of the date of the filing of the petition.

(2) If the debtor fails to file with its chapter 10 petition a balance sheet reflecting a good faith estimate of its assets and liabilities as of the date of the filing of the

petition, the court *sua sponte* may dismiss, or the United States trustee or a party in interest may file a motion to obtain as of right dismissal of, the chapter 10 case.

(3) On request of a party in interest, the court may order the debtor to turn over the valuation information package, subject to appropriate confidentiality restrictions.

(b) The court *sua sponte*, the United States trustee, or a party in interest may object to the debtor's qualification as a small or medium-sized enterprise under this chapter, but only on the ground that the debtor does not in fact meet the definition. Such objection must be made by or filed with the court on or before 14 days after the date of the filing of the chapter 10 petition, and will be resolved on an expedited basis after notice and a hearing.

(c) Pending resolution of an objection under subsection (b), the debtor will be treated for all purposes as a small or medium-sized enterprise under this chapter.

§ 1022. Operation of the small or medium-sized enterprise

(a) Unless the court orders otherwise, or a trustee has been elected or appointed and is serving in the case, the debtor may operate the business of the debtor and, subject to any limitations on a trustee under sections 363(c) and 364 of this title and to such limitations or conditions as the court prescribes, shall have the rights and powers of the trustee under such sections.

(b) A debtor operating its business shall perform the duties of the trustee specified in section 704(a)(8) of this title.

§ 1023. Creditors' Committees

Only on motion of the United States trustee or a creditor holding an unsecured claim, after notice and a hearing, may the court order the appointment of a creditors' committee, if and only if the court determines that such appointment is necessary to protect the interests of unsecured creditors in the case.

§ 1024. Estate Neutral

(a) On motion of the United States trustee, the debtor, or a party in interest, after notice and a hearing, or acting *sua sponte*, the court may order the United States trustee to appoint an estate neutral that has the authority to advise the debtor in possession on operational and financial matters, as well as the content and negotiation of its plan.

(b) An estate neutral appointed in accordance with subsection (a) represents the interests of the estate and has the capacity to sue and be sued on behalf of the estate.

(c) The estate neutral will be compensated as a professional person in accordance with section 330 of this title with total compensation and reimbursement of expenses for such neutral not to exceed ten percent of the aggregate amount of creditor distributions.

(d) The estate neutral lacks the capacity to retain professionals for itself or on behalf of the estate.

SUBCHAPTER III—The Plan

§ 1031. Soliciting Acceptances of the Plan

(a) Within 60 days after the entry of the order for relief, after consultation with any estate neutral or committee serving in the case, the debtor shall file with the court a timeline for filing the plan and disclosure statement and soliciting acceptances of the plan, and, to the extent applicable, any budget that describes the excess cash flow calculation method and includes projections of the debtor's excess cash flow for the three fiscal years following the anticipated effective date of the plan.

(b) After the debtor files the timeline for filing and soliciting acceptances of its plan, the court shall promptly enter an order under section 105(d)(2) of this title setting the deadlines for the debtor to file a plan and disclosure statement, parties in interest to solicit acceptance or rejection of the plan, establishing a briefing schedule, and setting the time for the confirmation hearing.

§ 1032. Confirmation of Plan

(a) Notwithstanding section 1129 of this title, the court shall confirm a plan that satisfies all of the requirements of section 1129 other than subsections (a)(8), (b)(1), and (b)(2)(B) if and only if—

(1) The prepetition holders of the debtor's equity securities will continue to support the debtor's successful emergence from chapter 10 by remaining involved, on a basis reasonably comparable to their prepetition involvement, in the ongoing operations of the reorganized debtor; and the reorganized debtor will pay to the holders of allowed unsecured claims, no less often than annually, all of its excess cash flow calculated in a manner reasonable in relation to its operating cash flow for each of the three full fiscal years following the effective date of the plan;

(2) The prepetition holders of the debtor's equity securities will receive or retain 100 percent of the common stock, or similar ownership interests, issued or outstanding as of the effective date entitling the holders as a class to receive, while any creditors' preferred interests are outstanding, 15 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor;

(3) The holders of allowed unsecured claims as a class receive on the effective date of the plan 100 percent of a class of creditors' preferred interests;

(4) The creditors' preferred interests mature on the fourth anniversary of the effective date, at which time the interests will convert into 85 percent of the common stock, or similar ownership interests, of the reorganized debtor, unless the reorganized debtor exercises its right to redeem such preferred interests in cash on or before the maturity date for their full face amount, and

(A) The face amount of the creditors' preferred interests equals the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order; and (B) Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) before the maturity date will reduce the redemption or conversion value of such interests accordingly;

(5) Any extraordinary transactions will require at least an absolute majority vote of the holders of creditors' preferred interest, but the chapter 10 plan may require a higher level of approval. Whether an extraordinary transaction has been approved by the requisite majority vote (or such higher level as required by the plan) should be determined in accordance with applicable state entity governance law; and

(6) The consummation of any extraordinary transactions without the requisite approval will constitute a default under the chapter 10 plan, and holders of creditors' preferred interests will have the ability to request appropriate relief for such breach from the court that confirmed the plan. In addition, upon any such default, the creditors' preferred interests will be entitled to a liquidation preference over the common stock in the full face amount of the creditors' preferred interests, reduced by any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to liquidation.

SEC. 4. Conforming Amendments.

(a) Title 11, United States Code, is amended by deleting sections 101(51C) and (51D), 308, 362(n), 1102(a)(3), 1116, 1121(e), 1125(f), and 1129(e).

(b) Section 103 of title 11, United States Code, is amended by—

(i) inserting in subsection (a) "10," after "7,";

(ii) adding at the end the following new subsection: "(l) Chapter 10 of this title applies only in a case under such chapter."

(c) Section 109 of title 11, United States Code, is amended by adding at the end the following new subsection: "(i) Only a small or medium-sized enterprise may be a debtor under chapter 10 of this title."

(d) Section 365(d)(2), (g)(1), and (g)(2) of title 11, United States Code, are amended by inserting "10," after "9,".

(e) Section 502(g)(1) of title 11, United States Code, is amended by inserting "10," after "9,".

SUBCHAPTER V -- REORGANIZATION OF A SMALL BUSINESS ENTERPRISE DEBTOR.

§ 1181. Applicability of Subchapter.

This subchapter shall only apply in those chapter 11 cases in which a small business enterprise debtor elects that this subchapter applies.

§ 1182. Inapplicability of Other Sections.

(a) Sections 105(d), 1101(1), 1104, 1105, 1106, 1107, 1108, 1115, 1116, 1121, 1123(a)(8), 1123(c), 1127, 1129(a)(15), 1129(b), 1129(c), 1129(e) and 1141(d)(5) of this title do not apply in a case under this subchapter.

(b) Unless the court for cause orders otherwise, sections 1102, 1103, 1125 of this title do not apply in a case under this subchapter.

(c) If a plan is confirmed under section 1193(b), section 1141(d) of this title shall not apply, except as provided in section 1194.

§ 1183. Definitions.

In this subchapter,

(a) the term "small business enterprise debtor" means a debtor

(1) engaged in commercial or business activities; and

(2) that has aggregate noncontingent, liquidated, secured, and unsecured debts as of the date of the order for relief

(A) in an amount not more than $7,500,000 (excluding debts owed to 1 or more affiliates or insiders); and
(B) not less than 50% of which arose from the commercial or business activities of the debtor.

(b) the term "debtor in possession" means the small business enterprise debtor unless removed as debtor in possession under section 1186(a).

§ 1184. Trustee

(a) IN GENERAL.—If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this subchapter and if such individual qualifies as a trustee under section 322, then such individual shall serve as trustee in any case under this subchapter. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case if necessary.

(b) DUTIES.—The trustee shall—

(1) perform the duties specified in paragraphs (2), (5), (6), (7), and (9) of section 704(a) of this title;

(2) perform the duties specified in paragraphs (3), (4) and (7) of section 1106(a) if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

(3) appear and be heard at any hearing that concerns—

- (A) the value of property subject to a lien;
- (B) confirmation of a plan filed under this subchapter;
- (C) modification of the plan after confirmation; or
- (D) the sale of property of the estate;

(4) ensure that the small business enterprise debtor commences making timely payments required by a plan confirmed under this subchapter;

(5) if the small business enterprise debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8), paragraphs (1),

(2) and (6) of section 1106(a) of this title, including operating the small business enterprise debtor's business; and

(6) if there is a claim for a domestic support obligation with respect to the small business enterprise debtor, perform the duties specified in section 704(c).

(7) facilitate the development of a consensual plan of reorganization.

(c) If the small business enterprise debtor's plan is confirmed under section 1193(a), the trustee's service in the case shall terminate when the plan has been substantially consummated.

§ 1185. Rights and powers of a debtor in possession.

Subject to such limitations or conditions as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), (4) and (6) of section 1106(a) of this title, of a trustee serving in a case under chapter 11, including operating the small business enterprise debtor's business.

§ 1186. Removal of debtor in possession.

(a) On request of a party in interest, and after noticed and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case, or for failure to perform the debtor's obligations under a confirmed plan.

(b) On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

§ 1187. Property of the Estate.

(a) If a plan is confirmed under section 1193(b) of this title, property of the estate includes, in addition to the property specified in section 541 of this title --

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first; and
(2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7 of this title, whichever occurs first.

(b) Except as provided in section 1186 of this title, a confirmed plan, or an order confirming a plan, the small business enterprise debtor shall remain in possession of all property of the estate.

§ 1188. Duties and Reporting Requirements of Small Business Enterprise Debtor.

(a) Upon electing to be a debtor under this subchapter, the small business enterprise debtor shall file the documents required by section 1116(1)(A) and (B) of this title whether or not such debtor is a small business debtor.
(b) A small business enterprise debtor, in addition to the duties provided in this title and as otherwise required by law, shall comply with the requirements of sections 308 and 1116(2), (3), (4), (5), (6), and (7) of this title, whether or not such debtor is a small business debtor.
(c) If the court orders under section 1182(b) that section 1125 of this title applies, section 1125(f) of this title shall apply whether or not such debtor is a small business debtor.

§ 1189. Filing of the plan.

(a) WHO MAY FILE A PLAN.—Only the small business enterprise debtor may file a plan under this subchapter.

(b) DEADLINE.—The small business enterprise debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend the period if the need for an extension is attributable to circumstances for which the small business enterprise debtor should not justly be held accountable.

§ 1190. Contents of Plan

A plan filed under this subchapter —

(a) shall include a brief history of the business operations of the small business enterprise debtor, a liquidation analysis, and projections with respect to the ability of the small business enterprise debtor to make payments under the proposed plan of reorganization; and

(b) may, notwithstanding section 1123(b)(5) of this title, modify the rights of the holder of a claim secured only by a security interest in real property that is the debtor's principal residence if the new value received in connection with the granting of the security interest was (A) not used primarily to acquire such property, and (B) was used primarily in connection with the small business enterprise.

§ 1191. Deemed Acceptance of Plan.

For purposes of section 1126(c) or (d) of this title, a holder of a claim or interest shall be deemed to have accepted a plan if the holder fails to file a timely ballot after being notified by the small business enterprise debtor of

(a)the treatment that such holder will receive under the proposed plan, and

(b) the consequence under this section of the failure by the holder to file a timely ballot.

§ 1192. Status Conference.

The court shall hold a status conference to further the expeditious and economical resolution of the case, and to encourage and facilitate the attainment of a consensual plan of reorganization.

§ 1193. Confirmation of Plan

(a) The court shall confirm a plan only if all of the requirements of section 1129(a), other than section 1129(a)(15), of this title are met.

(b) Notwithstanding section 510(a) of this title, if all of the applicable requirements of section 1129(a), other than paragraphs (8), (10) and (15), of this title are met with respect to a plan, the court, on request of the small business enterprise debtor, shall confirm the plan notwithstanding the requirements of such paragraphs if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(c) For purposes of this subsection, the condition that a plan be fair and equitable with respect to each class of claims or interests includes the following requirements:

(1) With respect to a class of secured claims, the plan meets the requirements of section 1129(b)(2)(A);

(2) As of the effective date of the plan --

(A) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period not to exceed five years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

(B) the value of the property to be distributed under the plan in the three-year period, or longer period not to exceed five years as the court may fix, beginning on the date that the first distribution is

(1) on which the last payment is due after the first three years of the plan or such other time not to exceed five years fixed by the court; or
(2) of the kind specified in section 523(a) of this title.

§ 1195. Modification of Plan.

(a) The small business enterprise debtor may modify a plan at any time before confirmation, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1122 and, with the exception of 1123(a)(8), section 1123 of this title. After the modification is filed with the court, the plan as modified becomes the plan.

(b) If a plan has been confirmed under section 1193(a), the small business enterprise debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1122 and, with the exception of 1123(a)(8), section 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified under section 1193(a) of this title.

(c) If a plan has been confirmed under section 1193(b), the small business enterprise debtor may modify such plan at any time within three years, or such longer time not to exceed five years fixed by the court, but may not modify such plan so that such plan as modified fails to meet the requirements of section 1193(b) of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified under section 1193(b) of this title.

(d) If a plan has been confirmed under section 1193(a), any holder of a claim or interest that has accepted or rejected such plan is deemed to have accepted or rejected, as the case may be, such plan as modified, unless, within the time fixed by the court, such holder changes such holder's previous acceptance or rejection.

§ 1196. Payments.

(a) Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the small business enterprise debtor after deducting --

(1) any unpaid claim allowed under section 503(b) of this title;

(2) any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and

(3) any fee owing to the trustee.

(b) If a plan is confirmed under section 1193(b) of this title, except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

(c) Prior to confirmation of a plan, the court, after notice and a hearing, may authorize the trustee to make payments to the holder of a secured claim for the purpose of providing adequate protection of an interest in property.

§ 1197. Transactions with Professionals.

Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a small business enterprise debtor solely because such person holds a claim of less than $5,000 that arose prior to commencement of the case.

END OF SUBCHAPTER V

There will need to be amendments to other sections of titles 11 and 28

Title 11

103(i) Subchapter V of chapter 11 of this title applies only in a case under chapter 11 concerning a Small Business Enterprise Debtor in which such debtor elects that Subchapter V shall apply.

322(a) add trustee selected under 1184

326(a) add chapter 11 other than a case under subchapter V.

326(b) add subchapter V of chapter 11

347 (a) and (b) add chapter 11, subchapter V and 1196

363(c)(1) add 1184 and 1185

364(a) add 1184 and 1185

523(a) add 1194

524(a), (c)(1) and (d) add 1194

557(d)(3) add 1184

1146(a) add 1193

Title 28

586(a)(3) add Subchapter V

586(b) add Subchapter V

586(d)(1) add Subchapter V

586(e)(1) and (2) add Subchapter V - also add a provision that "in the event that the trustee's services are terminated upon substantial consummation under section

1184(c), the court shall award compensation to the trustee consistent with services performed by the trustee and the limits on the trustee's compensation established pursuant to section 586(e)(1) of title 28."

589b(a)(1) add Subchapter V

589b(d) and (d)(8) add Subchapter V

1930(a)(6) except Subchapter V from chapter 11 quarterly fees

II

115TH CONGRESS
2D SESSION

S. 3689

To amend chapter 11 of title 11, United States Code, to address reorganization of small businesses, and for other purposes.

IN THE SENATE OF THE UNITED STATES

NOVEMBER 29, 2018

Mr. GRASSLEY (for himself and Mr. WHITEHOUSE) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To amend chapter 11 of title 11, United States Code, to address reorganization of small businesses, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Reorganization Act of 2018".

SEC. 2. REORGANIZATION OF SMALL BUSINESS DEBTORS.

(a) IN GENERAL.—Chapter 11 of title 11, United States Code, is amended by adding at the end the following:

"SUBCHAPTER V—SMALL BUSINESS DEBTOR REORGANIZATION

"§ 1181. Inapplicability of other sections

"(a) IN GENERAL.—Sections 105(d), 1101(1), 1104, 1105, 1106, 1107, 1108, 1115, 1116, 1121, 1123(a)(8), 1123(c), 1127, 1129(a)(15), 1129(b), 1129(c), 1129(e) and 1141(d)(5) of this title do not apply in a case under this subchapter.

"(b) COURT AUTHORITY.—Unless the court for cause orders otherwise, paragraphs (1), (2), and (4) of section 1102(a) and sections 1102(b), 1103, and 1125 of this title do not apply in a case under this subchapter.

"(c) SPECIAL RULE FOR DISCHARGE.—If a plan is confirmed under section 1191(b) of this title, section 1141(d) of this title shall not apply, except as provided in section 1192 of this title.

"§ 1182. Definitions

"In this subchapter:

"(1) DEBTOR.—The term 'debtor' means a small business debtor.

"(2) DEBTOR IN POSSESSION.—The term 'debtor in possession' means the debtor, unless removed as debtor in possession under section 1185(a) of this title.

"§ 1183. Trustee

"(a) IN GENERAL.—If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this subchapter, and if such individual qualifies as a trustee under section 322 of this title, then that individual shall serve as trustee in any case under this subchapter. Otherwise, the United States trustee shall appoint 1 disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case, as necessary.

"(b) DUTIES.—The trustee shall—

"(1) perform the duties specified in paragraphs (2), (5), (6), (7), and (9) of section 704(a) of this title;

"(2) perform the duties specified in paragraphs (3), (4), and (7) of section 1106(a) of this title, if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

"(3) appear and be heard at the status conference under section 1188 of this title and any hearing that concerns—

"(A) the value of property subject to a lien;

"(B) confirmation of a plan filed under this subchapter;

"(C) modification of the plan after confirmation; or

"(D) the sale of property of the estate;

"(4) ensure that the debtor commences making timely payments required by a plan confirmed under this subchapter;

"(5) if the debtor ceases to be a debtor in possession, perform the duties specified in section 704(a)(8) and paragraphs (1), (2), and (6) of section 1106(a) of this title, including operating the business of the debtor;

"(6) if there is a claim for a domestic support obligation with respect to the debtor, perform the duties specified in section 704(c) of this title; and

"(7) facilitate the development of a consensual plan of reorganization.

"(c) TERMINATION OF TRUSTEE SERVICE.—

"(1) IN GENERAL.—If the plan of the debtor is confirmed under section 1191(a) of this title, the service of the trustee in the case shall terminate when the plan has been substantially consummated, except that the United States trustee may reappoint a trustee as needed for performance of duties under subsection (b)(3)(C) of this section and section 1185(a) of this title.

"(2) SERVICE OF NOTICE OF SUBSTANTIAL CONSUMMATION.—Not later than 14 days after the plan of the debtor is substantially consummated, the debtor shall file with the court and serve on the trustee, the United States trustee, and all parties in interest notice of such substantial consummation.

"§ 1184. Rights and powers of a debtor in possession

"Subject to such limitations or conditions as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all functions and duties, except the duties specified in paragraphs (2), (3), and (4) of section 1106(a) of this title, of a trustee serving in a case under this chapter, including operating the business of the debtor.

"§ 1185. Removal of debtor in possession

"(a) IN GENERAL.—On request of a party in interest, and after notice and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the date of commencement of the case, or for failure to perform the obligations of the debtor under a plan confirmed under this subchapter.

"(b) REINSTATEMENT.—On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

"§ 1186. Property of the estate

"(a) INCLUSIONS.—If a plan is confirmed under section 1191(b) of this title, property of the estate includes, in addition to the property specified in section 541 of this title—

"(1) all property of the kind specified in that section that the debtor acquires after the date of commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first; and

"(2) earnings from services performed by the debtor after the date of commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 12, or 13 of this title, whichever occurs first.

"(b) DEBTOR REMAINING IN POSSESSION.—Except as provided in section 1185 of this title, a plan confirmed under this subchapter, or an order confirming a plan under this subchapter, the debtor shall remain in possession of all property of the estate.

"§ 1187. Duties and reporting requirements of debtors

"(a) FILING REQUIREMENTS.—Upon electing to be a debtor under this subchapter, the debtor shall file the documents required by subparagraphs (A) and (B) of section 1116(1) of this title.

"(b) OTHER APPLICABLE PROVISIONS.—A debtor, in addition to the duties provided in this title and as otherwise required by law, shall comply with the requirements of section 308 and paragraphs (2), (3), (4), (5), (6), and (7) of section 1116 of this title.

"(c) SEPARATE DISCLOSURE STATEMENT EXEMPTION.—If the court orders under section 1181(b) of this title that section 1125 of this title applies, section 1125(f) of this title shall apply.

"§ 1188. Status conference

"(a) IN GENERAL.—Except as provided in subsection (b), not later than 60 days after the entry of the order for relief under this chapter, the court shall hold a status conference to further the expeditious and economical resolution of a case under this subchapter.

"(b) EXCEPTION.—The court may extend the period of time for holding a status conference under subsection (a) if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.

"(c) REPORT.—Not later than 14 days before the date of the status conference under subsection (a), the debtor shall file with the court and serve on the trustee and all parties in interest a report that details the efforts the debtor has undertaken and will undertake to attain a consensual plan of reorganization.

"§ 1189. Filing of the plan

"(a) WHO MAY FILE A PLAN.—Only the debtor may file a plan under this subchapter.

"(b) DEADLINE.—The debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable.

"§ 1190. Contents of plan

"A plan filed under this subchapter—

"(1) shall include—

"(A) a brief history of the business operations of the debtor;

"(B) a liquidation analysis; and

"(C) projections with respect to the ability of the debtor to make payments under the proposed plan of reorganization;

"(2) shall provide for the submission of all or such portion of the future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan; and

"(3) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a secured claim if—

"(A) the claim is secured only by a security interest in real property that is the principal residence of the debtor; and

"(B) the new value received in connection with the granting of the security interest—

"(i) was not used primarily to acquire the real property; and

"(ii) was used primarily in connection with the small business of the debtor.

"§ 1191. Confirmation of plan

"(a) TERMS.—The court shall confirm a plan under this subchapter only if all of the requirements of section 1129(a), other than paragraph (15) of that section, of this title are met.

"(b) EXCEPTION.—Notwithstanding section 510(a) of this title, if all of the applicable requirements of section 1129(a) of this title, other than paragraphs (8), (10), and (15) of that section, are met with respect to a plan, the court, on request of the debtor, shall confirm the plan notwithstanding the requirements of such paragraphs if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

"(c) RULE OF CONSTRUCTION.—For purposes of this section, the condition that a plan be fair and equitable with respect to each class of claims or interests includes the following requirements:

"(1) With respect to a class of secured claims, the plan meets the requirements of section 1129(b)(2)(A) of this title.

"(2) As of the effective date of the plan—

"(A) the plan provides that all of the projected disposable income of the debtor to be received in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

"(B) the value of the property to be distributed under the plan in the 3-year period, or such longer period not to exceed 5 years as the court may fix, beginning on the date on which the first distribution is due under the plan is not less than the projected disposable income of the debtor.

"(3)(A)(i) The debtor will be able to make all payments under the plan; or

"(ii) there is a reasonable likelihood that the debtor will be able to make all payments under the plan; and

"(B) the plan provides appropriate remedies, which may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made.

"(d) DISPOSABLE INCOME.—For purposes of this section, the term 'disposable income' means the income that is received by the debtor and that is not reasonably necessary to be expended—

"(1) for—

"(A) the maintenance or support of the debtor or a dependent of the debtor; or

"(B) a domestic support obligation that first becomes payable after the date of the filing of the petition; or

"(2) for the payment of expenditures necessary for the continuation, preservation, or operation of the business of the debtor.

"(e) SPECIAL RULE.—Notwithstanding section 1129(a)(9)(A) of this title, a plan that provides for the payment through the plan of a claim of a kind specified in paragraph (2) or (3) of section 507(a) of this title may be confirmed under subsection (b) of this section.

"§ 1192. Discharge

"If the plan of the debtor is confirmed under section 1191(b) of this title, as soon as practicable after completion by the debtor of all payments due within the first 3 years of the plan, or such longer period not to exceed 5 years as the court may fix, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided in section 1141(d)(1)(A) of this title, and all other debts allowed under section 503 of this title and provided for in the plan, except any debt—

"(1) on which the last payment is due after the first 3 years of the plan, or such other time not to exceed 5 years fixed by the court; or

"(2) of the kind specified in section 523(a) of this title.

"§ 1193. Modification of plan

"(a) MODIFICATION BEFORE CONFIRMATION.—The debtor may modify a plan at any time before confirmation, but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title, with the exception of subsection (a)(8) of such section 1123. After the modification is filed with the court, the plan as modified becomes the plan.

"(b) MODIFICATION AFTER CONFIRMATION.—If a plan has been confirmed under section 1191(a) of this title, the debtor may modify the plan at any time after confirmation of the plan and before substantial consummation of the plan, but may not modify the plan so that the plan as modified fails to meet the requirements of sections 1122 and 1123 of this title, with the exception of subsection (a)(8) of such section 1123. The plan, as modified under this subsection, becomes the plan only if circumstances warrant the modification and the court, after notice and a hearing, confirms the plan as modified under section 1191(a) of this title.

"(c) CERTAIN OTHER MODIFICATIONS.—If a plan has been confirmed under section 1191(b) of this title, the debtor may modify the plan at any time within 3 years, or such longer time not to exceed 5 years, as fixed by the court, but may not modify the plan so that the plan as modified fails to meet the requirements of section 1191(b) of this title. The plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan, as modified, under section 1191(b) of this title.

"(d) HOLDERS OF A CLAIM OR INTEREST.—If a plan has been confirmed under section 1191(a) of this title, any holder of a claim or interest that has accepted or rejected the plan is deemed to have accepted or rejected, as the case may be, the plan as modified, unless, within the time fixed by the court, such holder changes the previous acceptance or rejection of the holder.

"§ 1194. Payments

"(a) RETENTION AND DISTRIBUTION BY TRUSTEE.—Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor after deducting—

"(1) any unpaid claim allowed under section 503(b) of this title;

"(2) any payment made for the purpose of providing adequate protection of an interest in property due to the holder of a secured claim; and

"(3) any fee owing to the trustee.

"(b) OTHER PLANS.—If a plan is confirmed under section 1191(b) of this title, except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

"(c) PAYMENTS PRIOR TO CONFIRMATION.—Prior to confirmation of a plan, the court, after notice and a hearing, may authorize the trustee to make payments to the holder of a secured claim for the purpose of providing adequate protection of an interest in property.

"§ 1195. Transactions with professionals

"Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title, by a debtor solely because that person holds a claim of less than $10,000 that arose prior to commencement of the case.".

(b) CLERICAL AMENDMENT.—The table of subchapters at the beginning of chapter 11 of title 11, United States Code, is amended by adding at the end the following:

"SUBCHAPTER V—SMALL BUSINESS DEBTOR REORGANIZATION

"1181. Inapplicability of other sections.
"1182. Definitions.
"1183. Trustee.
"1184. Rights and powers of a debtor in possession.
"1185. Removal of debtor in possession.
"1186. Property of the estate.
"1187. Duties and reporting requirements of debtors.
"1188. Status conference.
"1189. Filing of the plan.
"1190. Contents of plan.
"1191. Confirmation of plan.
"1192. Discharge.

SEC. 3. PREFERENCES; VENUE OF CERTAIN PROCEEDINGS.

(a) PREFERENCES.—Section 547(b) of title 11, United States Code, is amended by inserting ", based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c)," after "may".

(b) VENUE OF CERTAIN PROCEEDINGS.—Section 1409(b) of title 28, United States Code, is amended by striking "$10,000" and inserting "$25,000".

SEC. 4. CONFORMING AMENDMENTS.

(a) TITLE 11.—Title 11, United States Code, is amended—

(1) in section 101—

(A) in paragraph (51C), by inserting "and has not elected that subchapter V of chapter 11 of this title shall apply" after "is a small business debtor"; and

(B) in paragraph (51D)—

(i) in subparagraph (A)—

(I) by striking "or operating real property or activities incidental thereto" and inserting "single asset real estate"; and

(II) by striking "for a case in which" and all that follows and inserting "not less than 50 percent of which arose from the commercial or business activities of the debtor; and"; and

(ii) in subparagraph (B)—

(I) by striking the period at the end and inserting a semicolon;

(II) by striking "does not include any member" and inserting the following: "does not include—

"(i) any member"; and

(III) by adding at the end the following:

"(ii) any debtor that is a corporation subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); or

"(iii) any corporation that—

"(I) is subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)); and

"(II) is an affiliate of a debtor.";

(2) in section 103—

(A) by redesignating subsections (i) through (k) as subsections (j) through (l), respectively; and

(B) by inserting after subsection (h) the following:

"(i) Subchapter V of chapter 11 of this title applies only in a case under chapter 11 in which a small business debtor elects that subchapter V of chapter 11 shall apply.";

(3) in section 322(a), by inserting "1183," after "1163,";

(4) in section 326—

(A) in subsection (a), by inserting ", other than a case under subchapter V of chapter 11," after "7 or 11"; and

(B) in subsection (b), by inserting "subchapter V of chapter 11 or" after "In a case under";

(5) in section 347—

(A) in subsection (a)—

(i) by inserting "1194," after "726,"; and

(ii) by inserting "subchapter V of chapter 11," after "chapter 7,"; and

(B) in subsection (b), by inserting "1194," after "1173,";

(6) in section 363(c)(1), by inserting "1183, 1184," after "1108,";

(7) in section 364(a), by inserting "1183, 1184," after "1108,";

(8) in section 523(a), in the matter preceding paragraph (1), by inserting "1192," after "1141,";

(9) in section 524—

(A) in subsection (a)—

(i) in paragraph (1), by inserting "1192," after "1141,"; and

(ii) in paragraph (3), by inserting "1192," after "523,";

(B) in subsection (c)(1), by inserting "1192," after "1141,"; and

(C) in subsection (d), by inserting "1192," after "1141,";

(10) in section 557(d)(3), by inserting "1183," after "1104,";

(11) in section 1102(a), by striking paragraph (3) and inserting the following:

"(3) Unless the court for cause orders otherwise, a committee of creditors may not be appointed in a small business case or a case under subchapter V of this chapter.''; and

(12) in section 1146(a), by inserting ''or 1191'' after ''1129''.

(b) TITLE 28.—Title 28 United States Code, is amended—

(1) in section 586—

(A) in subsection (a)(3), by inserting ''(including subchapter V of chapter 11)'' after ''7, 11'';

(B) in subsection (b), by inserting ''subchapter V of chapter 11 or'' after ''cases under'';

(C) in subsection (d)(1), by inserting ''subchapter V of chapter 11 or'' after ''cases under'' each place that term appears; and

(D) in subsection (e)—

(i) in paragraph (1), by inserting ''subchapter V of chapter 11 or'' after ''cases under'';

(ii) in paragraph (2), by inserting ''subchapter V of chapter 11 or'' after ''cases under'' each place that term appears; and

(iii) by adding at the end the following:

"(5) In the event that the services of the trustee in a case under subchapter V of chapter 11 of title 11 are terminated by dismissal or conversion of the case, or upon substantial consummation of a plan under section 1183(c)(1) of that title, the court shall award compensation to the trustee consistent with services performed by the trustee and the limits on the compensation of the trustee established pursuant to paragraph (1) of this subsection.";

(2) in section 589b—

(A) in subsection (a)(1), by inserting "subchapter V of chapter 11 and" after "cases under"; and

(B) in subsection (d)—

(i) in the matter preceding paragraph (1), by inserting "subchapter V of chapter 11 and" after "trustees under"; and

(ii) in the undesignated matter following paragraph (8), by inserting "subchapter V of chapter 11 and" after "cases under"; and

(3) in section 1930(a)(6)(A), by inserting ", other than under subchapter V," after "chapter 11 of title 11".

SEC. 5. EFFECTIVE DATE.

This Act and the amendments made by this Act shall take effect 180 days after the date of enactment of this Act.

○

Recent Developments Regarding Make-Whole Provisions

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A. The Ultra Petroleum Saga: *In re Ultra Petroleum Corp*., 575 B.R. 361 (Bankr. S.D. Tex 2017), rev'd in part, vacated in part by 913 F.3d 533 (5th Cir. 2019), petition for rehearing *en banc* filed (5th Cir. Jan. 31, 2019) (No. 17-20793).

(1) The Bankruptcy Court Decision: *In re Ultra Petroleum Corp.,* 575 B.R. 361 (Bankr. S.D. Tex 2017)

The bankruptcy court held that a make-whole premium was payable to lenders under the debtor's plan of reorganization, where the parties' loan agreement expressly provided that the premium was due upon an automatic acceleration triggered by the debtor's bankruptcy filing, despite the fact that the plan proposed to leave the lenders unimpaired pursuant to § 1124(1). The bankruptcy court certified its decision for direct appeal to the Fifth Circuit.

One of the debtors ("OpCo") issued $1.46 billion in unsecured notes (the "Notes") pursuant to a master note purchase agreement (the "MNPA"). OpCo had a right under the MNPA to prepay Notes at 100% of their principal amount plus a contractual "Make-Whole Amount." Upon the occurrence of any contractual event of default, which included OpCo's filing of a bankruptcy petition, the entire unpaid principal, all accrued and unpaid interest, and any Make-Whole Amount would become immediately due. Thus, the MNPA in effect made the Make-Whole Amount due upon the automatic acceleration of the debt triggered by a bankruptcy filing.

After it filed its chapter 11 petition, OpCo became solvent and proposed a chapter 11 plan providing for full payment of unsecured claims, including the Notes, and a substantial recovery for equity holders. However, the plan of reorganization did not propose to pay holders of the Notes the Make-Whole Amount or to pay postpetition interest on the holders' claims at the default rates provided under the MNPA. Notably, the plan treated the holders of the Notes as unimpaired under § 1124(1), which requires that the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest."

An ad hoc committee of noteholders objected to the plan on the grounds that the holders' claims could not be unimpaired unless the Make-Whole Amount and postpetition interest were paid. OpCo argued that the claim for the Make-Whole Amount should be disallowed because: (i) the claim sought unmatured interest on unsecured claims barred by § 502(b)(2) and (ii) the Make-Whole Amount was an unenforceable penalty, rather than an enforceable liquidated-damages provision under New York law. The bankruptcy court observed that the Make-Whole Amount in dispute was over $350 million.

The bankruptcy court first held that the debtors had failed to prove that either the Make-Whole Amount or the default interest amounts were unenforceable under New York law. The bankruptcy court found that damages resulting from prepayment of the Notes were not readily ascertainable at the time the MNPA was executed and that the parties agreed on the reinvestment rate in the MNPA as a reasonable approximation of holders' damages. Further, the Make-Whole Amount and default interest did not lead to a double recovery of actual and liquidated damages for the same injury, because "the Make-Whole Amount only liquidates the noteholders' damages stemming from the early termination of their investment; in contrast, the postpetition default interest compensates the holders of the Noteholders for the debtors' failure to pay the principal, unpaid interest, and Make-Whole Amount as they came due at the time of acceleration of the Notes."

The bankruptcy court further rejected the debtors' argument that the issue of "impairment" should be applied only to the noteholders' "allowed claims under the Bankruptcy Code" (which, according to the debtors, would have excluded the Make-Whole Amount as disallowed unmatured interest), rather than being applied to the noteholders' full state-law claims. The bankruptcy court adopted the noteholders' argument that "unimpairment" required that the noteholders receive all that they were entitled to receive under state law, which included the Make-Whole Amount, stating that "'unimpairment' under § 1124(1) entitles a claimant's non-bankruptcy rights to be fully honored."

Takeaway: Bankruptcy Courts determining enforceability of make-whole provisions often employ a two-prong test. First, is the make-whole premium enforceable under state law? If the premium passes this test, the second hurdle is the Bankruptcy Code itself. If the Bankruptcy Code disallows a portion of a creditor's claim (even if allowed under state law) then the claim is unimpaired. Section 1124(1) says "a class of claims or interests" is not impaired if "the plan . . . leaves unaltered the [claimant's] legal, equitable, and contractual rights." The bankruptcy court found that the Bankruptcy Code, and not the plan, altered the right.

(2) **The Fifth Circuit Decision:** *In Re Ultra Petroleum,* 913 F.3d 533 (5th Cir. 2019) ("*Ultra II*").

On January 17, 2019, a three-judge panel of the Fifth Circuit Court of Appeals reversed, in part, and vacated, in part, the bankruptcy court's decision. In reversing, the Fifth Circuit discussed the historical basis of the "solvent debtor" exception in the context of whether the Bankruptcy Code disallowed the claims for the Make-Whole Amount and the post-petition interest at the default rate.

The case was remanded back to the bankruptcy court to determine whether the "solvent debtor" exception survives the enactment of § 502(b)(2) (although the Fifth Circuit doubted it did). If not, the Make-Whole Amount is not recoverable by the creditors.

The Fifth Circuit discussed whether the Make-Whole Amount is allowed by §502(b)(2), and found that the Make-Whole Amount, being the economic equivalent to "interest," was in fact unmatured when the debtors filed their chapter 11 petitions since the acceleration provision was an unenforceable *ipso facto* bankruptcy clause.

The Fifth Circuit decision also discussed whether, in the absence of any contractual provision, a creditor may be entitled to post-petition interest. This question was remanded as well.

Takeaway: The Ultra II opinion does not explicitly hold that make-whole provisions will always be deemed the equivalent of unmatured interest subject to disallowance under §502(b), but, the implication is that more times than not it will be. One might also surmise that a make-whole provision may be both a liquidated damages clause and unmatured interest, subject to disallowance under §502(b). As a result, assuming the bankruptcy court adopts *Ultra II*, a creditor will be unable to enforce a make-whole provision in the Fifth Circuit unless the debtor is solvent and/or the creditor is oversecured. Even if the debtor is solvent, there are no guarantees that the solvent debtor exception will apply as a result of the doubt expressed in *Ultra II* regarding its applicability and the Fifth Circuit's expectation that the bankruptcy court will consider whether the creditor's ability to seek dismissal of a bad-faith filing impacts the continued application of the solvent debtor exception.

(3) The Petition for Rehearing *En Banc*

On January 31, 2019, the creditor-appellees filed a joint petition for rehearing *Ultra II en banc*. Therein, the appellees assert that:

(1) The Fifth Circuit erred in holding that make-whole amounts are the "economic equivalent of interest," and therefore, disallowed under §502(b)(2) of the Bankruptcy Code because:

(a) The *Ultra II* holding contravenes previous decisions issued by the Fifth Circuit (and other courts) holding that a make-whole amount is not the equivalent of interest;

(b) The issue should have been remanded because (i) the bankruptcy court had not decided it, and (ii) if, on remand, the bankruptcy court determines that the make-whole amount is payable under the solvent debtor exception, the issue is moot; and

(c) Reconsideration is necessary to avoid disruption of financial markets.

(2) The Fifth Circuit erred in holding that, following Congress' repeal of §1124(3) of the Bankruptcy Code, a creditor who is not paid its contractual interest by a solvent debtor is nonetheless unimpaired under §1124(1) of the Bankruptcy Code because the holding misconstrues and/or conflicts with:

(a) Congress' intent in repealing §1124(3) of the Bankruptcy Code; and

(b) The only other Circuit-level decision analyzing the repeal of §1124(3), *In re PPI Enterprises (U.S.) Inc.*, 324 F.3d 197 (3d Cir. 2003).

B. *Delaware Trust Co. v. Energy Future Intermediate Holding Co. LLC (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. 2016).

The Third Circuit Court of Appeals held that Energy Future Intermediate Holding Co. LLC and EFIH Finance Inc. (collectively, "EFH") were required to pay the make-whole obligation triggered when EFH elected to pay outstanding notes (the "Notes") with post-petition funds. The Notes were automatically accelerated when EFH filed for bankruptcy, but the Third Circuit held that the note indentures did not provide that acceleration cancelled the obligation to make the redemption premium.

The case revolved around two provisions in the indentures for the loan. Section 3.07 provided that "at any time prior to December 2015, [the debtor] may redeem all or part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium . . . and accrued and unpaid interest."

The Third Circuit stated that the "Applicable Premium" was a make-whole or yield-protection contractual substitute for interest lost on Notes redeemed prior to their original expected due dates. Section 6.02 provided that the Notes were accelerated if the debtor filed for bankruptcy but also gave the Noteholders the right to rescind any acceleration and its consequences. When market interest rates went down, the debtor considered refinancing the Notes. In accordance with Section 3.07, a refinancing would have triggered the right of the Noteholders to receive the redemption premium.

The debtor, however, thought that it could avoid payment of the premium by filing for bankruptcy. The debtor laid out its plan in an 8-K filed with the Securities and Exchange Commission, where it stated that it would file for bankruptcy and refinance the Notes without having to pay the premium. True to its word, the debtor filed for bankruptcy and sought to refinance the Notes without paying the premium. The Noteholders commenced an adversary proceeding to enforce the premium. The bankruptcy court ruled against the Noteholders, reasoning that Section 6.02, the acceleration provision, did not expressly mention the premium, and due to such omission, the bankruptcy court ruled that none was due.

Before the Third Circuit, the debtor argued that "redemption," an undefined term in the indenture, meant repayment of debt that pre-date the maturity date of the Notes. The Third Circuit rejected this argument, noting that under the applicable New York law, redemption includes both pre- and post-maturity repayments of debt.

The Third Circuit also noted that the redemption by the debtor was voluntary and that the debtor had the option of reinstating the original maturity date under the Bankruptcy Code instead of repaying the notes.

The debtor also argued that the redemption was not optional after it filed for bankruptcy. The Third Circuit rejected this argument because the bankruptcy filing was voluntary, and the debtor had the option to reinstate the original maturity date of the Notes in its plan of reorganization under § 1124(2). In this regard, the debtor's pre-bankruptcy 8-K form did not help its cause.

Finally, the debtor argued that once the acceleration provided under Section 6.02 of the indenture was triggered, then Section 3.07 was no longer applicable. The Third Circuit rejected the debtor's reading of the indenture. In doing so, the Third Circuit declined to follow *In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015) ("*Momentive*") and *Nw. Mutl. Life Ins. Co. v. Uniondale Realty Assocs*., 816 N.Y.S.2d 831 (N.Y. Sup. Ct. 2006) ("*Northwestern").*

The Third Circuit noted that *Momentive* was wrongly decided because the court failed to enforce the contract as written, which expressly provided that after acceleration, "premiums, if any" were due.

With respect to *Momentive*, the Third Circuit interpreted the case as establishing the following rule: prepayments cannot occur when payment is now due by acceleration of the debt's maturity. If the parties want to mandate a "prepayment" premium following acceleration, they must clearly state it in their agreement.

The Third Circuit, however, did not see the redemption or yield protection payment in its case as a prepayment premium. Nor did the Third Circuit believe that the policy considerations behind *Northwestern* were applicable. There, the court was concerned that lenders should not be able to seek immediate repayment after a default and seek a premium on top of that. In contrast, the Noteholders did not seek immediate payment and it was the debtor who voluntarily redeemed the Notes.

Finally, the Third Circuit noted that the decision of the bankruptcy court erred in failing to enforce Section 3.07 by running afoul of the decision of the New York Court of Appeals in *NML Capital v. Argentina*, 952 N.E.2d 482 (N.Y. 2011). In *NML Capital*, Argentina argued that the acceleration of the bonds at issue terminated its obligation to make biannual interest payments as the indenture documents required. The New York Court of Appeals rejected Argentina's position, ruling that the bond language requiring the biannual payments made no reference to acceleration or maturity, and thus remained effective after the bond's acceleration. Following this reasoning, the Third Circuit ruled that Section 3.07 applied no less after the acceleration of the Notes than it would to a pre-acceleration redemption.

Takeaway: Debt documents should explicitly provide that acceleration terminates the availability of make-whole premiums. Where such documents are silent, the voluntary bankruptcy filing which otherwise would trigger an automatic acceleration, did not cancel the debtor's obligation to pay the make-whole premium prompted by an early redemption.

C. ***Apollo Global Mgmt v. BOKF, NA (In re MPM Silicones, LLC)***, 874 F.3d 787 (2d Cir. 2017)

The Second Circuit Court of Appeals held that secured lenders could not enforce a "make-whole" premium that would have been due if the lenders' notes were "redeemed" at the debtors' option prior to a certain date, because the lenders' debt had been accelerated automatically upon the debtors' filing for bankruptcy.

The debtors filed a chapter 11 plan that proposed, inter alia, to pay their senior secured lenders all principal and accrued interest outstanding on the effective date of the plan, in cash, if their class accepted the plan. However, the cash option did not include any payment of the make-whole premium that was required under the indenture governing the notes if the debtors prepaid the notes before a specific date. Alternatively, if the senior secured lenders' class voted to reject the plan, they would be crammed down with replacement notes providing for a payment stream having a present value equal to the allowed amount of their claims. The bankruptcy court would determine whether the allowed amount of their claim must include the make-whole premium.

The senior secured lenders voted to reject the plan, which the bankruptcy court confirmed over their objection. The bankruptcy court and the district court for the Southern District of New York both ruled that the senior secured lenders were not entitled to the make-whole premium.

On appeal to the Second Circuit, the senior secured lenders argued, among other things, that the lower courts had erred when they failed to award the make-whole premium, which the indenture and the notes required if the debtors "redeemed" the notes before October 15, 2015. The lenders contended that the debtors' commencement of the chapter 11 cases constituted such a premature redemption. The debtors argued that filing the bankruptcy petition was an event of default under the documents, which caused an automatic, mandatory acceleration of "the principal of, premium, *if any*, and interest on all the [Senior Lien] Notes"; the transactional documents did not provide expressly for a make-whole premium upon acceleration; and under New York law, acceleration is not the same as redemption. Therefore, the debtors argued, no make-whole premium was due. The Second Circuit agreed with the debtors.

The Second Circuit reasoned that the automatic acceleration of the debt upon the bankruptcy filing changed the date of maturity from some specified point in the future to a new, earlier maturity date for the debt, *i.e.*, the date of the bankruptcy filing, and that any repayment or restructuring of the debt after that date would no longer be either a "redemption" or "optional" for purposes of the indenture's optional redemption provision.

Notably, the Third Circuit Court of Appeals had reached a contrary decision with respect to a nearly identical make-whole issue in *Delaware Trust Co. v. Energy Future Intermediate Holding Co. (In re Energy Future Holdings Corp.)*, 842 F.3d 247 (3d Cir. 2016). Although the Second Circuit cited the contrary opinion of the Third Circuit, it did not explicitly address the Third Circuit's reasoning in that case.

Takeaway: In contrast to the Third Circuit's *EFH* holding, the Second Circuit has determined that the automatic acceleration of notes due to a bankruptcy filing does not amount to a voluntary, optional redemption enabling a make-whole premium. Rather, automatic acceleration under a bankruptcy filing changes a note's maturity date to make it due as of debtor's petition date.

D. ***In re Tara Retail Grp., LLC***, Case No. 17-57 (Bankr. N.D.W. Va. Sept. 19, 2018)

This bankruptcy court decision arose over a dispute between Tara Retail Group, LLC ("Debtor") and its principal secured lender, Comm2013-CCRE12 Crossings Mall Road, LLC ("Comm2013"), regarding the amount of Comm2013's proof of claim. Specifically, the parties disputed whether Comm2013 could collect a "prepayment premium" of $3,139,776.71. The loan documents at issue were governed by New York law.

The Debtor asserted that Comm2013 was not entitled to that amount because, among other things, Comm2013's acceleration of the note changed the maturity date such that any present attempt to repay the debt as part of its reorganization could not constitute a "prepayment." In support of its argument, the Debtor relied upon *In re MPM Silicones*, *L.L.C.*, 874 F.3d 787 (2d Cir. 2017). In opposition, Comm2013 contended that it was entitled to the premium because prepayment premiums compensate lenders for the loss of their bargain upon prepayment, that they are enforceable as liquidated damages, and they remain enforceable without regard to acceleration. Comm2013 recognized *MPM Silicones* as an affirmation of the general rule under New York law that acceleration negates a prepayment penalty, but asserted that the case at hand represented the exception. In support of its argument, it primarily relied upon *In re Energy Future Holdings Corp*., 842 F.3d 247 (3rd Cir. 2016) (applying New York law).

The bankruptcy court explained that the parties in *Energy Future Holdings* divorced the make-whole premium from other provisions related to the acceleration of the obligation. According to the *Energy Future Holdings* court, "[a]cceleration here has no bearing on whether and when the make-whole is due." Instead, the premium was due upon voluntary redemption. "Thus, while a premium contingent on 'prepayment' could not take effect after the debt's maturity, a premium tied to a 'redemption' would be unaffected by acceleration of a debt's maturity."

Here, the Debtor asserted that because the requested premium was based upon prepayment and because the debt was accelerated by the bankruptcy, the payment was no longer "pre." The bankruptcy court agreed and further noted that the agreement did not specifically require the payment of the premium based upon the acceleration of the Note. Rather, in the bankruptcy court's view, the relevant language contemplated a "prepayment" during an event of default in the absence of an accelerated note. The bankruptcy court noted "there is no cause to depart from the general rule that acceleration neuters a make-whole provision and no offense is given to the contractual language for which the parties bargained."

Takeaway: The *In re Tara Retail* Court diverges from *EFH*'s reasoning to agree with the Second Circuit *MPM Silicones* decision, finding that when a note is accelerated, the acceleration effectively changes its maturity date to the present. This change in the maturity date makes it so that any repayment on the note is not considered a "pre-payment," and therefore eliminates the existence of a prepayment make-whole premium.

Recent Developments Relating to Third-Party Releases

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A. Constitutional Power of a Bankruptcy Court to Approve Compelled Third-Party Releases

i. Millennium Lab Holdings, II, LLC

In *In re Millennium Lab Holdings, II, LLC,* No. 15-12284 (Bankr. D. Del. Dec. 14, 2015), D.E. 195 (the "Millennium Conf. Order"), the chapter 11 debtors proposed a prepackaged plan that included the non-consensual release of certain creditors' claims against the debtor's equity holders. The would-be releasing creditors had already filed a complaint against the would-be released owners in District Court, and the creditors objected to confirmation of a plan that would release the claims asserted in that complaint without their consent. *See In re Millennium Lab Holdings, II, LLC,* No. 15-12284 (Bankr. D. Del. Dec. 11, 2015), D.E. 206 (the "Millennium Bench Ruling") at 12. In particular, the objectors argued *inter alia* that the bankruptcy court lacked subject matter jurisdiction to grant the compelled third-party releases. *See In re Millennium Lab Holdings, II, LLC,* No. 15-12284 (Bankr. D. Del. Dec. 4, 2015), D.E. 122 (the "Initial Objection") at 17-26; No. 15-12284 (Bankr. D. Del. Dec. 9, 2015), D.E. 174 (the "Supplemental Objection") at 4-10. Although the objectors did include a "reservation of rights" in their initial objection indicating that they did not consent to the bankruptcy court's entry of a final order, they described the issue as one of *jurisdiction* and not constitutional power, *see* Initial Objection at ¶ 75; *see also Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC),* 242 F. Supp. 3d 322, 331 (D. Del. 2017) (the "District Court Remand") (observing perfunctory reference to the constitutional authority issue and the objectors' apparent conflation of that issue with the jurisdictional issue), and failed to press that objection in their more detailed Supplemental Objection.

The bankruptcy court found that it had subject matter jurisdiction to consider the releases in the context of plan confirmation, but never reached the issue of whether it had constitutional power to grant them. *See* District Court Remand at 332. In particular, the Bankruptcy Court found that it *at least* had related-to jurisdiction over the released claims because each of the non-debtor release beneficiaries had a prepetition contractual indemnification right against the debtors, and thus there was a clear "conceivabl[e]" effect "on the estate being administered in bankruptcy." Millennium Bench Ruling at 13-14 (citing *Pacor v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (overruled in part on other grounds), *Lower Bucks Hospital,* 488 B.R. 303 (E.D.

Pa. 2013), *aff'd* 571 Fed. Appx 139 (3d Cir. 2014)).[1] The court ultimately disagreed that such releases contravened the Bankruptcy Code and confirmed the plan. Millennium Bench Ruling at 12, 16; *see also id.* at 16-30 (detailed ruling on satisfaction of applicable factors). The objectors appealed but failed clearly to raise the issue of whether the bankruptcy court had the constitutional authority to confirm a plan containing compelled third-party releases (although they did challenge subject matter jurisdiction generally). *See* District Court Remand at 330-31.

At the District Court, the debtors moved to dismiss on the basis that the appeal was equitably moot, and the appellants raised the constitutional argument (for the first time, at least comprehensively) in opposition. *See* District Court Remand at 325, 339. Determining that it could not consider the motion to dismiss without first determining whether there had been a constitutional defect in the decision below, the District Court remanded for the bankruptcy court to determine whether as an Article I court, it had the constitutional authority to confirm a plan containing compelled third-party releases. *See* District Court Remand at 325, 338-39. In so doing, the District Court recapped the Constitution's "limitation on the power of an Article I court to enter final orders or judgments on state law claims without the parties' consent." District Court Remand at 325-26 (quoting *Wellness Int'l Network, Ltd. v. Sharif,* 135 S.Ct. 1932, 1938-39 (2015)). The District Court was persuaded (though did not decide) that the appellants' purportedly released claims were "between two private parties based on state common law or statutes that are not closely intertwined with a federal regulatory program," District Court Remand at 339 (quoting *Stern v. Marshall,* 564 U.S. 462, 131 S.Ct. 2594, 2614 (2011)) (quotations omitted), and that the "extinguish[ment]" of those claims was "tantamount to resolution of those claims on the merits." District Court Remand at 339 (citing *In re Digital Impact, Inc.,* 223 B.R. 1, 13 n.6 (Bankr. N.D. Okla. 1998)) (additional cites omitted). As such, the District Court seemed persuaded that the bankruptcy lacked constitutional authority to release the objectors' claims. *See* District Court Remand at 340 ("*Notwithstanding the seeming merits of Appellants' arguments*, the Court will not rule on an issue [i.e. the constitutional power issue] that the Bankruptcy Court itself may not have ruled upon . . . .) (emphasis added).

On remand, the bankruptcy court found that it had such constitutional authority. *In re Millennium Lab Holdings, II, LLC,* 575 B.R. 252 (Bankr. D. Del. 2017) (the "<u>Second Bankruptcy Decision</u>"). As a threshold matter, the bankruptcy court ruled that no interpretation of <u>Stern</u>—which applied only in the context of "a state law cause of action filed by a trustee," *see* Second Bankruptcy Decision at 274—affected a bankruptcy court's ability to confirm of plan, which is a quintessential feature unique to federal bankruptcy law. Second Bankruptcy Decision at 271-72. As such, *Stern's* so-called "Disjunctive Test"—"whether the action at issue stems from the bankruptcy itself ***or*** would necessarily be resolved in the claims allowance process,"[2] need not even be applied. *Cf.* Second Bankruptcy Decision at 274 ("Assuming that it is ever appropriate to import the Disjunctive Test into a context other than a state law cause of action filed by a

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1 The bankruptcy court disregarded the objectors' argument that the causes of action articulated in the District Court complaint sounded in fraud and intentional conduct, which fell outside the scope of the indemnification obligations—finding that even a suit sounding in fraud would have a "conceivable effect" because plaintiffs could amend their complaint to include non-fraud causes of action, and because the defendants would be entitled to fee reimbursement against the estate regardless of their entitlement to indemnification for any judgment obtained. *See* Millennium Bench Ruling at 14-15.

2 *Stern*, 131 S.Ct. at 2618 (emphasis added).

trustee . . . ."), 275 ("But, if I were going to import the Stern Disjunctive Test into Millennium's plan confirmation proceeding . . . ."). The bankruptcy court rejected the objectors' view that the confirmation context was irrelevant, and that the bankruptcy court should instead analyze whether it had constitutional authority to adjudicate the merits of the underlying claims being affected by confirmation. Second Bankruptcy Decision at 273-74. Rather, the Bankruptcy Court determined that consideration of the factors "against which a third-party release is measured . . . do[es] not ask the bankruptcy judge to examine or make rulings with respect to the many claims that may be released by virtue of the third party releases. An order confirming a plan with releases, therefore, does not rule on the merits of the state law claims being released." Second Bankruptcy Decision at 272-73 (internal citations omitted).

The bankruptcy court went on to find that even if Stern governed its analysis, the "action at issue" under the Disjunctive Test was confirmation of a plan, not the claims articulated in the District Court complaint. Second Bankruptcy Decision at 274. In support, the bankruptcy court found that "*Stern* does not preclude a bankruptcy judge from entering final orders in statutorily core proceedings *notwithstanding the orders' collateral impact on state law claims*." Second Bankruptcy Decision at 275-76 (citing *In re Lazy Days' RV Center Inc.,* 724 F.3d 418 (3d Cir. 2013)) (emphasis added).[3] Rather, "[t]aking the position that third party releases in a plan are equivalent to an impermissible adjudication of the litigation being released is, at best, a substantive argument against third party releases, not an argument that confirmation orders containing releases must be entered by a district court." Second Bankruptcy Decision at 283.

The objectors appealed the Second Bankruptcy Decision, arguing that "the relevant inquiry is not whether plan confirmation is core, but whether the other proceedings . . . affected by plan confirmation are core." *See Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC),* No. 17-1461-LPS, 2018 WL 4521941, at *11 (D. Del., September 21, 2018) (the "District Court Affirmance") (summarizing objectors' view). Commentators and practitioners braced for reversal, given the District Court's original skepticism on the bankruptcy court's constitutional authority. *See also* District Court Affirmance at 11, 13 (acknowledging that in the District Court Remand, the District Court had been persuaded by objectors' arguments). But to the surprise of many, the District Court affirmed, agreeing that "*Stern* did not address, either expressly or by implication, any context other than counterclaims, nor did it announce a broad holding addressing every facet of the bankruptcy process." *See* District Court Affirmance at 12 (quoting Second Bankruptcy Decision at 274)) (internal quotations omitted). The District Court therefore determined that Stern did not require application of the Disjunctive Test in the confirmation context. *Id.* at 12. The District Court went on to affirm the bankruptcy court's ruling that the confirmation order approving the release of state-law claims was *not* an adjudication of the released claims on the merits, favoring the distinction drawn between approval of a *settlement* of claims—which involved application of a federal bankruptcy standard—and a ruling on the merits. *See id.* at 14. The District Court agreed that the *impact* of that "settlement" (the release of claims) went to whether the settlement satisfied the federal standard for approval; that is, the objectors' contention was an argument as

[3] *See also* Second Bankruptcy Decision at 280 (citing *inter alia Hart v. S. Heritage Bank (In re Hart),* 564 Fed. App'x. 773 (6th Cir. 2014) (same holding as *Lazy Days'*), *Fisher Island Invs., Inc. v. Solby+Westbrae Partners (In re Fisher Island),* 778 F.3d 1172, 1192 n.13 (11th Cir. 2015) (bankruptcy judge could enter a final order notwithstanding its substantial impact on the pending proceedings in other courts).

to why the release was *inappropriate*, not a challenge to the bankruptcy court's constitutional authority to approve it in the first place. *Id.* at 13-14.

ii. Lynch v. Lapidem Limited (In re Kirwan Offices S.A.R.L.)

After the *Millennium* Bankruptcy Court had issued the Second Bankruptcy Decision (but before issuance of the District Court Affirmance), the issue of bankruptcy courts' constitutional authority to confirm plans containing compelled third-party releases had been raised but not reached in the Southern District of New York.[4] But shortly after the District Court Affirmance in *Millennium*, the Southern District of New York reached a similar question.

In *Kirwan*, co-investors of the debtor had been sparring over settlement of certain contingent liabilities of the company.[5] Ultimately, two of the three investors (the "Petitioning Creditors") commenced an involuntary proceeding against Kirwan, without the consent of the third investor (the "Objector"). *Id.* at 5. The Objector moved to dismiss the involuntary petition or else abstain from adjudicating it, arguing that the Petitioning Creditors had filed the case in a bad-faith scheme to circumnavigate his consent rights over the pending litigation. *Id.* at 5-6. The bankruptcy court denied the motion to dismiss or abstain, finding that abstention would impermissibly interfere with resolution of matters within its core subject matter jurisdiction. *Id.* at 6 (internal citations omitted).

The Petitioning Creditors filed a chapter 11 plan that included a non-consensual third-party release prohibiting, *inter alia*, the Objector from initiating arbitration in London aimed at showing that the involuntary bankruptcy was unauthorized. Kirwan Affirmance at 7. The Objector never appeared at the confirmation hearing. *Id.* The bankruptcy court did not articulate extensive reasoning on its approval of the third-party release—in particular, there was no discussion of subject matter jurisdiction or the satisfaction of any factors tending to show that the releases were appropriate—and ultimately confirmed the plan. *Id.*[6]

Contending that the bankruptcy court lacked subject matter jurisdiction and constitutional power to enjoin later litigation of non-bankruptcy claims, the Objector appealed the confirmation order. Kirwan Affirmance at 8. The District Court affirmed, finding first that "[a] bankruptcy court acts pursuant to its core jurisdiction when it considers the involuntary release of claims against a third-party, non-debtor in connection with the confirmation of a proposed plan of

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4 *See In re SunEdison, Inc.,* 576 B.R. 453, 457 n.5 (Bankr. S.D.N.Y. 2017) (noting the Second Bankruptcy Decision in *Millennium* but stating that the SunEdison Court had—in an earlier decision—"expressed a third concern: did *Stern* prohibit the Court from entering a final judgment approving the non-consensual Release? The Second Circuit has interpreted *Stern* narrowly and limited the ruling to its facts. . . . Since I am not approving the Release, I do not resolve the question." (internal citations omitted)).

5 *See Lynch v. Lapidem Limited (In re Kirwan Offices S.A.R.L.),* Nos. 17 Civ. 4339, 17 Civ .4340 (S.D.N.Y. Oct. 10, 2018) (slip op.) (the "Kirwan Affirmance"), at 2-4.

6 The Court's somewhat cursory treatment likely resulted from the fact that the provision in question was more akin to an exculpation than a compelled third-party release, given that the focus was releasing the plan proponents and related parties from causes of action related to beginning and administering the bankruptcy case. Approving such provisions is squarely within the court's "arising in" and "arising under" jurisdiction, *see* 28 U.S.C. 157(b), and there has been no serious challenge to bankruptcy courts' constitutional authority to confirm plans containing exculpations.

reorganization, which is a statutorily defined core proceeding." *Id.* at 17-18 (citing 28 U.S.C. § 157(b)(2)(L)). Citing *inter alia* the portion of the District Court Affirmance in Millennium pertaining to the *constitutional* analysis, the District Court went on to find that "[a] confirmed reorganization plan that includes such releases ***does not address the merits of the claims being released***; those, of course, are governed by non-bankruptcy law. Rather, it effectively cancels those claims so as to permit a total reorganization of the debtor's affairs in a manner available only in bankruptcy." *Id.* (collecting substantial citations, omitted here) (emphasis added). The District Court specified that "it [was] of no moment" that the Objector's claims "arise under a pre-petition contract, subject to the laws of another jurisdiction, and were against a non-debtor." *Id.* at 21. It was the fact that their extinction was essential to "adjudicate[ion] of the proposed corporate reorganization of Kirwan" that brought the releases within the bankruptcy court's core subject matter jurisdiction. *Id.*[7]

The District Court then turned to the "distinct" constitutional analysis, Kirwan Affirmance at 25, observing that bankruptcy courts' constitutional authority extends only to matters that are "integral to the restructuring of the debtor-creditor relationship." *Id.* at 27-28 (quoting *Stern*, 131 S.Ct. at 2617) (internal quotations omitted). Reiterating the finding it made in its jurisdictional analysis (and indeed, adopting the "core" terminology, even in the constitutional context), the District Court found that the releases were not an "adjudication of the merits of third-party claims," but rather "merely extinguish those claims as part of [the] core bankruptcy process" of confirming a plan in accordance with federal bankruptcy law. *Id.* at 29.

Continuing its reliance on "core" terminology, the District Court explained that "a bankruptcy court's constitutional adjudicatory authority depends, not on the nature of a related claim at issue, but rather on *how resolving that claim relates to a core Article I bankruptcy process*. As a practical matter, resolving claims against a debtor will nearly always be integral to resolving a bankruptcy process, while claims against third parties will be integral only in 'rare cases.'" *Id.* at 28 (quoting *In re Metromedia Fiber Network, Inc.,* 416 F.3d 136, 141 (2d Cir. 2005)) (emphasis added). The District Court found that this was one such rare case because the compelled release of claims was "absolutely necessary to the operation of Kirwan's reorganization plan," and that was in turn "because [the release] was integral to the 'restructuring of debtor-creditor relations.'" *Id.* at 28 (evidently erroneously citing *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50, 71 (1982); correct citation would appear to be to *Stern*, 131 S.Ct. at 2617). Finally, departing from the District Court in *Millennium*, the District Court *did not* disclaim the relevance of *Stern's* Disjunctive Test, but found that the releases at bar satisfied that test because they stemmed from the bankruptcy process, as they were subject to 11 U.S.C. §§ 1129, 1123, 105 and 524(e). *Id.* at 28-29 (citing the Second Bankruptcy Decision from *Millennium*, where the bankruptcy court had applied the Disjunctive Test in an "even if" analysis).

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7 The District Court in *Kirwan* does not appear to have squarely addressed the applicability of *Manville* and its mandate that bankruptcy courts have subject matter jurisdiction over the claims released. *See* In re *Johns-Manville Corp.,* 600 F.3d 135, 153 (2d Cir. 2010) (reaffirming threshold determination of subject-matter jurisdiction before approving third-party releases in plans). This may be because the release at issue in *Kirwan* appears more akin to exculpation than to a release of claims held by a non-debtor against non-related parties. *See also supra* at n.6. In any event, the District Court did find that the bankruptcy court had subject matter jurisdiction over *plan confirmation*, which was what the District Court found to be the relevant touchpoint (not the adjudication of the underlying claim).

iii. Takeaway from Millennium Lab and Kirwan Offices

Barring further review, the District Court opinions in *Millennium Lab* and *Kirwan Offices* emphatically reaffirm the constitutional authority of bankruptcy courts to enter final orders confirming plans containing compelled third-party releases. Given the extensive analysis in each of the decisions, particularly *Millennium Lab,* other districts are likely to follow suit. Critically, both the *Millennium Lab* and *Kirwan Offices* Courts concluded that confirming plans containing compelled third-party releases did not constitute an adjudication of the underlying dispute, and that the proceeding at issue for a determination of constitutional authority was the plan confirmation proceeding itself. While the *Stern* constitutional analysis is, of course, completely distinct from subject matter jurisdiction analysis (*Stern* is *not* about jurisdiction), the conclusion that confirming a plan containing compelled third-party releases does not result in an adjudication of the underlying claims may have implications for the jurisdictional analysis.

In the Second Circuit, for example, in light of the *Manville* decisions,[8] the first step in confirming a plan containing compelled third-party releases is determining if the bankruptcy court has subject matter jurisdiction *over the released claims*, which turns on whether the claims might have 'any conceivable effect' on the bankruptcy estate."[9] However, if confirming such a plan does not effectively adjudicate such claims, must the bankruptcy court have "related to" jurisdiction over the underlying claims when it has "arising in" and "arising under" jurisdiction over the confirmation process? Why select this issue from the collection of issues—state law and otherwise—implicated by confirmation?[10] Perhaps the Second Circuit, and others, should reconsider whether "related to" jurisdiction over the released claims is a gating issue. The nexus of the released claims to the estate—and their importance or necessity to the plan—would remain a factor in the analysis of whether to approve the compelled third-party releases on the merits and confirm the plan, but the issue would cease to be jurisdictional.

Of course, even if other courts were to depart from the holdings in *Millennium Lab* and *Kirwan Offices* and find that bankruptcy courts lack the constitutional power to order third-party releases, it would not mean that bankruptcy courts cannot *facilitate* confirmation of plans containing them—it would just mean that bankruptcy courts could not *themselves* enter final confirmation orders containing such releases. Instead, bankruptcy courts would have to issue recommended findings of fact and conclusions of law to the district courts, altering the "division

8 *In re Johns-Manville Corp.,* 517 F.3d 52, 66 (2d Cir. 2008), *rev'd and remanded on other grounds sub nom*. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S. Ct. 2195 (2009); *In re Johns-Manville Corp.,* 600 F.3d 135, 153 (2d Cir. 2010) (reaffirming threshold determination of subject matter jurisdiction before approving third-party releases in plans); *see also In re FairPoint Commc'ns, Inc.,* 452 B.R. 21, 29 (S.D.N.Y. 2011) ("[A] bankruptcy court has jurisdiction to enjoin third party non-debtor claims, but only to the extent that those claims 'directly affect' the res of the bankruptcy estate.") (citing *Manville*, 517 F.3d at 66, *reaff'd*, 600 F.3d 135, 153 (2010)).

9 *In re Sabine Oil & Gas Corp.,* 555 B.R. 180, 288-89 (Bankr. S.D.N.Y. 2016) (internal citations omitted).

10 As noted above, the District Court in *Kirwan* found subject matter jurisdiction because the focus was on plan confirmation—clearly within "arising in" and "arising under" jurisdiction—not the underlying cause of action. The *Kirwan* Court did not, however, address the *Manville* decisions and their progeny in reaching this conclusion. Again, this is likely because the case really dealt with an exculpation rather than a broader, compelled third-party release involving prepetition activity.

of labor"[11] as between the bankruptcy and district courts—perhaps to a greater extent than envisioned by the Supreme Court in *Stern*.[12] The constitutional authority controversy is, of course, just about *which court* can order the third party release, not whether the release is available in the first instance.

In any event, thanks to *Millennium Lab* and *Kirwan Offices*, plan proponents now have a strong basis to argue that the bankruptcy court presiding over confirmation has the constitutional power to enter a confirmation order including compelled third-party releases. The potential larger implications of the decisions will play out in subsequent decisions.

[11] *See*, *e.g.*, Stern, 131 S.Ct. at 2620 (finding that the Court's holding did not "meaningfully change[] the division of labor" between the bankruptcy and district courts).

[12] *See*, *e.g.*, In re Montreal Maine & Atl. Ry., Ltd., No. 1:15-MC-329-JDL, 2015 WL 7302223, at *1 (D. Me. Nov. 18, 2015) (adopting proposed findings of fact and conclusions of law submitted by bankruptcy judge in accordance with Bankruptcy Rule 9033).

Approval of Compelled Third-Party Releases Via a Chapter 15 Proceeding: *In re Avanti Commc'ns Grp.*, 582 B.R. 603 (S.D.N.Y. 2018)

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In its 2018 decision in *In re Avanti Commc'ns Grp.,* 582 B.R. 603 (S.D.N.Y. 2018), the United States Bankruptcy Court for the Southern District of New York recognized and enforced an English "scheme of arrangement" (the "Scheme") under chapter 15. The Court held that the Scheme was enforceable although the debtor, Avanti Communications Group plc ("Avanti") did not have a place of business in the United States, and the Scheme released non-debtor affiliate-guarantors (the "Guarantors") of one class of Avanti's issued debt from all guarantee obligations.

Avanti is incorporated in England and Wales, with subsidiaries in multiple countries in Europe, the Middle East, and Africa, and its primary place of business in London, England. Avanti is a satellite operator and seller of satellite data communications. At the end of 2017, Avanti's capital structure consisted of borrowings under a super-senior term loan and senior secured notes maturing in 2021 and 2023 (the "2021 Notes" and "2023 Notes", respectively).

Avanti encountered issues with manufacturing and launching a number of its satellites, and began to struggle financially. Avanti then began negotiations with Solus Alternative Asset Management LP, Tennenbaum Capital Partners, LLC and Great Elm Capital Management Inc. (collectively, the "Ad Hoc Group") regarding a potential restructuring. In early December 2017, Avanti and certain members of the Ad Hoc Group entered into an agreement to restructure the Avanti debt.

Among other treatment, the Scheme provided for a debt-for-equity exchange of the 2023 Notes in exchange for 92.5% of Avanti's issued share capital. Additionally, holders of the 2023 Notes agreed to broad releases: "releases of any claim or liability, whether present or future, known or unknown, prospective or contingent, against the Debtor arising directly or indirectly out of, from or in connection with, the 2023 Notes and the 2023 Indenture, including in respect of any accrued but unpaid interest, other than any claim or liability arising after the [effective date of the restructuring]." Avanti, 582 B.R. at 609.

In February 2018, the High Court of Justice of England and Wales (the "UK Court") granted Avanti permission to hold a meeting to approve the Scheme with the creditors of the 2023 Notes and authorized the appointment of a foreign representative for the U.S. Chapter 15 proceeding. At the meeting, 98.3% of the holders of the 2023 Notes (who held an aggregate of $547,320,250 of the 2023 Notes) voted in favor of the Scheme. Consequently, Avanti requested and obtained the UK Court's approval of the Scheme.

Section 1517 of the Bankruptcy Code provides that a foreign proceeding should be recognized and enforced under Chapter 15 if "(1) such foreign proceeding for which recognition is sought is a foreign main proceeding or foreign non-main proceeding within the meaning of section 1502; (2) the foreign representative applying for recognition is a person or body; and (3) the petition meets the requirements of section 1515." 11 U.S.C. § 1517(a). If a court recognizes a foreign proceeding, section 1521(i) of the Bankruptcy Code provides that the court may grant the foreign representative "any appropriate relief" if such relief is "necessary to effectuate the purpose of [chapter 15] and to protect the assets of the debtor or the interests of the creditors." 11 U.S.C. §1521(i). Moreover, in accordance with Code section 1507(b), a court may provide "additional assistance, consistent with the principles of comity." 11 U.S.C. § 1507(b).

With respect to the requirement under section 109(a) that the Debtor hold "property in the United States," the Court found that Avanti held sufficient property in the form of a $100,000 retainer in New York for counsel for Avanti. Additionally, the Court also noted that the 2023 Notes indenture was governed by New York law, a separate ground for satisfaction of section 109(a). With respect to whether Avanti's proceeding in the UK Court was a "foreign [main] proceeding" under section 1517, the Court found that the Debtor's February 2018 UK Court proceeding was a "collective proceeding for the adjustment of debt." Moreover, the Court noted that two other factors were indicative of the UK proceeding's qualification as a "foreign main proceeding": (i) the UK Court's formal authorization of the foreign representative under section 1515(c) and (ii) the location of a significant proportion of Avanti's assets in the UK, which signified that the UK was the debtor's "center of main interests." 11 U.S.C. § 1515(c); § 1517(b)(1).

Finally, with respect to the release of the Guarantors without unanimous consent from the holders of the 2023 Notes, the Court found that consent for the Scheme amongst the holders of the 2023 Notes existed not only because the 2023 Notes' creditors had a "full and fair opportunity" to vote on the Scheme, but also because these noteholders voted overwhelmingly in favor of its approval. *Id.* at 616. The Court held that the UK Court's proceeding, including the releases of all claims against Avanti and the Guarantors, should be recognized and enforced, with the rationale that granting these releases would "assist the orderly administration of [Scheme] by the UK Court and help the implementation of the Scheme for the Debtor." *Id.* at 619.

Takeaway: *Avanti* lays the groundwork for international debtors to receive approval of third-party releases from U.S. bankruptcy courts via a chapter 15 proceeding grounded in the theory of comity.

Recent Developments Relating to Section 363 Asset Sales

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A. Section 363 Break-Up Fees: *In re Energy Future Holdings Corp.,* 904 F.3d 298 (3d Cir. 2018), petition for cert. filed (U.S. Jan. 18, 2019) (No. 18-957).

In April 2018, the Third Circuit Court of Appeals upheld the Delaware Bankruptcy Court's ruling denying NextEra Energy Inc. ("NextEra") payment of its previously approved $275 million breakup fee.[1] The Third Circuit found that the bankruptcy court did not err in granting the motion to reconsider the approval of the $275 million breakup fee.

Energy Future Holdings Corp. ("EFH"), Energy Future Intermediate Holding Company LLC ("EFIH") and certain of its subsidiaries and affiliates (together with EFH and EFIH, the "Debtors") filed for chapter 11 in April 2014. Among other assets, EFIH owned approximately eighty-percent of Oncor Electric Delivery Co. LLC ("Oncor"), the largest electricity transmission and distribution system in Texas. In July 2016, EFH, EFIH and certain other Debtors entered into a merger agreement with NextEra. The merger provided that NextEra would purchase EFIH's interest in Oncor for $18.7 billion implied enterprise value. As bid protection, the Debtors agreed to pay NextEra a $275 million breakup fee under certain circumstances. Importantly, the merger agreement included a provision that the breakup fee would not be payable in the event that (i) NextEra terminated the merger agreement and (ii) approval of the transaction from the Public Utility Commission of Texas ("PUCT") was the only unsatisfied closing condition.

At the hearing to approve the Debtors' entry into the merger agreement and the bid protections, Judge Sontchi raised questions regarding the circumstances in which the breakup fee would be payable. Counsel for the Debtors and counsel for NextEra sought to clarify the terms of the breakup fee. However, neither party noted that the merger agreement did not include an outside date by which PUCT approval would be obtained. In other words, the merger agreement in effect allowed NextEra, "in the face of regulatory rejection . . . [to] simply be patient . . . and wait for Debtors to terminate first, which would allow NextEra to collect the $275 million Termination Fee." 904 F.3d at 304. Without this clarification, the bankruptcy court approved the Debtors' entry into the merger agreement and the related breakup fee (the "Approval Order").

In April 2017, the PUCT determined that some terms of the NextEra transaction were not in the public interest under Texas law, and denied NextEra's application for the change of control of Oncor to NextEra. The Debtors subsequently terminated the merger agreement in July 2017 and entered into a new agreement with another third party. The Debtors terminated the NextEra transaction due to PUTC's denial of the transaction and NextEra's breach of the merger agreement. Shortly thereafter, creditors of EFIH, Elliott Associates, L.P., Elliott

[1] *In re Energy Future Holdings Corp.,* 575 B.R. 616 (Bankr. D. Del. 2017).

International, L.P., and The Liverpool Limited Partnership (collectively, "Elliott") filed a motion for reconsideration of the Approval Order with respect to the $275 million breakup fee.

With respect to the issue of timeliness, the bankruptcy court found that the motion was timely because the Approval Order was interlocutory. NextEra had argued that the motion was filed over a year after the entry of the Approval Order and therefore untimely. The Third Circuit upheld the Bankruptcy Court's reasoning on this issue, holding that the bankruptcy court did not abuse its discretion in finding that the motion was timely, and that the Approval Order was in fact an interlocutory order. Therefore, there was no explicit time constraint imposed on Elliott's filing of its motion for reconsideration. The Third Circuit concurred, noting that the Approval Order had not fully and finally decided a discrete set of issues, as required for the Approval Order to be considered a final order, even under a flexible, pragmatic approach to finality. *Id.* at 308-09. The Approval Order reserved specific questions for later determination, including the allocation of the breakup fee expense between the EFH and EFIH estates. *Id.* at 309.

On the merits of the motion for reconsideration, the bankruptcy court held that it had "misapprehended the facts" in the conversation surrounding the breakup fee, in part because neither party pointed out the fact that NextEra had "no economic incentive" to terminate the merger agreement if PUCT approval was not obtained. *Id.* at 313-14. The Bankruptcy Court also held that although the breakup fee may have been allowed under section 503(b) of the Bankruptcy Code, it did not meet the Third Circuit's *O'Brien* standard, which requires that a termination fee must be "actually necessary to preserve the value of the estate," rather than merely providing "some benefit." 575 B.R. at 634-35. Payment of the breakup fee was not actually beneficial to the Debtors' estate in the circumstance at hand, and the Bankruptcy Court found that the payment of the breakup fee was not in line with the interests of justice.

With respect to the Bankruptcy Court's claimed misapprehension of the facts of the case, the Third Circuit stated that it could not "say that the [bankruptcy] court's findings with regard to its own subjective understanding were clearly erroneous." 904 F.3d at 313. With respect to the Bankruptcy Court's abuse of discretion, the Third Circuit held that the Bankruptcy Court did not abuse its discretion in denying NextEra the termination fee, because the lower court would not have been able to fully analyze the fee's effect without a complete understanding of its terms. Namely, the Bankruptcy Court would have had to have been aware of "critical fact that profoundly altered the underlying legal determination"—both parties' failure to include an outside date for PUCT approval of the transaction. *Id.* at 316.

Of note, the Third Circuit opinion was a 2-1 decision. In rejecting the majority reasoning, Judge Rendell noted that:

> ... hindsight cannot justify nullifying a material term of the deal that was struck with all of the facts on the table.
>
> …..
>
> … Parties to commercial transactions present the terms of the deal to the court for approval, and once approved, are entitled to rely on the court's order, which is based on a thoughtful, well-reasoned analysis. Here, that should have been the guiding

> principle, and the grant of reconsideration so as to nullify the previously approved fee when there was no clear error of law or fact was an abuse of discretion.

Id. at 317 & 319.

Takeway: As indicated by the dissenting opinion, the Third Circuit and bankruptcy court decisions have significant implications for purchasers of assets seeking bid protections. Purchasers should ensure that when approving the bid protections, the court understands the parameters of the bid protections and circumstances in which they become due.

B. “Good Faith” Purchaser Standard in 363 Sales

i. In re Old Cold LLC, 879 F.3d 376 (1st Cir. 2018)

In In re Old Cold LLC, the First Circuit affirmed a 363 sale of substantially all of the assets of Tempnology, LLC. (“Tempnology”). The First Circuit found that the appellant, Mission Products Holdings, Inc. (“Mission”), was precluded from challenging the sale pursuant to section 363(m) because the purchaser, Schleicher and Stebbins Hotels LLC (“S&S”), was a “good faith purchaser” within the meaning of section 363(m). Additionally, the First Circuit found that because the sale had not been stayed pending appeal, Mission’s challenge was statutorily mooted.

Tempnology manufactured products such as towels, socks, and headbands that were designed to remain at cool temperatures when used during exercise. Tempnology and Mission are parties to a co-marketing and distribution agreement pursuant to which Mission was granted a nonexclusive, perpetual license to Tempnology’s intellectual property and an exclusive distributorship for certain of Tempnology’s manufactured products.

When Tempnology’s finances began to deteriorate, Tempnology took on more debt from S&S. In addition to being Tempnology’s lender, two of S&S principals sat on Tempnology’s management committee and S&S owned a majority interest in Tempnology. Prior to the chapter 11 filing, Tempnology and S&S entered into a forbearance agreement wherein Tempnology agreed to file for chapter 11 and sell its assets in a 363 sale. Shortly thereafter, S&S’s two principals stepped down from the management committee and ceased contact with Tempnology’s management regarding operations or the chapter 11.

S&S became a stalking horse in Tempnology’s subsequent asset sale and, under the scrutiny of an independent examiner, Tempnology’s proposed auction procedures were approved by the bankruptcy court. The auction drew only two bidders – S&S and Mission. S&S’s eventual winning bid included a combination of credit bidding, assumption of certain liabilities, and leaving certain assets in the estate.

The bankruptcy court then held an evidentiary hearing on Tempnology’s sale motion, during which Mission alleged that the sales process was tainted by fraud and collusion. In approving the sales, the court found that “there is no evidence in the record establishing any misconduct or collusion in the sales process by the Debtor and S&S”. *Id.* at 381. Further, the bankruptcy court found that S&S was a “good faith purchaser” for purposes of section 363(m) and while S&S was at one time an insider of the Debtor, it had successfully divorced itself from Tempnology and the entire transaction was oversaw by the U.S. Trustee and an independent examiner.

The First Circuit affirmed the bankruptcy court's finding that S&S was a good faith purchaser. Once a bankruptcy court approve an asset sale under 363, section 363(m) provides that the reversal or modification on appeal of an authorization of a sale does not affect the validity of a sale if (i) the assets were purchased in good faith, and (ii) the authorization was not stayed pending appeal. "The effect of this provision is to render statutorily moot any appellate challenge to a sale that is both to a good faith purchaser, and not stayed." *Id.* at 383.

A "good faith purchaser" determination is reviewed for clear error, unless the analysis was "infected by legal error". *See In re SW Bos. Hotel Venture,* 748 F.3d 393 (1st Cir. 2014). The First Circuit first rejected Mission's allegation that the bankruptcy court committed legal error by not applying heightened scrutiny to an insider transaction. After citing multiples instances in which the bankruptcy court mentioned heightened scrutiny, the First Circuit found "no basis to [the] claim that the bankruptcy court applied a standard of scrutiny too favorable to Debtor or S&S."

The First Circuit proceeded to review for clear error as to the determination of good faith. "Although the Bankruptcy Code does not define 'good faith purchaser', we have defined this phrase in the context of 363(m) as 'one who buys property in good faith and for value, without knowledge of adverse claims.'" (quoting *In re Mark Bell Furniture Warehouse, Inc.*, 992 F.2d 7, 8). In rejecting Mission's argument for bad faith, the Court cited to the fact that (i) S&S did not exert influence over Tempnology after stepping down from management, (ii) the forbearance agreement and stalking horse bid were negotiated by counsel, (iii) issues with the stalking horse bid were resolved prior to the auction, (iv) S&S was entitled to credit bid, (v) certain asset revaluations during the auction applied equally to both bidding parties, (vi) the sales procedures permitted ex parte communication, and (vii) S&S's bid was superior to Mission's. *Id.* at 385.

The First Circuit also refused to apply the rationale of a recent Ninth Circuit Bankruptcy Appellate Panel decision, permitting an appellate court to consider post-sale conduct in evaluating the purchaser's good faith. *See Hujazi v. Schoenmann*, 2016 WL 721485 at *1 (B.A.P. 9th Cir. 2016). Certain branded inventory left in the estate could only be sold to S&S because S&S had purchased the intellectual property rights to the brand. Mission alleged that leaving these restricted assets in the estate, which only S&S could purchase, evidenced a secret agreement between S&S and Tempnology. The Court expressed reticence to reviewing a bankruptcy court's decision based on post-sale conduct because "[d]oing so risks placing an appellate court in the shoes of a trial court and undermines the policy of finality underlying section 363(m)." *Id.* at 386.

ii. ***In re Mountain Divide, LLC,*** **2018 WL 2063711 (Bankr. D. Mont., April 30, 2018)**

In *Mountain Divide*, the United States Bankruptcy Court for the District of Montana examined whether section 363(m) afforded protection from counterclaims to the purchaser of assets in a 363 sale.

Mountain Divide, LLC ("Mountain Divide") filed for chapter 11 and shortly after filed a motion to sell substantially all of its assets to Deep River Operating, LLC ("Deep

River") and Future Acquisition Company, LLC ("FAC"). Deep River and FAC were considered a joint stalking horse bidder. Deep River, however, failed to provide Mountain Divide with the financial information necessary to demonstrate its ability to close the transaction. As a result, FAC stepped into Deep River's position in accordance with the court approved bidding procedures order, and was ultimately determined to be the success bidder at the auction.

The bankruptcy court approved the sale to FAC and found that, among other things, (i) Mountain Divide and FAC negotiated and entered into the purchase agreement at arm's length without collusion or fraud, (ii) FAC was a "good faith purchaser" in accordance with section 363(m), and (iii) Mountain Divide's assets would be sold to FAC free and clear of all liens, claims and interests.

After closing of the sale, FAC filed a complaint against Deep River in the United States District Court for the Southern District of Texas alleging that Deep River breached the provisions of their joint bid agreement. In response, Deep River asserted counterclaims against FAC, alleging that FAC breached the joint bid agreement and tortuously interfered with Deep River's existing and prospective contracts.

FAC filed a motion in the bankruptcy court seeking enforcement of the sale order against Deep River. FAC argued that Deep River's counterclaims were interests that had been sold free and clear and that the sale order enjoined Deep River from pursuing such interests against FAC. The bankruptcy court disagreed and found that Deep River's counterclaims against FAC were not dependent on FAC's ownership of Mountain Divide's assets and not dependent on the outcome of the sale itself. Although not raised by FAC, the bankruptcy court analyzed whether the sale order's good faith finding under section 363(m) precluded Deep River's counterclaims. The court found that because the counterclaims posed no risk of reversal or modification, section 363(m) did not preclude Deep River from pursuing its counterclaims. *Id.* at *7.

***iii. In re Cooper,* 592 B.R. 469 (S.D.N.Y. 2018), appeal docketed sub nom. *In re Imperial Capital LLC,* (2nd Cir. Oct. 25, 2018) (No. 18-3212).**

In *In re Cooper*, the United States District Court for the Southern District of New York found that a purchaser in a section 363 sale is not a "good faith purchaser" under section 363(m) if the purchaser had a "detailed, long-standing knowledge" of adverse claims to ownership of the property being sold.

The case involved two entities—a non-debtor entity and the trustee of a debtor company—who both claimed ownership of a lawsuit. The trustee negotiated a settlement with the defendants pursuant to which the trustee would sell the claims to the defendants under section 363 thereby allowing the defendants to extinguish the claims and the defendants would waive all claims against the debtor estate. The non-debtor entity filed an objection to the sale, which was overruled by the bankruptcy court.

The non-debtor entity appealed and in response to the appeal, the trustee argued that the appeal was statutorily mooted pursuant to section 363(m).

After determining that the transfer of the causes of action constituted a "sale" for purposes of section 363(m), the Court turned toward whether the defendants were "good faith purchasers." The Court found that the "robust record" suggested that "the settlements and compromises set forth in the stipulations were thought long and hard over the last two years" and that there was no evidence of fraud, collusion, or bad faith by the purchasers. *Id.* at 481. However, the Court found that the defendants *could not* be "good faith purchasers" due to their knowledge of the adverse claims against the assets. While mere knowledge of adverse claims is not enough for a finding of bad faith, the fact that the defendants were party to the litigation giving rise to the adverse claims and participated in discovery precluded section 363(m) statutory mootness. *Id.*

After finding that the matter was not statutorily mooted, the Court reached the merits of the appellant's claims and rejected their appeal. The decision is now being appealed to the Second Circuit.

iv. Takeaways

The continuing trend with respect to section 363(m) is that it is narrower in scope than purchasers would like. As each of these three cases indicated, section 363(m) does not protect purchasers from every cause of action and does not shield purchasers from all appeals post-closing.

Recent Developments Regarding Chapter 11 Plan Confirmation Matters

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A. Plan Failure to Enforce Contractual Intercreditor Subordination Held not to be Unfair Discrimination: *In re Tribune Media Company*, 587 B.R. 606 (D. Del. 2018).

The backdrop to this latest installment in the *Tribune* saga is the hotly contested plan confirmation process that spanned multiple years and involved completing plans: one proposed jointly by the *Tribune* debtors, the official committee of unsecured creditors and certain senior lenders (the "DCL Plan"); and one proposed by jointly by the holders of certain bonds that were issued prior to the 2007 leveraged buyout of the company (the "Noteholder Plan"). In its initial ruling issued on October 31, 2011, the U.S. Bankruptcy Court for the District of Delaware denied confirmation of both the DCL Plan and the Noteholder Plan. *See In re Tribune Co.,* 464 B.R. 126 (Bankr. D. Del. 2011). A central difference between the DCL Plan and the Noteholder Plan was what to do about various claims and causes of action arising out of a multi-billion leverage buyout transaction orchestrated by Sam Zell and various entities under his control, pursuant to which the company had been taken private in late 2007 and saddled with approximately $8 billion of new debt (collectively, the "LBO-Related Causes of Action"). The Tribune debtors and other proponents of the DCL Plan crafted a plan of reorganization around the settlement of the LBO-Related Causes of Action for $369 million. Proponents of the Noteholder Plan, including Aurelius Capital Management, L.P. and other investors that had acquired substantial amounts of the pre-LBO debt at deep discounts after the Tribune bankruptcy cases were filed, believed the LBO-Related Causes of Action to be substantially more valuable if litigated. Ultimately, after substantial further motion practice and litigation, on July 23, 2012, Bankruptcy Judge Kevin J. Carey confirmed the DCL Plan, as amended, over the objection of Aurelius and indenture trustees for various issuances of pre-LBO bond debt that Aurelius and other like-minded investors had acquired (the "Trustees").

Appeals by Aurelius and the Trustees from the Bankruptcy Court's order confirming the DCL Plan followed. Initially, the U.S. District Court for the District of Delaware dismissed both appeals on equitable mootness grounds. *See In re Tribune Co.,* 2014 WL 2797042 (D. Del. June 18, 2014). Both appellants tried again with the Third Circuit Court of Appeals. The Third Circuit affirmed the dismissal of Aurelius' appeal, noting that Aurelius sought to overturn the settlement of the LBO-Related Causes of Action that were at the heart of the DCL Plan and had not availed itself of the opportunity to obtain a stay pending appeal (albeit one that was conditioned on Aurelius posting a $1.5 billion bond). *In re Tribune Media Co.,* 799 F.3d 272, 280-82 (3d Cir. 2015). The Trustees, however, fared better. The Third Circuit reversed the District Court's dismissal on equitable mootness grounds of the Trustee's appeal, which focused on an issue less central to the implementation of the admittedly already substantially consummated DCL Plan – the DCL Plan's failure to enforce an intercreditor subordination agreement that contended should guarantee that the Trustees (as holders of Class 1E claims under the DCL Plan) "will receive any recovery that goes to the holders of the PHONES and EGI Notes ahead of a class of trade and other creditors (Class 1F)." *Id.* at 282-84.

This was the posture of the case when the appeal was remanded back to Judge Sleet for further consideration consistent with the Third Circuit's opinion. *See In re Tribune Media Company*, 587 B.R. 606 (D. Del. 2018). In the event of a bankruptcy, the subordination agreement at issue stated that the subordinated creditors (referred to as the PHONES and EGI Notes and classified in Class 1F under the DCL Plan; hereafter the "Class 1F Creditors") would distribute any recoveries in a chapter 11 proceeding to the senior noteholders on behalf of which the Trustees were acting (the "Class 1E Creditors"). *Id.* at 610. The DCL Plan, however, called for a pro rata distribution that would result in the Class 1F Creditors represented by the Trustees sharing their recovery ratably with the Class 1F Creditors. *Id.* As a result, the Class 1E Creditors recovery was reduced from 35.9% to 33.6% (or approximately $31 million). *Id.* at 611.

The Trustees, on behalf of the Class 1E Creditors, pressed three appellate challenges to the Bankruptcy Court's confirmation of the DCL Plan: "(1) that the bankruptcy court erroneously refused to enforce the subordination agreements, in violation of 11 U.S.C. § 1129(b)(1); (2) even if the subordination agreements were not enforceable, the bankruptcy court erred in holding the plan does not "discriminate unfairly" against the Senior Notes; and (3) that the bankruptcy court erred in holding that a contract claim resulting from Tribune's termination of interest-rate hedges … was senior debt under the two subordination agreements." *Id.* at 612-13. The first and second of these issues occupied most of the District Court's attention in its remand opinion.

Judge Sleet first rejected the Trustee's contention that the failure to enforce the subordination agreement somehow violated section 1129(b)(1) of the Bankruptcy Code, explaining: "Section 1129(b)(1) of the Code … provides that the court 'shall confirm' a plan over the objection of an impaired dissenting class *'[n]otwithstanding* section 510(a).' 11 U.S.C. § 1129(b)(1)." *Id.* at 613 (emphasis in original). Essentially adopting the Bankruptcy Court's analysis of this issue, the District Court determined that the plain meaning of the word "notwithstanding" as used in section 1129(b)(1) left no doubt that the Bankruptcy Court was permitted "to confirm a plan over the objection of a dissenting class where 'the plan does not discriminate unfairly, and is fair and equitable,' even if the plan does not fully and completely enforce a subordination agreement." *Id.* at 614.

The District Court next turned to the unfair discrimination question. As to the issue, the Trustees argued that "the DCL Plan's violation of the Senior Noteholders' subordination rights amounted to unfair discrimination against them" because, among other alleged legal errors, "it refused to evaluate the difference in the DCL Plan's treatment of the two classes—Class 1E and Class 1F." *Id.* at 616. In approaching this question, Judge Sleet acknowledged that courts have traditionally applied a four-factor test established in *In re Ambanc La Mesa Limited Partnership*, 115 F.3d 650 (9th Cir. 1997), to determine whether a plan engages in unfair discrimination in violation of section 1129(b)(1) of the Bankruptcy Code. *Id.* at 617. However, because the Third Circuit has not yet endorsed a specific standard to apply when assessing unfair discrimination and because neither party had disputed the Bankruptcy Court's reliance on an alternative formulation of the standard for assessing unfair discrimination, the District Court used the rebuttable presumption test first proposed by Professor Bruce A. Markell in the AMERICAN BANKRUPTCY LAW JOURNAL. *Tribune*, 587 B.R. at 616-18.[1] Under the Markell test, a rebuttable presumption of unfair discrimination arises when there is:

> (1) a dissenting class; (2) another class of the same priority; and (3) a *difference in the plan's treatment of the two classes* that results in either (a) *a materially lower percentage recovery* for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

In re Dow Corning Corp., 244 B.R. 696, 702 (Bank. E.D. Mich. 1999). Thus, where there is an allegation of a materially lower percentage recovery based on unequal treatment, the presumption of discrimination can be rebutted by demonstrating that the dissenting class, outside of bankruptcy, would similarly receive less than the class receiving a greater recovery, or that the alleged preferred class infused new value into the reorganization which offset its gain. *Tribune* 587 B.R. at 617 (citing *Dow Corning*, 244 B.R. at 702).

In applying the rebuttable presumption test to the facts at hand, Judge Sleet found that the Class 1E Creditors as the dissenting class received, at most, only 2.3 percentage points lower than what they claimed they would be entitled to outside of bankruptcy. *Id.* at 617. Judge Sleet commented that "[w]hile the actual amount of money at issue is large, the percentage difference is not significant or material," and as such affirmed the Bankruptcy Court's confirmation order finding that no rebuttable presumption of unfair discrimination arose. *Id.* at 618.

Takeaway: The *Tribune* opinion is notable because it illustrates that what constitutes "unfair discrimination" under section 1129(b)(1) of the Bankruptcy remains, in many respects, broadly open to interpretation in the Third Circuit and other Circuits that have not opined definitively on this standard. Moreover, the decision has generated some decree of controversy because of the District Court's conclusion that a $30 million swing in creditor recoveries (even if only a few percentage points in the class's overall recovery) did not rise above a minor or immaterial difference for evaluating the presence of unfair discrimination.

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1 While Judge Sleet chose to use the rebuttable presumption test because the parties agreed the test to be applicable in the instant case, it should be noted that the "Third Circuit has yet to mandate application of the Markell test in determining whether a plan discriminates unfairly, and Markell's useful analysis is not exhaustive of the facts and circumstances that may rebut a presumption of unfair discrimination. *In re Nuverra Environmental Solutions, Inc.*, 590 B.R. 75, 93 (D. Del. 2018).

B. Accepting Impaired Class Requirement Held to Apply on a Per Plan, not Per Debtor, Basis: *JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Properties Inc. (In re Matter of Transwest Resort Properties, Inc.),* 881 F.3d 724 (9th Cir. 2018).

In what the Court described as a matter of first impression among all Circuit Courts of Appeal, a Ninth Circuit panel in *In re Matter of Transwest Resort Properties, Inc.* 881 F.3d 724 (9th Cir. 2018), addressed whether the requirement that at least one impaired class accept a cram down of a chapter 11 plan under 11 U.S.C. § 1129(a)(10) applies on a per plan or a per debtor basis.

In 2010, five Transwest related entities filed for chapter 11 relief and sought their cases to be jointly administered. *Transwest, 881 F.3d* at 726. The structure of the entities was as follows: Transwest Hilton Head Property LLC and Transwest Tucson Property LLC were the operating companies (the "Operating Debtors"); Transwest Hilton Head II LLC and Transwest Tucson II LLC were the mezzanine companies (the "Mezzanine Debtors"); and Transwest Resort Properties, Inc. was the holding company (the "Holding Company Debtor"). *Id.* JPMCC 2007-C1 Grasslawn Lodging (the "Lender") held a $298 million prepetition claim against the Operating Debtors, and later acquired a $39 million claim against the Mezzanine Debtors, ultimately making the Lender the sole creditor of the Mezzanine Debtors. *Id.* at 725.

Shortly after filing their petitions, the Debtors filed a joint chapter 11 plan (the "Plan"). *Id.* The Plan had several classes of impaired creditors other than the Lender that all voted to approve the Plan. *Id.* at 726. Opposing confirmation of the Plan, the Lender asserted, among other objections, that section 1129(a)(10) required that at least one impaired class accept the plan on a per debtor basis. *Id.* As the Lender did not accept the Plan and was the only impaired creditor for the Mezzanine Debtors, the Lenders argued that the Plan could not be crammed down. *Id.*

The *Transwest* court began its analysis by noting that section 1129(a)(10) states that a court may confirm a plan if certain requirements are met, and one such requirement is "[i]if a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." *Id*. at 729 (citing 11 U.S.C. § 1110(a)(10)). Based upon section 1129(a)(10) repeating "the plan," with no "distinction concerning or reference to the creditors of different debtors under 'the plan,'" the *Transwest* court reasoned that Congress clearly intended that plan approval from an impaired class perspective was to be based on a per plan basis. *Id.* Had Congress sought otherwise, it would have required plan approval for each debtor rather than just those listed under the plan. *Id.* As such, the *Transwest* court found the plain language supported the per plan approach. *Id.*

Next, the *Transwest* court looked to the statutory context of section 1129(a)(10). Section 102(7) of the Bankruptcy Code provides that when the Bankruptcy Code provides a term in the singular, that term includes the plural. *Id.* at 729-30. Utilizing this, the *Transwest* court reasoned that section 102(7) effectively lead section 1129(a)(10) to read: "at least one class of claims that is impaired under *the plans* has accepted *the plans*." *Id.* at 730 (emphasis added). As the definition mentions *the plans*, plural, the court found that section 102(7) supports the per plan approach. *Id.*

The Lender made two arguments in support of its argument for the per debtor approach. First, the Lender citied to the court in *In re Tribune Co.*, 464 B.R. 126, 182-83 (Bankr. D. Del. 2011), which had concluded that the 1129(a)(10) must apply on a per debtor basis because the other subsections applied on a per debtor basis. *Id.* at 730 (citing to *Tribune*, 464 B.R. at 182-83). The *Transwest* Court dismissed this argument, stating that that the *Tribune* ruling ignored the plain text of the subsection that indicates that it applies on a per debtor basis, and that the statute provides no other argument that it should be read as per debtor other than the fact that the *Tribune* case applied as such. *Id.*

Second, the Lender argued that the Plan, if made effective, is in effect substantive consolidation and therefore may produce bad policy results. *Id.* The *Transwest* court dismissed this argument as the Lender never objected to the Plan on this basis in the various stages of the case. *Id.* Furthermore, the *Transwest* court stated that "to the extent the Lender argues that the 'per plan' approach would result in a parade of horribles for mezzanine lenders, such hypothetical concerns are policy considerations best left for Congress to resolve" and that the proper role of the judiciary in statutory interpretation is to apply and not amend the work of Congress. *Id.* (citing *Henson v. Santander Consumer USA Inc.*, — U.S. —, 137 U.S. S. Ct. 1718, 1726, 198 L.Ed.2d 177 (2017)).

Takeway: This distinction of analyzing on a per plan basis has already begun to affect later filings, with parties attempting to place in certain joint administration orders language stating that in the event a plan proposes a cram down, it should be analyzed on a per debtor basis. Specifically, in *In re PG&E Corporation and Pacific Gas and Electric Company*, Case No. 19-30088 (DM) (N.D. Cal. 2019), an ad hoc group of institutional bondholders objected to the debtor's motion requesting joint administration of the chapter 11 cases. Citing specifically the *Transwest* opinion and the ad hoc committee's concerns with an application of the per plan analysis, the ad hoc group requested that the joint administration order include the following language: "This Order shall not, for purposes of confirmation of a chapter 11 plan, allow the plan proponent to satisfy the requirement of section 1129(a)(10) of title 11 of the United States Code with less than one impaired accepting class per debtor in a joint plan for more than one debtor." While the language did not end up being added to the joint administration order, it shows the strategy some creditors may take after the *Transwest* decision as they anticipate a cram down in the case.

C. Horizontal Gifting in Plan Endorsed as Not Violating Section 1129(b)(1) of the Bankruptcy Code: *In re Nuverra Environmental Solutions, Inc.*, 590 B.R. 75, 79 (D. Del. 2018).

This appeal arose from the Delaware Bankruptcy Court's confirmation of a plan of reorganization, pursuant to which secured creditors, who would not receive a full recovery under the plan, made a gift to general unsecured creditors, who would otherwise receive no distribution under the Bankruptcy Code's priority scheme. *Id.* at 79. Specifically, under the terms of the plan – and solely by virtue of the gift made to them by the senior secured creditors – trade creditors were receiving a 100% recovery. *Id.* at 79-80. At issue on appeal was whether the plan unfairly discriminated against a separately classified group of unsecured noteholders (collectively, the "Class A6 Claimants") whose class had not accepted the plan and who stood to receive distributions of cash and stock under the plan that amounted to only a 4-6% recovery on their claims. *Id.* at 79. Like the separately classified trade creditors, that the Class A6 Creditors were receiving any recovery at all was solely a function of gifted distributions from the senior secured creditors. *Id.* The Bankruptcy Court overruled the Class A6 Claimants' objections and confirmed the Plan, finding that the rebuttable presumption of unfair discrimination was rebutted because not only were the Class A6 Claimants out of the money and only receiving any distribution because of the gift from the secured creditors, but also because the Class A6 Claimants, unlike the trade creditors, were non-essential to the debtors' reorganization. *Id.* at 80-81. Certain of the Class A6 Claimants appealed.

In addressing the Class A6 Claimants' argument that the plan unfairly discriminated against them, the *Nuverra* Court, applying the Markell test (*see In re Tribune Co.*, 587 B.R. 606 (D. Del. 2018)), specifically focused on the Third Circuit's treatment of horizontal gifting versus vertical gifting. The Class A6 Claimants argued that "multiple appellate courts have held that a plan may not use gifting to circumvent § 1229(b)'s express provisions." *Nuverra*, 590 B.R. at 94. The debtors defended confirmation of the plan, arguing that there is a clear distinction between "vertical gifting" and horizontal gifting," with courts rejecting the former but allowing, in certain situations, the latter. *Id.* The District Court, per Judge Richard C. Andrews, agreed, affirming the Bankruptcy Court in all material respects. *Id.*

First, the Court looked to *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001), a case with nearly identical facts, and noted that the *Genesis* court held that disparate treatment of similarly situated classes was permitted by the secured creditors and was not deemed to unfairly discriminate. *Nuverra*, 590 B.R. at 93-94 (citing *Genesis*, 266 B.R. at 612).

Next, the *Nuverra* Court looked to a set of cases, *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005) ("*Armstrong I*"), *aff'd*, 432 F.3d 507 (3d Cir. 2005) ("*Armstrong II"*), which further addressed gifting among similar and different classes. *Nuverra*, 590 B.R. at 94. In *Armstrong II*, the Third Circuit concluded that vertical gifting, a "'give-up' situation[] where a senior class [gives] property to a class junior to the dissenting class," was not permissible because it violated the absolute priority rule under section 1129(b)(2)(B)(ii). *Armstrong II*, 432 F.3d at 513. The *Armstrong II* court, in discussing horizontal gifting, distinguished, but did not disapprove of, *Genesis*, and found that secured creditors could give up a portion of their lien for the benefit junior creditors without violation the Bankruptcy Code. *Id.* at 513-14. Therefore, the *Armstrong II* court "purposefully carved out *Genesis I's* horizontal gift ruling from its decision prohibiting vertical gifting in violation of the absolute priority rule." *Nuverra*, 509 B.R. at 94 (citing *Armstrong II*, 432 F.3d at 513).

Applying the *Armstrong II* court's carve out, the *Nuverra* Court found that horizontal gifting, in certain circumstances may be permissible. The District Court opined that "a horizontal gift is not unfair discrimination against the class that does not receive the larger gift when (i) the creditor that does not receive the larger gift is not entitled to a distribution under a plan, and (ii) no class junior to the creditor receives a distribution under the plan." *Id.* at 95. Using this as a guide, the *Nuverra* Court found the horizontal gifting of the secured creditors to the Trade Creditors and the Class A6 Creditors was permissible because (i) the Class A6

Creditors were not entitled to a distribution absent the gift of the secured creditors, and (ii) no class junior to the Class A6 Creditors received a distribution. *Id.* at 94-96.[2]

Takeaway: The *Nuverra* opinion is a welcome endorsement of gifting in the plan context from senior secured creditors to junior creditors. The opinion also reaffirms the important principle that separately classified creditors can be treated differently if a rational basis for doing so exists without running afoul of sections 1122 or 1129(b)(2) of the Bankruptcy Code. Although appropriate guardrails are necessary to ensure that the plan process is not perverted in a way that harkens back to 19th century railroad reorganizations, decisions such as this one reinforce that horizontal gifting in certain circumstances and provide a wholly appropriate and important tool for consensus building in chapter 11 cases.

D. Ninth Circuit "Dishes" on the Question of Vote Designation under Section 1126(e) of the Bankruptcy Code: *In re Fagerdala USA-Lompoc, Inc.),* 891 F.3d 848 (9th Cir. 2018).

In *Fagerdala,* a Ninth Circuit panel was asked to overturn a bankruptcy court's order disqualifying an oversecured lender's vote pursuant to section 1126(e) of the Bankruptcy Code, when the lender on a post-petition basis had acquired some (but not all) unsecured claims against the debtor and had used the acquired claims to block confirmation of the debtor's plan. The plan at issue, had it been confirmed, would have crammed-down the claim of the oversecured creditor resulting in extension of modification of the terms of the lender's mortgage without its consent. The effect of the lender's actions clearly prejudiced the holders of general unsecured claims that the lender had not acquired because, the bankruptcy court found, such unsecured creditors would not fare as well in a liquidation of the debtor.

On appeal, the Ninth Circuit reversed. In so ruling, it faulted the Bankruptcy Court's refusal to consider evidence of the oversecured lender's "motivations or determine whether [the lender] was seeking an 'untoward advantage over other creditors for some ulterior motive,' *i.e.,* 'to obtain some benefit to which [the lender] w[as] not entitled.'" *Fagerdala,* 891 F.3d at 857 (quoting *Figter Ltd. v. Teachers Ins. & Annuity Ass'n of Am. (In re Figter),* 118 F.3d 635, 638-39 (9th Cir. 1997)). The panel further opined that "[t]he bankruptcy court both by considering the effect on other creditors, without additional evidence of bad faith, and not making actual findings on [the lender's] motivations." *Id.*

Takeaway: At a superficial level, it is tempting to view this opinion as in conflict with *Dish Network Corp. v. DBSD N. Am. Inc. (In re DBSD N. Am. Inc.),* 634 F.3d 79 (2d Cir. 2011), given that the Ninth Circuit clearly appears to endorse the tactical acquisition of claims at least in certain circumstances to block confirmation of an unwanted plan. However, this case and *DBSD* are more accurately thought of examples of the application of the same principles underlying section 1126(e) vote designation in different contexts. Indeed, the Second Circuit in *DBSD*

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2 The *Nuverra* Court did note that the Class A6 Claimants cited one case that addressed horizontal gifting in favor of the Class A6 Claimants arguments, *In re Sentry Operating Co. of Texas,* 264 B.R. 850 (Bankr. S.D. Tex. 2001), but found that this case was nonbinding and factually distinguishable because trade claims were being paid in full and there was only a *de minimis* distribution to the other general unsecured creditors. *Nuverra*, 509 B.R. at 96.

recognized that "[m]erely purchasing claims in bankruptcy 'for the purpose of securing the approval or rejection of a plan does not of itself amount to bad faith.'" *Id.* at 102 (quoting *In re P-R Holding Corp.,* 147 F.2d 895, 897 (2d Cir. 1945)).

What differentiates this case from *DBSD* is the oversecured lender's evident **defensive** purpose in acquiring claims against the debtor. The Ninth Circuit in *Fagerdala* plainly did not seek claim purchase made for the purpose of protecting the lender's rights in connection with its pre-existing secured claim against the debtor as indicative of an improper "ulterior motive". Dish Network in *DBSD,* however, was just as evidently using the power of its purse to acquire claims against the debtors in that case to facilitate what would be in effect a hostile takeover made possible by blocking confirmation of the debtors' plan. Hence, the broad takeaway here (in what is no doubt a gross oversimplification) is that: *defensive* claim acquisitions to block confirmation of an unwanted plan in furtherance of protecting a creditor's existing claim are generally just fine, whereas, *offensive* claim acquisitions of the ilk on display in *DBSD* are generally going to be viewed as bad behavior and predicate acts for, among other things, vote designation under section 1126(e) of the Bankruptcy Code.