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Bankruptcy 2022: Views from the Bench

Confirmation: Challenges of Today

Alexa J. Kranzley, Moderator

Sullivan & Cromwell LLP | New York

Hon. Ashely M. Chan

U.S. Bankruptcy Court (E.D. Pa.) | Philadelphia

Jay M. Goffman

Teneo

Hon. Michael B. Kaplan

U.S. Bankruptcy Court (D. N.J.) | Newark

Hon. Sean H. Lane

U.S. Bankruptcy Court (S.D.N.Y.) | New York

Hon. Karen B. Owens

U.S. Bankruptcy Court (D. Del.) | Wilmington

BANKRUPTCY VIEWS FROM THE BENCH

HOGAN LOVELLS US LLP
WASHINGTON, DC

SEPTEMBER 23, 2022



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CONFIRMATION ROUNDTABLE

Panelists

Hon. Michael B. Kaplan

U.S. Bankruptcy Court (D.N.J.)

Hon. Karen B. Owens

U.S. Bankruptcy Court (D. Del.)

Hon. Sean Lane

U.S. Bankruptcy Court (S.D.N.Y.)

Hon. Ashely M. Chan

U.S. Bankruptcy Court (E.D. Pa.)

Moderator

Alexa Kranzley

Sullivan & Cromwell LLP



TOPICS

I. Allowance of Unmatured Interest

II. Make-Whole Provisions

III. Private Sponsor and D&O Liability



Allowance of Unmatured Interest

1. Solvent Debtor Exception

- *Hertz; Ultra Petroleum; PG&E*

2. Which Interest Rate Applies?

- *Energy Future Holdings; Ultra Petroleum; Hertz;
PG&E*

3. Determining Impairment

- *PPI Enterprises; Ultra Petroleum; Hertz*

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Allowance of Unmatured Interest: Solvent Debtor Exception

- **Questions:** What is the source of the Solvent Debtor Exception? Which types of creditors are entitled to post-petition interest under the Solvent Debtor Exception and based on what authority?
 - Courts acknowledge that the solvent debtor exception was integrated in English and American case law even before the Bankruptcy Code was enacted.
 - Courts often cite the 1994 deletion of subsection (c) from § 1124(1) which previously stated that a creditor was unimpaired if they received payment of principal and prepetition interest but not postpetition interest.
- **Relevant case law:** *Hertz*; *Ultra Petroleum*; *PG&E*
 - *Ultra Petroleum*: the solvent debtor exception exists in via § 1124(1), 105(a), 1128(a)(7), and 1129(b)(1)
 - *Hertz*: cited § 506(b) with respect to oversecured creditors; cited §§ 1129(a)(7), 726(a)(5) with respect to unsecured creditors
 - *PG&E* (on remand): § 502(b)(2) does not prohibit unsecured creditors from receiving post-petition interest

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Allowance of Unmatured Interest: Which Interest Rate Applies?

- **Questions:** What is the “legal rate” provided for in § 765(b) of the Code? What interest rates should apply under § 1124? What amount of interest are different types of creditors entitled to?
 - Courts disagree on whether the “legal rate” is the contract default rate, the federal judgment rate, or any default rate under applicable state law. As yet, there is no clear consensus on what interest rate applies when post-petition interest is permitted outside of § 765(b).
- **Relevant case law:** *Energy Future Holdings*; *Hertz*; *Ultra Petroleum*; *PG&E*
 - *Energy Future Holdings*: unsecured creditors are entitled to post-petition interest “at the contract rate or such other rate as the Court deems appropriate.”
 - *Ultra Petroleum*: creditors entitled to post-petition interest at either the contract rate or the state default rate.
 - *Hertz*: unimpaired creditors are entitled to post-petition interest at the federal judgment rate.
 - *PG&E* (on remand): unimpaired creditors are entitled to post-petition interest at the contract rate or the state’s default rate.



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Allowance of Unmatured Interest: Determining Impairment

- **Questions:** Does entitlement to post-petition interest decide a creditor's status as impaired or unimpaired? Should impairment based on post-petition interest be determined based on § 1124 or § 1141(d)?
- **Relevant case law:** *PPI Enterprises*; *Ultra Petroleum*; *PG&E*
 - *PPI Enterprises*: the relevant inquiry is whether the plan itself is a source of limitation of the creditor's rights. If the creditor's rights are altered or capped because of statutory authority, the creditor is not impaired.
 - *Ultra Petroleum*: the issue is one of discharge rather than allowance and should thus be considered under § 1141(d) rather than § 1124.
 - *PG&E*: the 9th Cir. dissent argued that the question of impairment in light of post-petition interest is circular, i.e., a creditor's impairment status depends on whether and how much post-petition interest they are entitled to, but the allowance and amount of post-petition interest depends on the creditor's impairment status.



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Make-Whole Provisions

1. Enforceability of Make-Whole Provisions

- *Ultra Petroleum*; *Energy Future Holdings*; *Momentive*

2. Are Make-Whole Provisions Really Just Claims for Unmatured Interest?

- *Ultra Petroleum*; *Hertz*; *Momentive*



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Make-Whole Provisions: Enforceability of Make-Whole Provisions

- **Questions:** Should make-whole provisions be enforceable in chapter 11? Is there a difference between "prepayment" and "redemption"? What is the applicable maturity date?
- **Relevant case law:** *Energy Future Holdings*; *Momentive*; *Hertz*
 - *Energy Future Holdings*: "redemption" includes repayments before and after maturity. A voluntary chapter 11 filing and repayment (rather than reinstatement) constituted optional repayment.
 - *Momentive*: contractual acceleration of debt upon filing a chapter 11 petition automatically changed the maturity date to the petition date, thus payments under a plan were not prepayments. There is no distinction between "prepayment" and "redemption" for make-whole purposes.
 - *Hertz*: voluntary chapter 11 filing and plan distribution constates "voluntary prepayment," but where "maturity" was undefined, the relevant date was the petition date, and post-filing redemption did not trigger the premium.



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Make-Whole Provisions: Just Unmatured Interest?

- **Questions:** Are make-whole claims really just claims for unmatured interest, or are make-whole provisions more similar to liquidated damages clauses? How important is the specific language of a make-whole premium?
 - Generally, courts agree that the filing of a chapter 11 petition accelerates a debt's maturity date to that of the petition date. Courts, however, disagree with respect to whether payments after the petition date, but before a debt's original maturity date, constitute prepayment.
- **Relevant case law:** *Ultra Petroleum*; *Hertz*
 - *Ultra Petroleum*: the "economic realities" result in a make-whole premium effectively functioning as a claim for impermissible unmatured interest
 - *Hertz*: courts should determine on a case-by-case basis whether a make-whole is the "economic equivalent of unmatured interest"



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Private Sponsor and D&O Liability

1. **D&O Liability: Fiduciary Duties Approaching Insolvency**
 - Toys 'R' Us
2. **Private Sponsor Liability**
 - Toys 'R' Us; ASHINC
3. **Hypothetical Discussion**



BANKRUPTCY VIEWS FROM THE BENCH

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D&O Liability: Fiduciary Duties Approaching Insolvency

- **Questions:** Is it possible for courts to implement a bright-line rule specifying when D&Os must begin considering creditor constituencies in their business judgment decisions? What factors go into evaluating D&Os' prepetition valuation of a company? Do D&Os of private versus public companies have different fiduciary considerations?
 - Public companies must comply with heightened disclosure requirements, thus the public (and creditors) have access to additional financial information which they can use to perform their own valuations even before a company files for chapter 11.
 - The "zone of insolvency" is no longer an applicable concept in bankruptcy law.
- **Relevant case law:** *Toys 'R' Us* (ongoing litigation)
 - *Toys 'R' Us*: the company's D&Os breached their fiduciary duties in authorizing DIP financing that would include up to \$2.8 M in bonus payments for various D&Os and other management personnel despite knowing the Company was insolvent and there was an imminent threat of necessary liquidation. Questions with respect to sponsor liability and valuation (among others) are currently pending before the court.



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Private Sponsor and D&O Liability

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 - *Toys 'R' Us*
2. **Private Sponsor Liability**
 - *Toys 'R' Us*; *ASHINC*
3. **Hypothetical Discussion**



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Sponsor Liability: Private Equity Sponsor Liability

- **Questions:** Where is the line between a sponsor acting in its own best interests versus acting at the expense of a debtor? At what point must a sponsor's considerations shift towards fiduciary duties owed to a debtor? How might these considerations differ where the sponsor files an involuntary chapter 11 petition against its sponsoree? What about where the sponsor is not a private equity company?
 - Courts have previously held private equity shareholders, who later act as a debtor's sponsor, liable for actions taken with a distressed company. Liability may include continuous breach, fraudulent transfer, and potentially breach of fiduciary duties.
- **Relevant case law:** *ASHINC* (ongoing)
 - *ASHINC*: sponsor was liable on theory of continuous breach beginning when it first failed to make a payment required under one of its loan agreements. Sponsor was also liable on the theory of fraudulent transfer based on its requirement that the debtor pay certain of its fees. The question of breach of fiduciary duty liability is currently still pending before the court.



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Private Sponsor and D&O Liability: Hypothetical Discussion

Investor A, a private equity firm, was the largest shareholder of Corporation, a public company, and had two seats on Corporation's board of nine. Just before the COVID pandemic, Corporation took out a loan from Bank. During the pandemic, Corporation defaulted on the loan but Bank agreed not to enforce its default rights. When business resumed and Corporation filed its 10-Q, Investor B saw that Bank's agreement not to enforce its rights was close to expiring and did not think Corporation would be able to make its loan payments, so Investor B offered to acquire Corporation at a premium and bring the company private. At Corporation's board meeting, Investor A's two directors stated they—and Investor A—did not think Investor B's proposal was adequate. After a month of negotiations, Investor B submitted a final offer, which did not assure retaining Corporation's executives post-acquisition. The Investor A directors strongly advised against accepting and told the board Investor A had started putting out feelers and was preparing a proposal for Corporation that would include funding for a marketing process and advisory services to find public company buyer who would be willing to acquire Corporation on more favorable terms. Corporation let Investor B's offer expire and entered into an agreement with Investor A whereby Investor A would provide funding (solely for marketing and sale-related activities, not for operations) and advisory services to Corporation in connection with the marketing and potential sale of Corporation. After a few months, Investor A was still unable to find any legitimate potential buyers, and Bank filed an involuntary chapter 11 petition against Corporation.



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Thank you

**AMERICAN BANKRUPTCY INSTITUTE
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September 23, 2022**

BACKGROUND MATERIALS

INDEX

CASES

1. *In re Energy Future Holdings Corp.*, 527 B.R. 178 (Bankr. D. Del. 2015)
2. *In re Energy Future Holdings Corp.*, 842 F.3d 247 (2016)
3. *In re Hertz Corp.*, 637 B.R. 781 (2021)
4. *In re PPI Ent. (U.S.), Inc.*, 324 F.3d 197 (2003)
5. *In re Ultra Petroleum Corp.*, 575 B.R. 361 (2017) (Ultra I)
6. *In re Ultra Petroleum Corp.*, 943 F.3d 758 (2019) (Ultra II)
7. *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002)
8. *In re PG&E Corp.*, No. 21-16043, 2022 WL 3712478 (9th Cir. Aug. 29, 2022)
9. *In re AMR Corp.*, 730 F.3d 88 (2d Cir. 2013)
10. *Matter of MPM Silicones, L.L.C.*, 874 F.3d 787 (2017)
11. *In re ASHINC Corp.*, 629 B.R. 154 (2021)
12. *In re ASHINC Corp.*, 2022 WL 2666888 (District Court)
13. *TRU Creditor Litig. Tr. v. Brandon*, No. 3:20CV311 (DJN), 2022 WL 1494718, (E.D. Va. May 11, 2022)
14. *Westchester Fire Ins. Co. v. Schorsch*, 186 A.D.3d 132 (2020)



KeyCite Red Flag - Severe Negative Treatment
Reversed and Remanded by [In re Energy Future Holdings Corp.](#), 3rd Cir. (Del.), November 17, 2016

527 B.R. 178

United States Bankruptcy Court, D. Delaware.

IN RE ENERGY FUTURE

HOLDINGS CORP., et al., Debtors.

Delaware Trust Company as Indenture Trustee, Plaintiff,

v.

[Energy Future Intermediate Holding Company](#)

[LLC](#) and [EFIH Finance Inc.](#), Defendants.

Bankruptcy Case No. 14-10979

(CSS) (Jointly Administered)

|

Adversary Proceeding No. 14-50363 (CSS)

|

Signed March 26, 2015

Synopsis

Background: Indenture trustee objected to motion by debtor for leave to obtain debtor-in-possession financing to pay off notes that had been accelerated upon its bankruptcy filing, on ground that noteholders were entitled to prepayment premium.

Holdings: The Bankruptcy Court, [Sontchi](#), J., held that:

[1] trust indenture did not require payment of applicable prepayment premium upon satisfaction of notes that had been accelerated due to the issuer's bankruptcy filing;

[2] that debtors, prior to filing for bankruptcy, may have planned to use automatic default created by their bankruptcy filing, and the automatic acceleration of their notes, to avoid paying prepayment premium to noteholders was insufficient to raise genuine issue of material fact as to whether debtors had intentionally created event of default solely for purpose of avoiding payment of prepayment penalty;

[3] rescission notice that indenture trustee attempted to send was in nature of attempt to “collect, assess or recover” on a claim, and was void ab initio as violative of automatic stay;

[4] genuine issue of material fact as to whether indenture trustee could establish cause to retroactively lift automatic stay nunc pro tunc to allow trustee to waive automatic default and to decelerate notes precluded entry of summary judgment in dispute regarding noteholders' right to contractual prepayment premium

[5] New York “perfect tender” rule did not apply; and

[6] trustee had no claim for damages for denial of this purported right to rescind.

So ordered.

West Headnotes (25)

[1] [Contracts](#) 🔑 [Language of contract](#)

Under New York law, court need not look outside the four corners of a complete contract to determine what the parties intended.

[2] [Contracts](#) 🔑 [Existence of ambiguity](#)

Under New York law, contract is not ambiguous merely because the parties offer different constructions of same term.

[3] [Contracts](#) 🔑 [Language of contract](#)

Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

[4] [Contracts](#) 🔑 [Conflicting clauses in general](#)

Under New York law, should there be any inconsistency between specific and general provision of contract, the specific controls.

[1 Cases that cite this headnote](#)

[5] [Contracts](#) 🔑 [Construction to give validity and effect to contract](#)

Under New York law, court's reading of contract should not render any portion meaningless.

[6] Corporations and Business

Organizations ➡ [Construction, operation, and effect in general](#)

Under New York law, trust indenture did not require payment of applicable prepayment premium upon satisfaction of notes that had been accelerated due to the issuer's bankruptcy filing, where trust indenture, by its plain terms, required payment of prepayment penalty only upon optional redemption of notes prior to maturity, and further specified that notes would be accelerated automatically in event that issuer filed for bankruptcy with no indication that such acceleration would trigger issuer's obligation for prepayment penalty.

[4 Cases that cite this headnote](#)

[7] Corporations and Business

Organizations ➡ [Construction, operation, and effect in general](#)

Under New York law, trust indenture must contain express language requiring the payment of prepayment premium upon acceleration; otherwise, it is not owed.

[4 Cases that cite this headnote](#)

[8] Contracts ➡ [Rewriting, remaking, or revising contract](#)

Under New York law, courts will not read into agreements between sophisticated parties provisions that are not there.

[1 Cases that cite this headnote](#)

[9] Contracts ➡ [General and specific words and clauses](#)

Under New York law, specific provision in contract governs the circumstance to which it is directed, even in the face of a more general provision.

[10] Commercial Paper ➡ [Charges, premiums, and penalties](#)

Under New York law, borrower's repayment after acceleration is not considered voluntary, and will not trigger borrower's obligation for prepayment penalty under contract requiring payment of such a penalty upon voluntary repayment of loan prior to maturity.

[11] Commercial Paper ➡ [Acceleration](#)

Under New York law, acceleration of note moves maturity date from the original maturity date to the acceleration date, and that date becomes the new maturity date.

[1 Cases that cite this headnote](#)

[12] Commercial Paper ➡ [Charges, premiums, and penalties](#)

Under New York law, prepayment of note, of kind triggering borrower's obligation for prepayment penalty, can only occur prior to the maturity date, and acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity.

[2 Cases that cite this headnote](#)

[13] Bankruptcy ➡ [Judgment or Order](#)

That debtors, prior to filing for bankruptcy, may have planned to use the automatic default created by their bankruptcy filing, and the automatic acceleration of their notes, to avoid paying prepayment premium to noteholders was insufficient, in light of financial difficulties that debtors were facing and their obvious liquidity crisis, to raise genuine issue of material fact as to whether debtors had intentionally created event of default by filing for bankruptcy solely for purpose of avoiding payment of prepayment penalty, and did not foreclose entry of summary judgment for debtors on whether they became obligated for prepayment penalty due to their alleged bad faith in filing for bankruptcy, especially where trust indenture did not contain

a clause providing that premium would be owed if debtors intentionally caused event of default to avoid paying prepayment premium.

and was void ab initio as violative of automatic stay.  11 U.S.C.A. § 362(a).

[2 Cases that cite this headnote](#)

- [14] **Bankruptcy**  [Notice to creditors; commencement](#)

Corporations and Business

Organizations  [Construction, operation, and effect in general](#)

Limitation on indenture trustee's ability to waive automatic default and to rescind automatic acceleration of notes occurring if notes' issuer filed for bankruptcy, due to language in trust indenture that precluded trustee from exercising such rights if it would conflict with "any judgment of a court of competent jurisdiction," was not triggered by automatic stay that arose as of commencement of bankruptcy case; stay was not itself an "order of court," within meaning of this language in trust indenture, but arose automatically pursuant to statute.  11 U.S.C.A. § 362(a).

[1 Cases that cite this headnote](#)

- [15] **Bankruptcy**  [Notice to creditors; commencement](#)

Automatic stay arises pursuant to statute, and applies in every bankruptcy case automatically without any court order.  11 U.S.C.A. § 362(a).

[1 Cases that cite this headnote](#)

- [16] **Bankruptcy**  [Mortgages or Liens](#)
Bankruptcy  [Validity of acts in violation of injunction or stay](#)

Rescission notice that indenture trustee attempted to send following commencement of bankruptcy case by corporation that had issued \$2.18 billion in first lien notes, in attempt to rescind automatic acceleration that occurred because corporation's bankruptcy filing was event of default, and to preserve noteholders' right to prepayment premium, was in nature of attempt to "collect, assess or recover" on a claim,

- [17] **Bankruptcy**  [Judgment or Order](#)

Genuine issue of material fact as to whether indenture trustee could establish cause to retroactively lift the automatic stay nunc pro tunc to allow trustee to waive automatic default resulting when issuer of notes filed for bankruptcy and to decelerate notes precluded entry of summary judgment in dispute regarding noteholders' right to contractual prepayment premium based on issuer's payment of notes, with proceeds of debtor-in-possession financing, prior to their originally specified maturity date.

- [18] **Bankruptcy**  [Cause; Grounds and Objections](#)

Whether "cause" exists for relief from automatic stay must be determined based on totality of the circumstances in each particular case.  11 U.S.C.A. § 362(d)(1).

- [19] **Bankruptcy**  [Cause; Grounds and Objections](#)

Bankruptcy  [Balancing hardships](#)

Factors that bankruptcy courts consider in determining whether "cause" exists to lift stay are (1) whether any great prejudice to either the bankruptcy estate or debtor will result from lifting of stay, (2) whether hardship to movant from maintenance of stay considerably outweighs hardship to debtor, and (3) probability of movant prevailing on the merits.  11 U.S.C.A. § 362(d)(1).

- [20] **Bankruptcy**  [Cause; Grounds and Objections](#)

While debtor's solvency may, in certain cases, be relevant consideration for court in determining whether "cause" exists to lift automatic stay, it

is not the sole factor to be considered by court.

 [11 U.S.C.A. § 362\(d\)\(1\)](#).

[1 Cases that cite this headnote](#)

- [21] [Corporations and Business Organizations](#)  [Construction, operation, and effect in general](#)

Provision in trust indenture, requiring payment of prepayment premium if notes were redeemed prior to their maturity date, applied only to optional redemptions of notes whose maturity date had not automatically been accelerated due to event of default occurring on the issuer's bankruptcy filing, and was not in nature of no-call provision.

[3 Cases that cite this headnote](#)

- [22] [Commercial Paper](#)  [Prepayment](#)

Under New York's "perfect tender" rule, borrower has no right to pay off his obligation prior to its stated maturity date, in the absence of prepayment clause.

- [23] [Corporations and Business Organizations](#)  [Construction, operation, and effect in general](#)

New York "perfect tender" rule, pursuant to which borrower generally has no right to pay off his obligation prior to its stated maturity date, was inapplicable where trust indenture modified this common law rule by providing that notes were automatically accelerated and payable in full in event that issuer filed for bankruptcy relief.

- [24] [Bankruptcy](#)  [Claims allowable; what constitutes "claim."](#)
[Corporations and Business Organizations](#)  [Construction, operation, and effect in general](#)

While, pursuant to terms of trust indenture, trustee could waive automatic default occurring upon filing of bankruptcy petition by issuer of

notes and rescind any acceleration of notes, in order to preserve noteholders' right to prepayment premium, trustee had no claim for damages for denial of this purported right to rescind solely as result of operation of automatic stay, especially where trust indenture did not provide for any fee, cost, or charge for breach of purported right to rescind.  [11 U.S.C.A. §§ 362\(a\)](#),  [506\(b\)](#).

- [25] [Bankruptcy](#)  [Secured Claims](#)

Secured claims are not allowed for breach of contract damages, unless those damages are specifically provided for in contract.

Attorneys and Law Firms

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FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING CROSS- MOTIONS FOR SUMMARY JUDGMENT¹

[Sontchi](#), J.

I. INTRODUCTION & PROCEDURAL HISTORY²

1. This adversary proceeding relates to a series of 10% First Lien Notes issued by Energy Future Intermediate Holding Company LLC and EFIH Finance Inc., with original maturity of 2020, pursuant to an Indenture dated August 17, 2010. The original indenture was supplemented as of January 29, 2013.

2. On April 29, 2014, the EFIH Debtors filed petitions for relief under chapter 11 of the Bankruptcy Code. The EFIH Debtors sought approval of debtor-in-possession financing, in part, to repay all of the outstanding Notes and settle certain Noteholders' claims (the "*DIP Motion*"). (No. 14-10979, D.I. 74, 858, 859.) The non-settling Noteholders are represented by the Trustee, the Plaintiff in this adversary proceeding.

3. On May 13, 2014, the Trustee objected to the DIP Motion, arguing that the Noteholders were entitled to a secured claim for an amount described in the Indenture as the “Applicable Premium” because: (i) an Optional Redemption would occur when the Notes were repaid; (ii) the EFIH Debtors intentionally defaulted by filing bankruptcy to avoid paying the Applicable Premium, and (iii) the repayment would be a breach of the Noteholders’ purported right to rescind the Notes’ acceleration. (No. 14–10979, D.I. 421.)

4. On May 15, 2014, the Trustee initiated this adversary proceeding. (No. 14–10979, D.I. 470; No. 14–50363, D.I. 1.) The Complaint contained the claims from the May 13 objection, plus (a) an unsecured claim for breach of a purported “no-call” covenant in the Indenture; and (b) three unsecured claims, one for each of the three counts raised in its May 13 objection. (Compl. ¶ 76.) The Trustee also simultaneously filed a motion seeking a declaration that it could decelerate the Notes without violating the automatic stay. (No. 14–10979, D.I. 473 (“*Stay–Applicability Motion*”).) On June 4, 2014, the Trustee sent a purported notice of deceleration to the EFIH Debtors.

5. On June 6, 2014, the Court approved the DIP financing, the EFIH Debtors’ use of the DIP financing to pay the outstanding EFIH First Lien Noteholders, and the settlement resolving certain Noteholders’ claims for the Applicable Premium. (No. 14–10979, D.I. 858 (Order Approving EFIH First Lien Settlement), ³ 859 (Order approving use of DIP financing).) The Noteholders who chose not to accept the settlement are pursuing claims for an *183 Applicable Premium in this adversary proceeding. (No. 14–50363, D.I.9, 10.) These Noteholders have been paid their full principal and accrued interest using DIP financing, which was funded on June 19, 2014.

6. On September 12, 2014, the Court bifurcated this adversary proceeding. (D.I.128) ⁴ This is Phase One of the litigation in which the Court will determine (1) whether EFIH is “liable under applicable non-bankruptcy law for ... a Redemption Claim,” including the “make-whole” or other “damages ... under any ‘no-call’ covenant, ‘right to de-accelerate,’ ” or applicable law, and (2) “whether the Debtors intentionally defaulted in order to avoid paying an alleged make-whole premium or other damages.” (Id. at 2–3.) Except with respect to the Trustee’s claim that EFIH intentionally defaulted to evade payment of the make-whole, “the Court will assume solely for the purposes of Phase One that the EFIH Debtors

are solvent and able to pay all allowed claims of their creditors in full.” (*Id.*) If the Court finds EFIH liable for a Redemption Claim, and if EFIH contests that it is, in fact, solvent, Phase Two will determine “(a) whether the EFIH Debtors are insolvent, and, if so, whether that insolvency gives rise to any defenses arising under the Bankruptcy Code in favor of the EFIH Debtors that bar or limit the amount of the Redemption Claim, and (b) the dollar amount of ... any Redemption Claim.” (*Id.*)

7. The parties conducted full discovery on the Phase One issues, including the production of documents, multiple fact witness depositions, production of expert reports, and multiple expert witness depositions. Thereafter, the EFIH Debtors and the Trustee submitted cross-motions for summary judgment, seeking to resolve all of the claims raised in the contested matter, the adversary complaint, and the Stay–Applicability Motion. (D.I.175, 176, 178, 179.)

8. As set forth below, the Court will grant, in part, and deny, in part, the EFIH Debtors’ motion for summary judgment, and deny in its entirety the Trustee’s motion for summary judgment. More specifically, the Court holds as follows:

- a. The plain language of the Indenture does not require payment of an Applicable Premium upon a repayment of the Notes, following an acceleration under section 6.02 of the Indenture, arising from a default for the commencement of “proceeding to be adjudicated bankrupt or insolvent” under section 6.01(a)(6)(i) of the Indenture.
- b. The EFIH Debtors’ filing of bankruptcy, which gave rise to the default at issue, was not an intentional default under the Indenture.
- c. The Trustee’s right under Section 6.02 of the Indenture to waive the automatic default arising from the EFIH Debtors’ bankruptcy filing and rescind the acceleration of the Notes is not barred by the language in the Indenture extinguishing that right if rescission would “conflict with any judgment of a court of competent jurisdiction” because the automatic stay under  [section 362 of the Bankruptcy Code](#) is not a “judgment of a court.”
- d. The Trustee’s attempt to waive the default and decelerate the Notes by sending notice of same on June 4, 2014,

was barred by the automatic *184 stay under  [section 362\(a\)\(3\) and \(6\) of the Bankruptcy Code](#).

- e. If the Court were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium (also referred to as Redemption Claim) would be due and owing to the non-settling Noteholders.
- f. A genuine issue of material fact exists that requires a trial on the merits as to whether the Trustee can establish cause to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes.
- g. The Trustee has no claim for (i) breach of the “no-call” provision of section 3.07(c) of the Indenture; (ii) violation of the “perfect tender” rule under New York law; nor (iii) breach of the right to waive the default and decelerate the Notes.

II. FINDINGS OF FACT

9. The parties' cross-motions for summary judgment implicate various provisions in the Indenture dated August 17, 2010 governing the EFIH 10.000% Senior Secured Notes Due 2020 (“*Indenture*”). (March 2, 2015 Romanowicz Am. Decl. in Support of Defs.' Mot. for SJ (D.I. 197) (“*Romanowicz Am. Decl.*”), Ex. 1) (execution version of Indenture.) That Indenture was supplemented, as of January 29, 2013, but the parties agree that the provisions of that supplement are not relevant here. Additionally, EFIH issued certain 6.875% Senior Secured Notes Due 2012, pursuant to a separate 2012 indenture. That 2012 indenture is substantially identical in all relevant aspects to the Indenture.

A. The Parties

10. Plaintiff is the indenture trustee (the “*Trustee*” or “*Indenture Trustee*”) for the 10.000% Senior Secured Notes due 2020 (“*Notes*”), representing Noteholders who did not accept a settlement offer in connection with the repayment of the Notes at the outset of these chapter 11 cases. (See No. 14–10979, D.I. 74.) Defendants are Energy Future Intermediate Holding Company, LLC and EFIH Finance, Inc. (collectively “*EFIH*,” the “*EFIH Debtors*,” or “*Defendants*”).

11. In addition, the following parties are intervenors in this adversary proceeding: UMB, N.A., as indenture trustee for certain senior unsecured notes issued by EFIH (D.I. 13); Fidelity Management & Research Company (D.I. 14); the ad hoc committee of holders of certain unsecured EFIH toggle notes (D.I. 15); Pacific Investment Management Company LLC, investment manager for certain holders of the Notes (D.I. 16); Computershare Trust Company, N.A., and Computershare Trust Company of Canada, the indenture trustee for certain EFIH senior secured second lien notes (D.I. 19); the ad hoc group of holders of the so-called “Legacy Notes” issued by EFH Corp. (D.I. 18); the Official Committee of Unsecured Creditors of EFH Corp. and EFIH (D.I. 207); and the Official Committee of Unsecured Creditors of Energy Future Competitive Holdings Company LLC, Texas Competitive Electric Holdings Company LLC and their direct and indirect subsidiaries, and EFH Corporate Services Company (D.I. 227).

B. Negotiation of the EFIH Notes

12. In the summer of 2010, EFIH negotiated and ultimately executed a debt *185 exchange that involved the issuance of \$2.18 billion of Notes. EFIH and the so-called “Dealer Manager” investment banks, who represented the interests of the lenders who would be accepting the new Notes, were the principal negotiators of the offering and execution documents, including the governing Indenture that is at the center of the parties' cross-motions for summary judgment. (Moldovan Tr. 40:22–41:20, 47:17–21.)⁵ The Indenture Trustee for the Notes was involved in this process as well; the lead negotiating parties sent the Trustee (and its counsel) drafts of key issuing documents, such as the description of the Notes and the actual global note certificate representing the 10% Note, and solicited (and accepted many of) the Trustee's proposed changes. (Moldovan Tr. 41:16–20; March 2, 2015 Madron Decl. in Support of Defs.' Memo. in Opposition to Pl.'s Mot. for SJ (D.I. 205) (“*Madron Decl.*”), Exs. 19–21 (email communications transmitting draft documents to Indenture Trustee).)

13. Many terms and conditions of the Indenture were modeled on other indentures governing previous debt issuances by EFIH and EFH Corp. in 2009 and 2007, respectively. (Moldovan Tr. 143:11–20.) Like the Indenture, these previous agreements included an “Optional Redemption” provision providing for the payment of an “Applicable Premium” under certain circumstances upon an early, voluntary repayment of the Notes. (Indenture § 3.07.) Such “call protections” are

common features in the indentures governing the type of high-yield debt issued by the EFH corporate family.

C. The August 2010 EFIH Debt Exchange

14. The “August 2010 Exchange” called for exchanging outstanding 11.250%/12.000% Senior Toggle Notes due 2017 and 10.875% Senior Notes due 2017 issued by EFH Corp. in 2007 and guaranteed by EFIH (the “Old Notes”) for up to \$2.18 billion aggregate principal amount of Notes, as well as an aggregate of \$500 million in cash. (Press Release (July 30, 2010), <http://www.sec.gov/Archives/edgar/data/1023291/000119312510171555/dex992.htm>.) The EFIH Debtors also announced plans to amend the indenture governing any Old Notes that would remain outstanding after the August 2010 Exchange was executed. These amendments called for eliminating substantially all of the restrictive covenants contained in the existing indenture and the Old Notes, eliminating certain events of default, and modifying covenants regarding mergers and consolidations, in addition to other changes. (*Id.*) 99.51% of the Old Notes agreed to participate in the exchange, and the requisite number of holders also agreed to the proposed amendments. (*Id.*)

15. Therefore, the EFIH Debtors issued the new EFIH Notes pursuant to the Indenture dated August 17, 2010 between EFIH and the Bank of New York Mellon Trust Company, N.A., as trustee. (Press Release (August 18, 2010), <http://www.sec.gov/Archives/edgar/data/1023291/000119312510191917/d8k.htm>.) The Indenture is governed by New York Law. (Indenture § 13.08.) Plaintiff later succeeded Bank of New York Mellon Trust Company, N.A., as the indenture trustee.

D. Key Provisions of the Notes Indenture

16. These cross motions for summary judgment call for the Court to interpret the meaning of the Indenture, including section 3.07 (“*Optional Redemption*”), section *186 6.01 (“*Events of Default*”), section 6.02 (“*Acceleration*”), and the definition of “Applicable Premium” in section 1.01 (“*Definitions*”). Each is discussed below:

17. In section 3.07, the Indenture specifies what constitutes an Optional Redemption. Section 3.07(a) states:

At any time prior to December 1, 2015, the Issuer may redeem all or a part of the Notes at a redemption price equal

to 100% of the principal amount of the Notes redeemed *plus* the Applicable Premium as of, and accrued and unpaid interest to, the date of redemption (the “Redemption Date”)....

(Indenture § 3.07(a).)

18. The Applicable Premium referenced in section 3.07(a) is defined in section 1.01:

“Applicable Premium” means, with respect to any Note on any Redemption Date, the greater of: (1) 1.0% of the principal amount of such Note; and (2) the excess, if any, of (a) the present value at such Redemption Date of (i) the redemption price of such Note at December 1, 2015 (such redemption price as set forth in the table appearing under Section 3.07(d) hereof), plus (ii) all required interest payments due on such Note through December 1, 2015 (excluding accrued but unpaid interest to the Redemption Date), computed using a discount rate equal to the Treasury Rate as of such Redemption Date plus 50 basis points; over (b) the principal amount of such Note.

(*Id.* § 1.01.)

19. The Indenture also specifies certain Events of Default as well as the consequences of such Events of Default. Section 6.01 defines the various Events of Default and, relevant here, sections 6.01(a)(6) and (a)(7) specify Events of Default related to bankruptcy. In particular, section 6.01(a)(6)(i) states that an Event of Default occurs when EFIH “commences proceedings to be adjudicated bankrupt or insolvent.” (*Id.* § 6.01(a)(6)(i).)

20. The acceleration clause in section 6.02 explains the consequences of this bankruptcy-caused Event of Default:

[I]n the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof [including EFIH's bankruptcy filing], all outstanding Notes shall be due and payable immediately without further action or notice.

(*Id.* § 6.02, ¶ 2.)

21. By contrast, for an Event of Default unrelated to a bankruptcy filing, the Indenture provides an option to accelerate the Notes. (*Id.* § 6.02, ¶ 1.) Specifically, for non-bankruptcy defaults, the Trustee or holders of at least 30% of the Notes “may declare the principal, premium, if any, interest and any other monetary obligations on all the then outstanding Notes to be due and payable immediately.” (*Id.*) This optional right to accelerate the Notes, however, does not apply to a bankruptcy default; instead, acceleration upon a bankruptcy default is automatic. (*Id.*)

22. Finally, in the event of an acceleration of the Notes, the Trustee possesses a qualified right effectively to decelerate the Notes through the act of rescission:

The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may on behalf of all the Holders waive any existing Default and its consequences under the Indenture except a continuing Default in the payment of interest on, premium, if any, or the principal of any Note (held by a non consenting Holder) and rescind any acceleration with respect to the Notes and its consequences (so long as such rescission would not *187 conflict with any judgment of a court of competent jurisdiction).

(*Id.* § 6.02, ¶ 3.)

E. EFIH's Decision to File for Chapter 11 Protection

23. One of the issues before the Court is whether the Debtors intentionally defaulted in order to avoid paying an alleged make-whole premium or other damages. Both sides assert that there is no genuine issue of material fact as to why EFIH filed bankruptcy, which gave rise to the default. As discussed below, the Court agrees; thus, this issue is appropriate for summary judgment.

i. The EFIH Debtors' Position

24. The EFIH Debtors argue that there is no genuine issue of material fact as to why EFIH filed for bankruptcy—they were running out of cash. For many months before EFIH ultimately filed for chapter 11 protection, the EFH corporate family pursued restructuring strategies that would involve seeking bankruptcy protection for TCEH but keeping EFIH out of bankruptcy. (*See, e.g.*, Pl. App'x, A-112 (May 29, 2013 EFIH Unsecured Creditors Advisor Presentation calling for recapitalizing EFIH “out-of-court”); Horton Tr. 94:17–24.) This strategy, known as “Project Olympus,” was an effort to obtain the consent of key creditor constituencies to a consensual, prepackaged transaction that would minimize the amount of time spent in a restructuring, avoid potentially significant tax impacts, and maintain the EFH corporate family in one consolidated group. (8–K Filing of EFH (October 15, 2013).) This effort was ultimately unsuccessful, and all of the Debtors, including the EFIH Debtors, filed a bankruptcy petition on April 29, 2014.

25. After the company's attempts to pursue Project Olympus failed on November 1, 2013, it was clear that EFIH would have to join the rest of the EFH corporate family in filing for bankruptcy. As the company's Treasurer stated at his deposition, “We're going to have to file EFIH now regardless of what ... anyone else is saying because we're running out of cash.... Project Olympus isn't happening, ... EFIH is going to have to file....” (Horton Tr. 190:19–191:2.) EFIH's Executive Vice President and CFO further explained that by April 28, 2014, the day before EFIH filed for bankruptcy, the company had run out of cash to satisfy its interest obligations coming due on June 1 of that year. (Keglevic Tr. 52:25–53:14.) Mr. Keglevic also testified at the June 5, 2014 hearing that the DIP was needed, in part, to provide liquidity to fund operations. (Hr'g Tr. 96:14–20, 100:12–101:3 (June 5, 2014)) The EFIH Debtors did not see “any ability to issue debt or get equity

to increase the amount of cash” needed to meet those interest obligations. (*Id.* 172:14–173:4.)

ii. The Trustee's Position

26. The Trustee counters at length that there is no genuine issue of material fact as to why the EFIH Debtors filed bankruptcy—it was to avoid having to pay the Applicable Premium. First, the Trustee asserts that foregoing liability on the Applicable Premium was a reason for the bankruptcy filing. Second, the Trustee counters EFIH's position that liquidity issues ultimately required EFIH to file for bankruptcy. The Trustee asserts that EFIH avoided the most obvious potential source of liquidity for EFIH outside of bankruptcy, a sale of EFIH's equity stake in its principal assets, including its interest in Oncor Holdings.

27. As discussed above, from late 2012 until November 2013, the Debtors pursued a plan known as “Project Olympus.” (Horton Tr. 124:8–20.) The goal was to put TCEH into bankruptcy and convert its ***188** first-lien debt into EFH equity, but to “keep EFH and EFIH out of bankruptcy.” (Horton Tr. 94:6–95:3, 122:9–124:7; Keglevic Tr. 39:10–14.) EFIH's senior executives believed this approach made sense because they were convinced that EFIH was solvent. (Horton Tr. 125:4–13; Keglevic Affidavit at 26–28.)

28. In stage 1 of Project Olympus, EFH would raise \$2 billion of equity and use it to refinance EFIH first lien, second lien and unsecured notes (the so-called “*PIK Notes*”) while TCEH was in bankruptcy. (Horton Tr. 166:14–22; Horton Ex. 14 at –2605, –2606; Horton Ex. 15 at 5648.) In stage 2, after TCEH emerged from bankruptcy, all remaining EFIH first-lien and second-lien debt would be refinanced. (Horton Tr. 166:23–167:11; Horton Ex. 15 at 5648.) In both stages, EFIH would use the optional redemption provisions of the Indenture for the Notes and pay the required make-whole. (Horton Tr. 153:19–154:3, 162:25–163:22; Horton Ex. 14 at 2605, 2606; Horton Ex. 15 at 5648; Keglevic Tr. 84:22–86:25 (“To the extent we called it, we would of course follow the indenture which said a call premium was due.”).) During this period, the Debtors “were continuously looking for opportunities” to “refinance the first lien debt” through an optional redemption that EFIH admits would have triggered the make-whole. (Horton Tr. 70:18–71:23, 122:12–20; Horton Ex. 9; Horton Ex. 10.) But, in the Debtors' view, any restructuring “require[d]” the “agreement” of two

creditor groups: the “TCEH 1st lien creditors” and the “EFIH/EFH unsecured creditors,” i.e., the holders of the PIK Notes. (Horton Ex. 16 at 2696.)

29. In March 2013, the TCEH first-lien noteholders presented the Debtors with proposals that would put EFIH into bankruptcy. (Keglevic Tr. 87:9–88:25.) They proposed an “alternative refinancing case,” in which “significant value could be unlocked” if EFIH did not pay the make-whole after it filed for bankruptcy. (Keglevic Ex. 6 at 0825; *see also* (Millstein & Co., Project Olympus Preliminary Discussion Materials May 2013, SP_MW_000000741 (“If EFIH and EFH file for bankruptcy, thereby accelerating the maturity of the EFIH debt, the Company may be able to refinance EFIH without paying make-whole premiums, resulting in substantial savings compared to the Company's forecast.”).) In the view of these creditors, there was “more value through potentially going into bankruptcy and either negotiating or winning make-wholes than a settlement outside of bankruptcy.” (Keglevic Tr. 90:7–17.)

30. In addition, the Debtors had proposed that the PIK noteholders convert their debt to equity. (Horton Tr. 186:9–187:25.) Those PIK noteholders evidently viewed that equity as valuable. (Ying Tr. (6/23) 120:24–123:18; Horton Tr. 188:4–189:22.) Because that equity would be more valuable if EFIH could refinance its debt without paying a make-whole, they too pushed the Debtors to contest the Noteholders' right to a make-whole. (Horton Tr. 189:11–22.)

31. On October 15, 2013, EFIH filed an 8-K with the SEC disclosing a restructuring proposal from the TCEH first-lien noteholders, in which, among other things, EFIH would file for bankruptcy and “refinance” the EFIH Notes without paying “any make-whole amount.” (Horton Ex. 19 at 2–3 & Ex. 99.2; *id.* Ex. 99.2 at 1 (proposing that TCEH first-lien noteholders receive 100% of EFH equity); Horton Tr. 206:3–208:17.)

32. On October 24, 2013, the EFIH PIK noteholders sent the Debtors a restructuring proposal that likewise provided, among other things, for EFIH to file bankruptcy, refinance the Notes and “disallow ***189** ... any make-whole fee.” (Horton Ex. 17 at 6084, 6088; *id.* at 6086, 6088 (proposing that PIK noteholders receive up to 94.9% of EFIH equity); Horton Tr. 191:20–197:25.)

33. The Debtors agreed that “[t]here [was] value in not paying the [make-whole]” on the EFIH First Lien Notes. (Horton

Tr. 96:12–22; *see id.* 97:21–98:2.) On November 1, 2013, the Debtors filed an 8-K with the SEC disclosing their own proposal whereby, among other things, EFIH would file for bankruptcy and refinance the Notes without paying “any make-whole amount.” (Horton Ex. 20 (EFIH 8-K) at 4, Ex. 99.1 at 2; Horton Tr. 184:9–23, 213:13–219:13.) This was the first time EFIH had publicly suggested that it would, or could, refinance the Notes in bankruptcy without paying a make-whole. The Debtors ultimately memorialized this plan in a Restructuring Support Agreement (the “RSA”) with certain creditors, including the PIK noteholders, who were to receive most of the EFH equity. (Keglevic Affidavit at 71–72, 75–76; No. 14–10979, D.I. 98 (RSA term sheet) at 2–4.)

34. In the October 2012 and December 2012 dealer manager agreements for the EFIH 6.875% Notes and in the January 2013 exchange for the Notes, EFIH's executives represented to the Dealer Managers that EFIH was “solvent.”⁶ At no point did the Debtors conclude that EFIH's assets were worth less than its liabilities. (Horton Tr. 270:9–271:24; Keglevic Tr. 158:4–15, 169:24–170:11.) EFIH had not missed any payment on the Notes or otherwise defaulted. (Horton Tr. 80:23–81:16; Keglevic Tr. 52:17–53:14, 189:15–190:2.)

35. Before filing for bankruptcy, EFIH solicited, negotiated, and obtained commitments for, and obligated itself to pay commitment and other fees on, \$5.4 billion in DIP financing. (No. 14–50363, D.I. 27 ¶¶ 3, 15, 31–34.) On the Petition Date, EFIH filed and served the EFIH First Lien DIP Motion seeking authority for the DIP financing. Ultimately, EFIH obtained \$5.4 billion in DIP financing, most of which it used to pay off the outstanding principal and interest (other than disputed interest) on the Notes.

36. EFIH sought authority to, and did, redeem the Notes because it had “the opportunity to pay [them] off and ... replac[e] [them] with DIP financing, ... lower[ing] the interest costs.” (Keglevic Tr. 182:22–183:23.) The DIP financing bore an interest rate of 4.25% (Horton Tr. 37:1820; Keglevic Tr. 184:15–20), substantially less than the interest rate that EFIH was paying on the Notes (10% for most of the Notes; 6.875% for the rest). (Horton Tr. 37:21–25; Keglevic Tr. 184:2125). Mr. Keglevic testified that “by paying it sooner we could replace it with cheaper cost of money.” (Keglevic Tr. 186:10–187:1.) The refinancing's purpose, as EFIH explained, was “to take advantage of highly favorable debt market conditions to refinance the EFIH First Lien Notes,” “saving an estimated \$13 million in interest per month.” (No. 14–10979, D.I. 74

at 4 ¶ 4; Horton Tr. 40:9–41:13, 44:15–20, 89:11–24; Horton Ex. 5 (Goldstein Decl.) at 5 ¶ 9.)

37. On June 19, 2014, EFIH paid all outstanding principal and accrued interest *190 (other than disputed amounts of interest and any make-whole or comparable damages) on the First Lien Notes, and the Notes were then cancelled.⁷

38. Prior to filing bankruptcy, EFIH did not market its assets to avoid bankruptcy. (Horton Tr. 226:13–228:1; Keglevic Tr. 54:16–55:21, 57:2–58:5, 60:8–61:12.) EFIH did not pursue a possible sale of its interest in Oncor because it wanted to limit the tax liabilities of a separate entity, its parent EFH. *See, e.g.*, Omnibus Tax Memorandum (No. 14–10979, D.I. 2296 at 12 (“The principal goal of all the Debtors ... was to keep EFH, TCEH, and EFIH together as a single consolidated group for federal income tax purposes and to *avoid* a taxable separation ... [that] would trigger a tax liability of potentially \$7 billion or more for EFH.”)); Ruling on Bid Procedures, Nov. 3, 2014 Tr. at 13:1–6 (“There can be no question that the debtors' proposed tax structure that calls for a complicated tax-free deconsolidation of the E side and T side of the balance sheet was the fundamental element of the RSA, and is the debtors' preferred structure for the sale of the Oncor business....”).

III. CONCLUSIONS OF LAW

A. Jurisdiction and Venue

39. The Debtors commenced these chapter 11 cases on April 29, 2014 (the “*Petition Date*”). Venue in the United States Bankruptcy Court for the District of Delaware was proper as of the Petition Date pursuant to  [28 U.S.C. §§ 1408](#) and [1409](#) and continues to be so in the context of this adversary proceeding. This Court has subject matter jurisdiction over this adversary proceeding pursuant to  [28 U.S.C. §§ 157](#) and  [1334](#). This is a core proceeding pursuant to 11 U.S.C. § 157(b).

B. Standard for Summary Judgment

40. [Federal Rule of Civil Procedure 56](#), made applicable to adversary proceedings by [Federal Rule of Bankruptcy Procedure 7056](#), directs that summary judgment should be rendered if the pleadings, the discovery and disclosure materials on file, and any affidavits “show that there is no genuine issue as to any material fact and the movant is entitled to judgment as a matter of law.” [Fed. R. Civ. P. 56\(a\)](#); *see also*

In re Delta Mills, Inc., 404 B.R. 95, 103 (Bankr.D.Del.2009). Summary judgment is designed “to avoid trial or extensive discovery if facts are settled and the dispute turns on an issue of law.” *Delta Mills*, 404 B.R. at 104.

41. Here, the parties agree that there are no material facts in dispute, and that the questions necessary to resolve this proceeding are purely legal in nature. The Court mostly agrees. As discussed below, however, there is a genuine issue of material fact as to whether cause exists to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to decelerate the Notes. Otherwise, summary judgment is appropriate at this stage. *Niagara Frontier Transit Metro Sys., Inc. v. Cnty. of Erie*, 212 A.D.2d 1027, 623 N.Y.S.2d 33 (1995) (citing *W.W.W. Assoc., Inc. v. Giancontieri*, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639, 642 (1990) (“Where the contract is unambiguous on its face, it should be construed as a matter of law and summary judgment is appropriate.”)); *Green Mach. Corp. v. Zurich Am. Ins. Grp.*, No. CIV. A. 99-3048, 2001 WL 1003217, at *6 (E.D.Pa. Aug. 24, 2001) (“Whether a contract provision *191 is ambiguous is a question of law for the court.”), *aff’d sub nom.* *Green Mach. Corp. v. Zurich-Am. Ins. Grp.*, 313 F.3d 837 (3d Cir.2002).

C. Contract Interpretation Under New York Law

[1] [2] 42. Under New York law, which governs the Indenture, the Court need not look “outside the four corners” of a complete document to determine what the parties intended. *W.W.W.*, 565 N.Y.S.2d 440, 566 N.E.2d at 642; see also *R/S Assocs. v. N.Y. Job Dev. Auth.*, 98 N.Y.2d 29, 744 N.Y.S.2d 358, 771 N.E.2d 240, 242 (2002) (applying same principle). Here, neither party has alleged that the Indenture is an incomplete document, so it is not necessary to resort to extrinsic evidence to interpret it. Moreover, neither party contends that any term in the Indenture is ambiguous—instead, each party relies on its own “plain reading” of the indenture in reaching competing results. A contract is not ambiguous merely because the parties offer different constructions of the same term. *Sayers v. Rochester Tel. Corp. Supp. Mgmt. Pension Plan*, 7 F.3d 1091, 1095 (2d Cir.1993). The Court finds that the Indenture is not ambiguous.

[3] [4] [5] 43. Having reached the conclusion that the Indenture is unambiguous, the Court relies on long-recognized canons of interpretation to determine its meaning. First, “[t]he best evidence of what parties to a written

agreement intend is what they say in their writing.” *Schron v. Troutman Sanders LLP*, 20 N.Y.3d 430, 963 N.Y.S.2d 613, 986 N.E.2d 430, 433 (2013) (internal quotation marks and citation omitted). Second, should there be an inconsistency between a specific and general provision of a contract, the specific controls. *Muzak Corp. v. Hotel Taft Corp.*, 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956); *Waldman v. New Phone Dimensions, Inc.*, 109 A.D.2d 702, 487 N.Y.S.2d 29, 31 (N.Y.1985). Third, “[a] reading of the contract should not render any portion meaningless.” See *Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318, 834 N.Y.S.2d 44, 865 N.E.2d 1210, 1213 (2007) (quotation marks and citations omitted); *Barrow v. Lawrence United Corp.*, 146 A.D.2d 15, 538 N.Y.S.2d 363, 365 (N.Y.1989) (“Contracts are also to be interpreted to avoid inconsistencies and to give meaning to all of its terms.”).

D. The Plain Language Of The Indenture Does Not Require Payment Of The Applicable Premium

[6] 44. The Trustee seeks a declaratory judgment that EFIH’s refinancing of the Notes constituted a redemption requiring payment of the Applicable Premium as a secured claim. (Compl.¶¶ 51–57, 74–76.)⁸

45. The Court begins its analysis with the most relevant provision, the acceleration provision of section 6.02 of the Indenture. Under section 6.02, “in the case of an Event of Default arising under clause (6) or (7) of Section 6.01(a) hereof, all outstanding Notes shall be due and payable immediately without further action or notice.” Here, EFIH’s filing for bankruptcy was an Event of Default arising under clause (6) of Section 6.01(a). Thus, the Notes were automatically accelerated on the Petition Date and became due and payable immediately without further action *192 or notice of the Trustee or any Noteholder. (Indenture § 6.02, ¶ 2.)

46. There is no reference in Section 6.02 to the payment of the “Applicable Premium” upon an automatic acceleration, nor is section 3.07 incorporated into section 6.02. The parties included the concept of an Applicable Premium in only one instance (an optional redemption under section 3.07). It is not mentioned in section 6.02 or anywhere else in the Indenture.

[7] 47. Under New York law, an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed.

See [Northwestern Mut. Life Ins. Co. v. Uniondale Realty Assocs.](#), 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 (N.Y.Sup.Ct.2006) (“A prepayment premium will not be enforced under default circumstances in the absence of a clause which so states.”); [In re South Side House, LLC](#), 451 B.R. 248, 268 (Bankr.E.D.N.Y.2011) (“[A] lender is not entitled to prepayment consideration after a default unless the parties’ agreement expressly requires it.”), *aff’d* [U.S. Bank Nat’l Ass’n v. South Side House, LLC](#), No. 11–4135, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012); [In re Premier Entm’t Biloxi LLC](#), 445 B.R. 582, 626; Hr’g Tr. 36:9–14, [In MPM Silicones, LLC, et al.](#), No. 14–22503, 2014 WL 4436335, at *13–14 (Bankr.S.D.N.Y. Sept. 9, 2014) (“*Momentive*”).

[8] 48. The parties certainly could have bargained for such a provision. In many other cases—including cases decided before August of 2010, when this Indenture was negotiated—clauses specifically requiring post-acceleration payment of a make-whole, prepayment premium, or certain costs were upheld. See, e.g., [United Merchs. & Mfrs., Inc. v. Equitable Life Assurance Soc’y of the United States \(In re United Merchs. & Mfrs., Inc.\)](#), 674 F.2d 134, 141–43 (2d Cir.1982); [Parker Plaza W. Partners v. UNUM Pension & Ins. Co.](#), 941 F.2d 349, 355–56 (5th Cir.1991); [Teachers Ins. & Annuity Ass’n of Am. v. Butler](#), 626 F.Supp. 1229, 1230 (S.D.N.Y.1986); [In re AE Hotel Venture](#), 321 B.R. 209, 217–20 (Bankr.N.D.Ill.2005); [In re Vanderveer Estates Holdings, Inc.](#), 283 B.R. 122, 126–27 (Bankr.E.D.N.Y.2002); [In re Fin. Ctr. Assocs. of E. Meadow L.P.](#), 140 B.R. 829, 834–35 (Bankr.E.D.N.Y.1992); [In re Schaumburg Hotel Owner](#), 97 B.R. 943, 952–54 (Bankr.N.D.Ill.1989). The Indenture here was negotiated at arm’s length between sophisticated parties who were represented by counsel. The Court is unwilling to “read[] into agreements between sophisticated parties provisions that are not there.” [In re Solutia](#), 379 B.R. 473, 485 n. 7 (Bankr.S.D.N.Y.2007).⁹

[9] 49. The EFIH Debtors’ reading is also correct based on well-accepted canons of contract interpretation. Under established principles of New York law, “a specific provision ... governs the circumstance to which it is directed, even in the face of a more general provision.” [In re AMR Corp.](#), 730 F.3d 88, 99 (2d Cir.2013) (citation omitted), *cert*

denied, — U.S. —, 134 S.Ct. 1888, 188 L.Ed.2d 913 (2014); [Muzak Corp.](#), 150 N.Y.S.2d 171, 133 N.E.2d at 690 (“Even if there was an inconsistency between a specific provision and a general provision of a contract (we find none), the specific provision controls.”). *193 As the Second Circuit has reasoned, “[i]n analyzing whether a Make-Whole Amount is due, the Court turns first to the provision of the Indentures that most specifically addresses the circumstances before the Court. That provision is Section 4.01(g), which provides that the filing of a voluntary bankruptcy constitutes an event of default.” [In re AMR Corp.](#), 485 B.R. 279, 289 (Bankr.S.D.N.Y.2013), *aff’d* [730 F.3d 88 \(2d Cir.2013\)](#). Here, that specific provision is section 6.02. Nowhere in section 6.02 is there a reference to Applicable Premium, to Optional Redemption, section 3.07, or anything that would support the Trustee’s position that the Applicable Premium is owed upon a bankruptcy event of default and acceleration.

50. Comparing the relevant language in the governing Indenture with language from other cases compels the conclusion that the Indenture does not provide for a make-whole premium following a bankruptcy acceleration.

- [Calpine](#): “In the case of an Event of Default specified in clause (10) or (11) of Section 6.01 [which includes a bankruptcy filing], **all outstanding Notes will become due and payable immediately without further action or notice.**” (Romanowicz Decl., Ex. 2 § 6.02 ¶ 1, [In re Calpine Corp.](#), No. 05–60200, 2007 WL 950090 (Bankr.S.D.N.Y.2007) (Dkt. No. 3481–4), overruled by [HSBC Bank USA, N.A. v. Calpine Corp.](#), No. 07–3088, 2010 WL 3835200 (S.D.N.Y. Sept. 15, 2010) (emphasis added)); [HSBC Bank USA, N.A. v. Calpine Corp.](#), No. 07–3088, 2010 WL 3835200, at *4–*5 (S.D.N.Y. Sept. 15, 2010) (“Calpine II”).
- [Premier](#): “In the case of an Event of Default specified in clause (j) [commencement of a voluntary bankruptcy case] ... of § 6.01 hereof, with respect to Premier ... **all outstanding Notes will become due and payable immediately without further action or notice.**” (Romanowicz Decl., Ex. 3, at 73 (§ 6.02 ¶ 2), [In re Premier Entm’t Biloxi LLC](#), 445 B.R. 582 (Bankr.S.D.Miss.) (Dkt. No. 6–1 to –3) (emphasis added)); [In re Premier Entm’t Biloxi LLC](#), 445 B.R. at 626–632.

- **Momentive**: “If an Event of Default specified in Section 6.01(f) or (g) [which includes a bankruptcy filing] with respect to the Company occurs, *the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act* on the part of the Trustee or any Holders.” (Romanowicz Decl., Ex. 5, at 92, *In re MPM Silicones, LLC*, et al., No. 14–22503 (Bankr.S.D.N.Y. June 18, 2014) (Dkt. No. 464–1) (emphasis added)); *Momentive*, 2014 WL 443635, at *13–14.
- **Solutia**: “If an Event of default specified in 6.01(7) occurs with respect to the Company or any Subsidiary Guarantor [which includes filing a bankruptcy petition] *the principal of and premium, if any, and accrued interest, if any, on the Notes then outstanding shall become and be immediately due and payable without any declaration or other act* on the part of the Trustee or any Holder.” (Romanowicz Decl., Ex. 4, at 11/70 (§ 6.02 ¶ 1), *In re Solutia*, 379 B.R. 473 (Bankr.S.D.N.Y.2007) (Dkt. No. 4211–1 to –2) (emphasis added)); *In re Solutia Inc.*, 379 B.R. at 488.

51. In each of these cases, the court found no make-whole obligation was created by acceleration provisions substantially similar to the language before the Court. The Court agrees with the holdings in these cases and finds that the acceleration provision in the Indenture does not include *194 clear and unambiguous language that a make-whole premium (here the “Applicable Premium”) is due upon the repayment of the Notes following a bankruptcy acceleration. Because the Indenture does not specify that the Applicable Premium is owed after automatic acceleration, the Applicable Premium is not owed.

52. In contrast, the Trustee's reading of the Indenture does not give meaning to each provision. Both parties have argued that the Indenture must be read as a whole giving meaning to each provision. The Court agrees. See *Beal Sav. Bank v. Sommer*, 8 N.Y.3d 318, 834 N.Y.S.2d 44, 865 N.E.2d 1210, 1213 (2007) (A reading of the contract should not render any portion meaningless.”) (citations omitted); *Barrow v. Lawrence United Corp.*, 146 A.D.2d 15, 538 N.Y.S.2d 363, 365 (N.Y.1989) (“Contracts are also to be interpreted to avoid inconsistencies and to give meaning to all its terms.”). A review of section 3.07, one of the sections upon which the

Trustee heavily relies, does not change the Court's reading of section 6.02. The Trustee argues that section 3.07, the “Optional Redemption” provision, is a wholesale bar to any repayment before December 1, 2015. This reading is strained for a number of reasons.

53. As an initial matter, the Trustee looks to Article 3, “Redemption,” instead of Article 6, “Defaults and Remedies,” to determine the Debtors' obligations and the Trustee's remedies upon a default. This defies the canons of contract interpretation. Further, the Trustee asks this Court to conclude, contrary to New York law, that because section 3.07 does not include language expressly disclaiming the effect of section 6.02, section 3.07 must control.¹⁰ This argument fails on the same grounds.

54. “Optional Redemption” under section 3.07 is an act separate and apart from automatic acceleration. This is evident in part from the noticing scheme outlined in Article 3, “Redemption.” (See Indenture §§ 3.01–3.06 (requiring written notice prior to redemption and outlining procedures for same).) This noticing scheme specifies a detailed process for advance notice of redemption, including the “Redemption Date,” the Notes to be redeemed, and more. No part of this notice process is required to be followed when the Notes become “due and payable immediately without further action or notice” under section 6.02.

55. In other words, under the Indenture, redemption and acceleration are not the same thing. The Indenture in various places distinguishes between the two concepts:

- “(a) An ‘Event of Default’ ... means ... (1) default in payment when due and payable, upon *redemption, acceleration* or otherwise, of principal, or premium, if any, on the Notes....” (Indenture § 6.01(a)(1) (emphasis added).)
- “The due and punctual payment of the principal, premium, if any, and interest on the Notes when and as the same shall be due and payable, whether on an Interest Payment Date, at maturity, by *acceleration, repurchase, redemption* *195 or otherwise....” (*Id.* § 10.04 (emphasis added).)
- “[T]he principal, premium, if any, and interest on the Notes shall be promptly paid in full when due, whether at maturity, by *acceleration, redemption* or otherwise....” (*Id.* § 11.01 (emphasis added).)

[10] [11] 56. When the EFIH Debtors filed for bankruptcy, the Notes automatically accelerated and became due and payable immediately. Under New York law, “a borrower’s repayment after acceleration is not considered voluntary.”

[South Side](#), 451 B.R. at 268; see also [AMR](#), 730 F.3d at 103 (rejecting the claim that an accelerated repayment was a “voluntary redemption”). This is because “[a]cceleration moves the maturity date from the original maturity date to the acceleration date and that date becomes the new maturity date.” [Solutia](#), 379 B.R. at 484.

[12] 57. “Prepayment can only occur prior to the maturity date,” [Id.](#) at 488 (emphasis omitted), and “acceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity.” [In re LHD Realty Corp.](#), 726 F.2d 327, 330–31 (7th Cir.1984). “Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity.” [Northwestern Mutual](#), 816 N.Y.S.2d at 834 (quoting [Rodgers v. Rainier Nat’l Bank](#), 111 Wash.2d 232, 757 P.2d 976 (1988)); see also [Solutia](#), 379 B.R. at 488 (“Because the 2009 Notes were automatically accelerated, any payment at this time would not be a prepayment.”). Acceleration therefore “does not trigger the [Trustee’s] right to prepayment consideration” under the Optional Redemption provision. [South Side](#), 451 B.R. at 268. Thus, the Trustee’s claim that the EFIH Debtors’ repayment was an optional redemption must fail. For these reasons, the Trustee is not entitled to an Applicable Premium.

E. The EFIH Debtors’ Bankruptcy Filing Was Not An Intentional Default Under The Indenture

[13] 58. The Trustee also seeks judgment for an allowed secured claim arguing that EFIH’s default was done with intent to deny the Trustee the Applicable Premium. (Compl.¶¶ 58–65, 74–76.) The Court disagrees with the Trustee that it would be entitled to any relief.

59. First, unlike in some cases, the Indenture does not contain a provision stating that a premium will be owed if EFIH intentionally causes an event of default to avoid paying the Applicable Premium. Compare with [Premier](#), 445 B.R. at 591 (“If an Event of Default occurs ... by reason of any willful action ... with the intention of avoiding the prohibition on redemption of the Notes ... an additional premium shall

also become due.”); and [South Side](#), 451 B.R. at 269–70 (“[P]arties may agree that a borrower’s repayment of the debt after acceleration ... will be deemed an evasion of the parties’ prepayment agreement.”)

60. Second, the Trustee has the burden of supplying “sufficient evidence (not mere allegations)” for a reasonable factfinder to conclude that the EFIH Debtors intentionally defaulted. [United States v. Jamas Day Care Ctr. Corp.](#), 152 Fed.Appx. 171, 173 (3d Cir.2005) (quoting [Olson v. General Elec. Aerospace](#), 101 F.3d 947, 950 (3d Cir.1996)). A material fact is one that could “alter the outcome of the case.” [Argus Mgmt. Group v. GAB Robins, Inc. \(In re CVEO Corp.\)](#), 327 B.R. 210, 214 (Bankr.D.Del.2005) (quoting [Horowitz v. Fed. Kemper Life Assurance Co.](#), 57 F.3d 300, 302 n. 1 (3d Cir.1995)). It is genuine when it is “triable,” that is, when reasonable minds could disagree on the result. [*196 Id.](#) at 210 (quoting [Matsushita Elec. Indus Co. v. Zenith Radio Corp.](#), 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)).

61. Viewing all factual inferences in a light most favorable to the Trustee, its argument is nonetheless insufficient to create a genuine issue of material fact as to why the EFIH Debtors filed bankruptcy. While it is certainly the case that the EFIH Debtors planned pre-petition and followed through after filing bankruptcy to use the default created by that filing to refinance the Notes without having to pay the Applicable Premium, that is not enough to counter the overwhelming evidence that the Debtors filed bankruptcy because they were facing a severe liquidity crisis. The collapse of Project Olympus doomed a T-side only bankruptcy and to suggest that the Debtors refused to market and sell Oncor, which may be worth \$18 billion, to avoid having to pay a \$400 million make-whole premium stretches the bounds of credulity. The EFIH Debtors are no different than any other debtor that is forced into bankruptcy because of financial reasons but decides to use the tools provided by that bankruptcy, such as the power to reject unprofitable leases, for business reasons. The Trustee has presented insufficient evidence to rebut that put forth by the EFIH Debtors. There is no genuine issue of material fact—the EFIH Debtors did not file bankruptcy in an intentional effort to default under the Indenture so that the Applicable Premium would not be due.

F. The Trustee’s Right To Rescind Acceleration

62. The Trustee asserts that the Noteholders had an “absolute right” to rescind the automatic acceleration of the Notes. Based on this theory, the Trustee also seeks a declaratory judgment that it is entitled to an allowed secured claim in the amount of the Applicable Premium, for breach of the alleged right to rescind. (Compl. 11 69, 73.) The Trustee’s qualified right of rescission raises a number of issues.

i. The Trustee’s right to rescind the acceleration of the Notes is not barred because the automatic stay under section 362 of the Bankruptcy Code is not a “judgment of a court.”

[14] 62. First, while the Trustee has the right under Section 6.02 of the Indenture to waive the automatic default arising from the EFIH Debtors’ bankruptcy filing and rescind the acceleration of the Notes, that right is not absolute. Section 6.02 of the Indenture, the relevant provision, reads:

The Holders of at least a majority in aggregate principal amount of the Notes by written notice to the Trustee may on behalf of all the Holders waive any existing Default and its consequences under the Indenture except a continuing Default in the payment of interest on, premium, if any, or the principal of any Note (held by a non consenting Holder) and rescind any acceleration with respect to the Notes and its consequences (*so long as such rescission would not conflict with any judgment of a court of competent jurisdiction*).

(Indenture § 6.02, ¶ 3 (emphasis added).)

64. Thus, the Trustee may not rescind acceleration of the Notes if so doing would “conflict with any judgment of a court of competent jurisdiction.” The EFIH Debtors argue that the right to rescind incorporates and is expressly limited by judicial orders, including the automatic stay.  [In re Gruntz](#), 202 F.3d 1074, 1082 (9th Cir.2000) (“The automatic stay is an injunction issuing from the authority of the bankruptcy court, and bankruptcy court orders are not subject to collateral

attack in other courts.”); *197 [In re San Angelo Pro Hockey Club, Inc.](#), 292 B.R. 118, 124 (Bankr.N.D.Tex.2003) (“The automatic stay is self-executing injunction, and therefore, for contempt purposes, constitutes an order issuing from the bankruptcy court.”).

[15] 65. The Court disagrees. The automatic stay is not a “judgment of a court of competent jurisdiction.” It is prescribed by statute, not by any court, and applies in every bankruptcy case automatically without any court order. [See](#)  [11 U.S.C. § 362\(a\)](#);  [In re James](#), 257 B.R. 673, 678 (8th Cir. BAP 2001) (“[T]he stay is a statutory provision and not a court order[.]”);  [In re Alberts](#), 381 B.R. 171, 176 (Bankr.W.D.Pa.2008) (“The ‘automatic stay’ is a statutory injunction ... that ... arises without ... court order.”). Nor is the automatic stay a “judgment” under New York law, which provides that a judgment is “the determination of the rights of the parties in an action or special proceeding,”  [N.Y. CPLR § 5011](#), and is appealable as of right. ¹¹ [N.Y. CPLR § 5701\(a\)\(1\)](#). The fact that a bankruptcy filing gives rise to an automatic stay, by contrast, cannot be appealed.

Thus, the Trustee’s right to rescission is not barred by section 6.02 of the Indenture as a result of the imposition of the automatic stay. ¹²

ii. The automatic stay bars the Trustee’s rescission notice.

[16] 67. Second, the automatic stay bars the Trustee’s rescission notice of June 4, 2014. Upon filing its voluntary chapter 11 petition, EFIH’s assets, including its rights under the Indenture, became subject to the automatic stay.  [11 U.S.C. § 362\(a\)](#). Sending a notice of rescission is an act to “collect, assess or recover” on a claim, especially when the Noteholders have already been paid their full principal and accrued interest.  [Id. § 362\(a\)\(6\)](#); *see also* [Momentum](#),  [2014 WL 4436335, at *19](#) (“[T]he automatic stay does, in fact, apply to the sending of a rescission notice.”); [AMR Corp.](#), 485 B.R. at 294 (“Any deceleration of these notes, however, is barred by the automatic stay imposed by the filing of this bankruptcy.”), *aff’d*  [730 F.3d 88 \(2d Cir.2013\)](#);  [Solutia](#), 379 B.R. at 485 (“[W]here the indenture provides

for an automatic acceleration any attempt at deceleration would violate the automatic stay.”).

iii. If the Court were to lift the automatic stay the Applicable Premium would be due.

68. Third, if the Court were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders.

69. Had EFIH refinanced the debt on the same day (June 19, 2014), on the same terms, outside of bankruptcy, on which it redeemed the Notes in bankruptcy, it would have owed the Applicable Premium. *198 The only thing that stands in the way of owing the Applicable Premium is that the bankruptcy caused an automatic default that accelerated the debt. The Trustee, however, had the right to waive that default and decelerate the Notes, which it attempted to do by sending a rescission notice on June 4, 2014. That notice, however, was void *ab initio* as a result of the automatic stay. Were the Court, however, to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee's rescission notice to take effect then the automatic default would be waived, the Notes would no longer be immediately due and the refinancing would require payment of the Applicable Premium.

70. Were the Court, however, either not lift the stay or do so, but not *nunc pro tunc* to a date on or before June 19, 2014, the date the Notes were paid, then the Applicable Premium would not have been owed at the time the Notes were paid in full. At most, the Trustee and the Noteholders would have a damages claim for denial of the rescission right. Whether such a claim exists is discussed below.

iv. A genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay.

[17] 71. Fourth, a genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay, *nunc pro tunc* to a date on or before June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes, i.e., to give effect to the June 4, 2014 notice.

72. The Stay–Applicability Motion requests a determination that the automatic stay would not bar the Noteholders from rescinding acceleration or, in the alternative, that the stay should be lifted. The Court has already held that the automatic stay applies to the June 4 rescission notice. There is a genuine issue of material fact precluding summary judgment as to whether cause exists to lift the automatic stay.

[18] [19] 73. The Bankruptcy Code authorizes bankruptcy courts to grant relief from the stay for “cause.”  11 U.S.C. § 362(d)(1). Courts are to determine “cause” based on the totality of the circumstances in each particular case. *In re Wilson*, 116 F.3d 87, 90 (3d Cir.1997). The factors courts generally use in determining whether cause exists are (1) whether any great prejudice to either the bankrupt estate or the debtor will result from a lifting of the stay; (2) whether the hardship to the non-bankrupt party by maintenance of the stay considerably outweighs the hardship to the debtor; and (3) the probability of the creditor prevailing on the merits.  *In re Downey Fin. Corp.*, 428 B.R. 595, 609 (Bankr.D.Del.2010).

[20] 74. The Trustee argues that, as a matter of law, cause exists to lift the automatic stay because at this stage of the proceedings the EFIH Debtors are presumed to be solvent. The Trustee cites to a number of cases in support of its argument. *See, e.g.*,  *Cloughton v. Mixson*, 33 F.3d 4 (4th Cir.1994); and  *In re Texaco, Inc.*, 81 B.R. 804 (Bankr.S.D.N.Y.1988). These cases do not stand for the proposition that a debtor's solvency is, as a matter of law, cause to lift the automatic stay. While a debtor's solvency may, in certain cases, be a relevant consideration in determining whether cause exists to lift the automatic stay it is not the sole factor to be considered by the Court.

75. The Trustee further argues that lifting the automatic stay would not prejudice either the bankruptcy estate or the debtor because doing so would simply hold the EFIH Debtors to their bargain and *199 there can be no harm to a solvent estate. The Court disagrees. Several courts have held that lifting the automatic stay to trigger liability under a make-whole claim may harm a debtor or its estate and that analysis does not depend solely on whether that estate is insolvent. *See, e.g.*, *In re AMR Corp.*, 485 B.R. 279, 295 (Bankr.S.D.N.Y.2013);  *In re AMR Corp.*, 730 F.3d 88, 112 (2d Cir.2013), and *Momentive*,  2014 WL 4436335, at *23. Moreover, “denial” of the Noteholders' contractual right to

rescission does not, in and of itself, establish cause to lift the automatic stay.

76. While the Trustee cannot meet its burden on summary judgment that cause exists to lift the stay, the Court cannot hold on summary judgment, as urged by the EFIH Debtors, that cause does not exist. In short, there is a genuine dispute of material fact as to whether cause exists to lift the automatic stay.

G. The Trustee has no claim for (i) breach of the ‘no-call’ provision of section 3.07(c) of the Indenture; (ii) violation of the “perfect tender” rule under New York law; nor (iii) breach of the right to waive the default and decelerate the Notes.

77. The Trustee asserts claims for various breaches of the Indenture. No such claims exist.

i. Breach of no-call provision

[21] 78. The Trustee argues it should be entitled to a claim for damages arising from the Debtors' breach of section 3.07(c) of the Indenture's No-Call Provision. (Compl. ¶¶ 74–76.) The Court disagrees.

79. As an initial matter, the Trustee appears to concede that section 3.07(c) is *not* a “no-call” provision prohibiting repayment. (Pl.'s Memo. in Support of Mot. for SJ 66. (“*Pl. Br.*”)) The Trustee characterizes 3.07(c) as requiring payment of a make-whole premium if the Notes are repaid (under any circumstances) before December 1, 2015. But Section 3.07(c) provides only that redemptions at the EFIH Debtors' option, as defined by that section, require paying the Applicable Premium.

80. The court in *Momentive* analyzed a nearly identical provision. The indenture there provided: “the Note shall not be redeemable at the option of MPM prior to October 15, 2015,” which language, the court found, was “no more than an introduction or framing device for the notes' elective redemption provisions.” *Momentive*, [2014 WL 4436335, at *16](#). The same is true here.

81. Because the Notes were not optionally redeemed, section 3.07(c) does not apply, and the Court finds that the Trustee is not entitled to damages based on a breach of “no-call” theory.

ii. “Perfect Tender” claim

82. The Trustee also asserts that repayment pursuant to section 6.02 of the Indenture breached New York's common-law “perfect tender” rule. (Pl.Br.66–67.) The Court disagrees.

[22] 83. Under the perfect tender” rule, “a [borrower] has no right to pay off his obligation prior to its stated maturity date in the absence of a prepayment clause.” [Arthur v. Burkich, 131 A.D.2d 105, 106, 520 N.Y.S.2d 638 \(N.Y.1987\)](#). The Trustee claims that section 6.10 of the Indenture (“Rights and Remedies Cumulative”), which states that “every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy,” requires this Court to find the EFIH Debtors liable for damages under the rule of perfect tender.

[23] 84. In a subsequent opinion, the *Momentive* court explained that the perfect tender rule does not apply if, as was *200 the case there, the indenture modified the common-law rule. Bench Ruling Tr. 16:19–17:9, [In re MPM Silicones, LLC, et al., 518 B.R. 740 \(Bankr.S.D.N.Y.2014\)](#) (Dkt. No. 60). The Court agrees. Section 6.02 of the Indenture makes payment of the Notes automatic and mandatory before the Notes' stated maturity. This provision directly modifies the common-law “perfect tender” rule, and the Trustee therefore is not entitled to damages.

iii. Claim for denial of right of rescission

[24] 85. The Trustee also argues that it is entitled to a claim for the denial of the right to rescind acceleration, which constituted a breach of the Indenture giving rise to damages in the amount of the make-whole that the Noteholders would have been entitled to receive if their contractual right to rescind had been honored. The Court disagrees.

86. Oversecured creditors have allowed claims for “reasonable fees, costs, or charges” when those amounts are “provided for under the agreement ... under which such claim arose.” See [11 U.S.C. § 506\(b\)](#). The Indenture here does not provide for any fee, cost, or charge for breach of the purported right to rescind. The Trustee merely asserts a vague claim for damages arising out of its inability to decelerate the Notes.

[25] 87. As several courts have explained, secured claims are not allowed for breach of contract damages unless those damages are specifically provided for in the Indenture. For example, in  [*Continental Securities*](#) the lender sought damages for the alleged breach of a no-call provision.  [*Cont'l Secs. Corp. v. Shenandoah Nursing Home P'ship*](#), 188 B.R. 205, 215 (W.D.Va.1995), *aff'd*, 104 F.3d 359 (4th Cir.1996) (per curiam). The court denied the secured claim, however, because the note there did not include any penalty provision for breach of the no-call provision.  *Id.* Similarly, in  [*Vest Associates*](#) a lender acknowledged that the note at issue did not provide for a make-whole premium upon post-acceleration repayment, but the lender nonetheless asserted a secured claim for the adverse tax consequences allegedly caused by the prepayment.  [*In re Vest Assocs.*](#), 217 B.R. 696, 699 (Bankr.S.D.N.Y.1998). The court denied the claim because the damages sought were not provided for in the loan agreement.  *Id.* Here, as in  [*Continental*](#) and in  [*Vest*](#), the damages sought for the asserted breach of the alleged right to rescind are not set forth in the Indenture, and they cannot therefore be allowed as a secured claim.

88. The cases the Trustee cites are inapposite. See  [*In re Rodriguez*](#), 629 F.3d 136, 141–42 (3d Cir.2010) (finding that underlying agreement provided for an enforceable state law claim);  [*In re Chemtura Corp.*](#), 439 B.R. 561, 603 (Bankr.S.D.N.Y.2010) (noting first the requirement that a claim must be valid under applicable non-bankruptcy law).

H. Counts I–IV of the Complaint

89. Before the Court are cross motions for summary judgment on the Complaint filed by the Trustee. Having addressed the relevant factual and legal issues raised by the parties, the Court now turns to the Complaint.

i. Count I

90. Count I of the Complaint seeks a declaratory judgment that the EFIH Debtors' refinancing of the Notes constitutes a redemption under section 3.07 of the Indenture requiring payment of the Applicable Premium as an allowed secured claim. (Compl.¶¶ 51–57.) The Court has held that where, as here, the Notes were paid following an acceleration under section *201 6.02 of the Indenture arising from a default

for the commencement of “proceeding to be adjudicated bankrupt or insolvent” under section 6.01(a)(6)(i) of the Indenture, the plain language of the Indenture does not require payment of an Applicable Premium. The Court has also held that if it were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders. As a result, were the Court to grant relief from the automatic stay as outlined above, it could enter judgment in favor of the Trustee on Count I. Thus, the Court will grant summary judgment in favor of the EFIH Debtors on Count I of the Complaint without prejudice to the Court's right to reinstate Count I and enter judgment in favor of the Trustee if, and only if, the Court deems it appropriate upon entry of an order lifting the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and decelerate the Notes.

ii. Count II

91. Count II of the Complaint seeks a declaratory judgment that the EFIH Debtors' default under the Notes with an intent to deny payment of the Applicable Premium requires payment of the Applicable Premium as an allowed secured claim. (Compl.¶¶ 58–65.) The Court has held that the EFIH Debtors did not file bankruptcy in an intentional effort to default under the Indenture so that the Applicable Premium would not be due. Thus, the Court will enter summary judgment in favor of the EFIH Debtors on Count II of the Complaint.

iii. Count III

92. Count III of the Complaint seeks a declaratory judgment that the EFIH's Debtors' denial of the Noteholders' right to rescind acceleration of the Notes under section 6.02 of the Indenture gives rise to an allowed secured claim. (Compl.¶¶ 66–73.) The Court has held that while the Noteholders have a right of rescission under section 6.02 of the Indenture their attempt to exercise that right was a violation of the automatic stay. As such, there can be no claim for breach of contract arising from operation of the automatic stay. Moreover, secured claims are not allowed for breach of contract damages unless those damages are specifically provided for in the

Indenture, which is not the case here. Thus, the Court will enter summary judgment in favor of the EFIH Debtors on Count III of the Complaint

iv. Count IV

93. Count IV of the Complaint seeks a declaratory judgment that EFIH's refinancing gives rise to an unsecured claim for the same reasons set forth in Counts I–III as well as for breach of section 3.07(c) of the Indenture's “no-call” provision, violation of New York's “perfect tender rule” and denial of the right to rescission. (Compl. ¶¶ 74–76.) The Court has ruled that the EFIH Debtors' are entitled to summary judgment on Counts I–III (although without prejudice as to Count I) and there is no claim for breach of section 3.07(c) of the Indenture's “no-call” provision, violation of New York's “perfect tender rule” and denial of the right to rescission. The sole avenue for relief in connection with the denial of the right to rescission is to seek relief from the automatic stay, which, if granted, might give rise to a claim under Count I. Thus, the Court will grant summary judgment in favor of the EFIH Debtors on Count IV of the Complaint.

*202 I. The Stay–Applicability Motion

94. The parties have also sought summary judgment on the Stay–Applicability Motion, which requests a determination that the automatic stay would not bar the Noteholders from rescinding acceleration or, in the alternative, that the stay should be lifted to give effect of the rescission. The Court has held that the right of rescission is not barred by the automatic stay but the issuance of the notice of rescission was a stay violation and void *ab initio*. The Court has further held that if it were to lift the automatic stay, *nunc pro tunc* to a date on or before the repayment of the Notes on June 19, 2014, to allow the Trustee to waive the default and

decelerate the Notes than EFIH's refinancing would be an Optional Redemption under section 3.07 of the Indenture and the Applicable Premium would be due and owing to the non-settling Noteholders. In that instance, the Court could reinstate Count I of the Complaint, which is why summary judgment on Count I is being granted in favor of the EFIH Debtors without prejudice. Finally, the Court has held that a genuine issue of material fact exists as to whether the Trustee can establish cause to lift the automatic stay. Thus, the Court will grant summary judgment, in part, in favor of the EFIH Debtors on the Stay–Applicability Motion in that the automatic stay is applicable and the issuance of the notice of rescission was a stay violation. The Court will not grant summary judgment in favor of either party on the Stay–Applicability Motion on the issue of whether the Trustee can establish cause exists to lift the automatic stay.

IV. CONCLUSION

95. For the reasons and to the extent set forth above, the EFIH Debtors' motion for summary judgment is granted, in part, and denied, in part, and the Trustee's motion for summary judgment is denied in its entirety. Summary judgment is entered in favor of the EFIH Debtors on Counts I–IV of the Complaint, provided, however, that entry of summary judgment on Count I of the Complaint is without prejudice, summary judgment is entered, in part, in favor of the EFIH Debtors on the Stay–Applicability Motion, and summary judgment is not entered on the Stay–Applicability Motion solely to the issue of whether cause exists to lift the automatic stay.

96. An order will be issued.

All Citations

527 B.R. 178

Footnotes

- 1 The Court hereby makes the following findings of fact and conclusions of law pursuant to [Fed. R. Bank. P. 7052](#), which is applicable to this matter by virtue of [Fed. R. Bankr. P. 9014](#). To the extent any findings of fact constitute conclusions of law, they are adopted as such. To the extent any conclusions or law constitute findings of fact, they are adopted as such.

- [2](#) Capitalized terms in the Introduction and Procedural History section not otherwise defined in this section are defined below.
- [3](#) The non-settling Noteholders appealed the Court's Order approving the EFIH First Lien Settlement. The district court, in an order dated February 19, 2015, affirmed this Court's Order and dismissed the non-settling Noteholders' appeal. (No. 14–00723, D.I. 50 (D.Del. 2015).)
- [4](#) References in this opinion to “D.I.,” without further description, shall refer to docket entries in this adversary proceeding, No. 14–50363.
- [5](#) Deposition transcripts referenced herein are cited as “Deponent Tr. Page:line”
- [6](#) See Horton Tr. 129:12–135:23, 151:23–152:22, 162:15–24, 176:12–177:15, 181:6–17; Keglevic Tr. 153:3–8, 162:23163:18, 174:22–175:6, 207:13–208:1; Horton Ex. 13 (Oct. 18, 2012 dealer manager agreement) at 0018, 0030 (EFIH representation that it is solvent); Keglevic Ex. 9 (EFIH Dec. 21, 2012 dealer manager agreement) at 9706 (EFIH representation that it is solvent); Horton Ex. 14 (Feb.2013 presentation) at 2554 (referring to a “solvent” EFIH); Horton Ex. 15 (March 2013 presentation) at 5602 (same).
- [7](#) No. 14–10979, D.I. 859 (DIP Financing Order) ¶ 12 (directing Trustee to reduce Notes in customary manner following payment).
- [8](#) A secured claim is allowable only if, in the first instance, it is “provided for under the agreement ... under which such claim arose.”  [11 U.S.C. § 506\(b\)](#); see *id.* § 502(b); [HSBC Bank USA, N.A. v. Calpine Corp.](#), [No. 07–3088](#), [2010 WL 3835200](#), at *5 (S.D.N.Y. Sept. 15, 2010) (citing  [Travelers Cas. & Sur. Co. of Am.](#), [549 U.S. 443](#), [450, 127 S.Ct. 1199](#), [167 L.Ed.2d 178](#) (2007)).
- [9](#) Because this Court does not find that an ambiguity exists, it is not necessary to consider the question whether the Indenture need to be construed against the EFIH Debtors. [Wallace v. 600 Partners Co.](#), [86 N.Y.2d 543](#), [634 N.Y.S.2d 669](#), [658 N.E.2d 715](#), [717](#) (1995) (“The rules governing the construction of ambiguous contracts are not triggered unless the court first finds an ambiguity.”).
- [10](#) The Trustee cites to  [NML Capital v. Republic of Argentina](#), [17 N.Y.3d 250](#), [928 N.Y.S.2d 666](#), [952 N.E.2d 482](#), [492](#) (2011) for the proposition that absent specific language indicating that the parties intended for 3.07(c) to terminate upon acceleration, section 3.07(c) still applies after acceleration. This is not the law. In  [NML Capital](#), the Second Circuit stated that Argentina had not pointed to any language indicating that the biannual interest payment terminated upon acceleration of the debt.  [Id.](#) at 263. It did not state that there must be specific language indicating that the parties intended for a provision to terminate upon acceleration.
- [11](#) See also [Fed. R. Civ. P. 54\(a\)](#) (“Definition; Form. ‘Judgment’ as used in these rules includes a decree and any order from which an appeal lies.”); Black’s Law Dictionary 970 (10th ed.2014) (“judgment” means “[a] court’s final determination of the rights and obligations of the parties in a case. The term judgment includes an equitable decree and any order from which an appeal lies.”).
- [12](#) Moreover, even were the automatic stay a judgment under section 6.02 of the Indenture, the automatic stay can always be lifted. In that case, rescission would no longer conflict with a judgment of the Court because the stay/judgment would simply cease to exist.

In re Energy Future Holdings Corp., 842 F.3d 247 (2016)

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842 F.3d 247

United States Court of Appeals, Third Circuit.

IN RE: ENERGY FUTURE HOLDINGS

CORP., a/k/a TXU Corp. a/k/a TXU

Corp a/k/a/ Texas Utilities, et al., Debtors

Delaware Trust Company, f/k/a [CSC Trust Company of Delaware](#), as Indenture Trustee, Appellant

v.

[Energy Future Intermediate Holding Company LLC](#); [EFIH Finance Inc.](#); Ad Hoc Committee of EFIH Unsecured Noteholders

In re: Energy Future Holdings Corp., a/k/a TXU Corp. a/k/a TXU Corp a/k/a Texas Utilities, et al., Debtors Computer Trust Company, NA & Computershare Trust Company of Canada, Appellants

v.

[Energy Future Intermediate Holding Company LLC](#); [EFIH Finance Inc.](#)

No. 16-1351

|

Nos. 16-1926, 16-1927 & 16-1928

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Argued September 27, 2016

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(Opinion filed November 17, 2016)

Synopsis

Background: Indenture trustee objected to motion by Chapter 11 debtor for leave to obtain debtor-in-possession financing to pay off notes that had been accelerated upon its bankruptcy filing, on ground that noteholders were entitled to early redemption premium. The United States Bankruptcy Court for the District of Delaware, [Christopher S. Sontchi](#), J., [527 B.R. 178](#), concluded that noteholders were not entitled to premium, and later denied motion for relief from stay to decelerate notes, [533 B.R. 106](#), and reached same conclusion with regard to second lien noteholders' right to early redemption premium, [539 B.R. 723](#). Indenture trustee appealed, and the District Court, [Richard G. Andrews](#),

J., [2016 WL 1451045](#) and [2016 WL 627343](#), affirmed. Indenture trustee appealed.

Holdings: The Court of Appeals, [Ambro](#), Circuit Judge, held that:

[1] “redemption,” of kind required to trigger debtor-borrower's obligation for early redemption premium, could include both pre- and post-maturity repayments of note;

[2] debtor-borrower's redemption of notes that had been accelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as “voluntary”;

[3] redemption, coming before date specified in parties' agreement, triggered debtor's obligation for early redemption premium; and

[4] mere fact that promissory notes had been automatically accelerated as result of debtor-borrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable.

Reversed and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (20)

[1] [Bankruptcy](#) [Conclusions of law; de novo review](#)

Bankruptcy court's determinations on questions of statutory construction and contract interpretation are legal determinations reviewable de novo.

[3 Cases that cite this headnote](#)

[2] [Federal Courts](#) [Highest court](#)
[Federal Courts](#) [Anticipating or predicting state decision](#)

When interpreting state law, federal court must follow the state's highest court, and if state's highest court has not provided guidance, federal court is charged with predicting how that court would resolve the issue.

[14 Cases that cite this headnote](#)

- [3] [Federal Courts](#) ➡ [Highest court](#)
[Federal Courts](#) ➡ [Inferior courts](#)
[Federal Courts](#) ➡ [Sources of authority; assumptions permissible](#)

To predict how state's highest court would resolve an unsettled question of state law, federal court must take into consideration: (1) what that court has said in related areas; (2) the decisional law of state's intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue.

[12 Cases that cite this headnote](#)

- [4] [Contracts](#) ➡ [Intention of Parties](#)
 Under New York law, fundamental, neutral precept of contract interpretation is that agreements are construed in accordance with parties' intent.

[3 Cases that cite this headnote](#)

- [5] [Contracts](#) ➡ [Language of contract](#)
 Under New York law, best evidence of what parties to written agreement intend is what they say in their writing.

- [6] [Contracts](#) ➡ [Application to Contracts in General](#)
[Contracts](#) ➡ [Rewriting, remaking, or revising contract](#)

Under New York law, it is role of courts to enforce agreement made by the parties, not to add, excise or distort the meaning of terms that they chose to include, thereby creating a new contract under the guise of construction.

[1 Cases that cite this headnote](#)

- [7] [Contracts](#) ➡ [Rewriting, remaking, or revising contract](#)

[Contracts](#) ➡ [Language of contract](#)

Under New York law, adherence to traditional principles of contract construction, that best evidence of what parties to written agreement intend is what they say in their writing, and that court may not add to, excise or distort the meaning of the terms that parties chose to employ under the guise of contract construction, is particularly appropriate when interpreting documents drafted by sophisticated, counseled parties, that involve the loan of substantial sums of money.

[1 Cases that cite this headnote](#)

- [8] [Commercial Paper](#) ➡ [Charges, premiums, and penalties](#)

Under New York law, "redemption," of kind required to trigger borrower's obligation for early redemption premium, may include both pre- and post-maturity repayments of note.

- [9] [Commercial Paper](#) ➡ [Charges, premiums, and penalties](#)

Chapter 11 debtor-borrower's redemption of notes that had been accelerated automatically as result of its bankruptcy filing, over objection of noteholders that did not want to be repaid early, but that had been blocked by automatic stay from decelerating the notes, had to be regarded as "voluntary," as required to trigger debtor-borrower's obligation for early redemption premium, where debtor had the option, pursuant to its reorganization plan, to reinstate the accelerated notes' original maturity date but chose not to do so, and had in fact filed for bankruptcy in attempt to repay notes early while avoiding obligation for early redemption premium.

[2 Cases that cite this headnote](#)

[10] **Commercial Paper** ➡ [Charges, premiums, and penalties](#)

Chapter 11 debtor-borrower's voluntary redemption of notes that had been accelerated automatically as result of its bankruptcy filing was in nature of early redemption, of kind triggering its obligation for early redemption premium; while redemption occurred after notes had matured as result of being automatically accelerated, it occurred prior to due date specified in agreement between parties.

[1 Cases that cite this headnote](#)

[11] **Commercial Paper** ➡ [Charges, premiums, and penalties](#)

Mere fact that promissory notes had been automatically accelerated as result of debtor-borrower's Chapter 11 filing, pursuant to one provision of trust indenture, did not render another provision requiring payment of early redemption premium inapplicable; provisions had to be construed together in order to give effect to both.

[12] **Contracts** ➡ [Construction as a whole](#)

Under New York law, contracts are to be interpreted to avoid inconsistencies and to give meaning to all of their terms.

[4 Cases that cite this headnote](#)

[13] **Commercial Paper** ➡ [Charges, premiums, and penalties](#)

Language in second lien trust indenture, providing that, upon acceleration of notes, it was not only the principal, but "premium, if any," that would become immediately due and payable, was most naturally interpreted as referring to early redemption premium, the only "premium" referred to in trust indenture, and clarified that lender was entitled to this early redemption premium even after notes had been accelerated, without need for any greater level of exactness by parties.

[4 Cases that cite this headnote](#)

[14] **Commercial Paper** ➡ [Acceleration](#)
Commercial Paper ➡ [Charges, premiums, and penalties](#)

Under New York law, while agreement must clearly provide for payment of prepayment penalty even after note has been accelerated, in order for lender to obtain such a premium in connection with borrower's payment of accelerated note, that is not the rule with regard to yield-protection payments not styled as prepayment premiums; rather, if borrowers want their contractual obligation for yield protection payment not tied to any "prepayment" to terminate upon acceleration of debt, they must make that intent clear.

[15] **Federal Courts** ➡ [State Courts and Their Decisions in General](#)

In interpreting laws of state, federal court need not follow the judgments of its trial courts.

[8 Cases that cite this headnote](#)

[16] **Commercial Paper** ➡ [Acceleration](#)

Under New York law, while acceleration advances the maturity date of debt, other terms of contract that are not necessarily impacted by acceleration do not automatically cease to be enforceable after acceleration.

[1 Cases that cite this headnote](#)

[17] **Commercial Paper** ➡ [Acceleration](#)
Commercial Paper ➡ [Prepayment](#)
Commercial Paper ➡ [Prepayment](#)

Acceleration, by definition, advances the maturity date of debt, so that any payment thereafter is not prepayment, but is instead payment made after maturity; after maturity, any option to prepay can no longer be exercised.

[2 Cases that cite this headnote](#)

[18] Commercial Paper ➡ [Prepayment](#)

Unlike prepayment, redemption of debt security may occur at or before maturity.

[1 Cases that cite this headnote](#)

[19] Commercial Paper ➡ [Charges, premiums, and penalties](#)

Under New York law, while a premium contingent on “prepayment” cannot take effect after a debt’s maturity, a premium tied to a “redemption” is unaffected by acceleration of debt’s maturity.

[1 Cases that cite this headnote](#)

[20] Contracts ➡ [Application to Contracts in General](#)

In interpreting contract under New York law, court must give effect to the words and phrases that the parties chose.

[6 Cases that cite this headnote](#)

*250 Appeal from the United States District Court for the District of Delaware (D.C. Civil Action Nos. 1–15–cv–00620, 1–15–cv–01011, 1–15–cv–01014 & 1–15–cv–01015), District Judge: Honorable Richard G. Andrews

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Before: AMBRO, SMITH,* and [FISHER](#), Circuit Judges

OPINION OF THE COURT

[Ambro](#), Circuit Judge

We address what happens when one provision of an indenture for money loaned provides that the debt is accelerated if the debtor files for bankruptcy and while in bankruptcy it opts to redeem that debt when another indenture provision provides for a redemption premium. Does the premium, *251 meant to give the lenders the interest yield they expect, fall away because the full principal amount is now due and the noteholders are barred from rescinding the acceleration of debt? We hold no.

I. BACKGROUND

A. The Notes

Energy Future Intermediate Holding Company LLC and EFIH Finance Inc. (collectively, “EFIH”) borrowed in 2010

approximately \$4 billion at a 10% interest rate by issuing Notes due in 2020 and secured by a first-priority lien on their assets (the “First Lien Notes”). To protect (at least in part) the lenders’ anticipated interest-rate yield, the Indenture governing the loan (the “First Lien Indenture”) provides in § 3.07, captioned “Optional Redemption,” that “[a]t any time prior to December 1, 2015, [EFIH] may redeem all or a 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” (emphasis in original). “Applicable Premium” is what we shall call the make-whole, or yield-protection, contractual substitute for interest lost on Notes redeemed before their expected due date.

The First Lien Indenture contains an acceleration provision in § 6.02 that makes “all outstanding Notes ... due and payable immediately” if EFIH files a bankruptcy petition. The same provision also gives the First Lien Noteholders the right to “rescind any acceleration [of] the Notes and its consequences[.]”

EFIH borrowed funds again in 2011 and 2012 by issuing two sets of Notes secured by a second-priority lien on its assets (the “Second Lien Notes”). As with the First Lien Noteholders, EFIH promised to pay holders of the Second Lien Notes (the “Second Lien Noteholders”) a make-whole premium—in a provision essentially identical to the one quoted above—if it chose to redeem the Second Lien Notes, at its option, on or before a date certain (May 15, 2016 for Second Lien Notes set to mature in 2021 and March 1, 2017 for those maturing in 2022).

The Indenture for the Second Lien Notes (the “Second Lien Indenture”) contains an acceleration provision different from § 6.02 of the First Lien Indenture: if EFIH files a bankruptcy petition, “all principal of *and premium, if any*, interest ... [.] and *any other monetary obligations* on the outstanding Notes shall be due and payable immediately[.]” Second Lien Indenture § 6.02 (emphases added). Like the First Lien Noteholders, the Second Lien Noteholders have the right to “rescind any acceleration [of] the Notes and its consequences” under § 6.02.

B. Refinancing the First Lien Notes

When market interest rates went down, EFIH considered refinancing the Notes. Refinancing outside of bankruptcy would have required it to pay the make-whole premium. *See*

 [*In re Energy Future Holdings Corp.*, 527 B.R. 178, 188 \(Bankr. D. Del. 2015\)](#). By filing for bankruptcy, however, EFIH believed it might avoid the premium. So on November 1, 2013, it filed an 8-K form with the Securities and Exchange Commission “disclosing [its] proposal [whereby] ... EFIH would file for bankruptcy and refinance the Notes without paying any make-whole amount.”  [*Id.*](#) (internal quotation marks omitted).

Six months later, on April 29, 2014, EFIH and other members of its corporate family filed Chapter 11 bankruptcy petitions in the Bankruptcy Court for the District of Delaware. Once in bankruptcy, EFIH sought to “take advantage of highly favorable debt market conditions to refinance,” *252

beginning with the First Lien Notes.  [*Id.* at 189](#). It asked the Bankruptcy Court for leave to borrow funds to pay them off and to offer a settlement to any of its First Lien Noteholders who agreed to waive their right to the make-whole.  [*Id.* at 182, 189](#).

Fearing loss of the income stream EFIH had promised, the Trustee for the First Lien Noteholders—Delaware Trust Company—filed an adversary proceeding on May 15, 2014. It sought a declaration that refinancing the First Lien Notes would trigger the make-whole premium.

EFIH’s bankruptcy filing caused the “[First Lien] Notes [to] be[come] due and payable immediately” under Indenture § 6.02, subject to the right of their holders to rescind acceleration. So the Trustee also requested a declaration that it could rescind the First Lien Notes’ acceleration without violating the automatic stay of creditors’ acts to enforce their remedies once bankruptcy occurs,  [11 U.S.C. § 362](#). However, should the stay apply, the Trustee asked the Court to lift it.

When the Bankruptcy Court did not act, on June 4, 2014, the holders of a majority of the principal amount of the First Lien Notes sent a notice to EFIH rescinding acceleration, contingent on relief from the automatic stay. Two days later, the Bankruptcy Court granted EFIH’s motion to refinance. It ruled, however, that the refinancing would not prejudice the First Lien Noteholders’ rights in the pending adversary proceeding.

On June 19, 2014, EFIH paid off the First Lien Notes and refinanced the debt at a much lower interest rate of 4.25%,

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saving “an estimated \$13 million in interest per month.” [!\[\]\(4729e517bc6a7cd81c8025b9646574fb_img.jpg\) *In re Energy Future Holdings Corp.*, 527 B.R. at 189](#). This of course disadvantaged the First Lien Noteholders, who had contracted to receive interest at 10% until the Notes’ full maturity in 2020. EFIH did not compensate the loss set by contract by paying the make-whole, which would have been approximately \$431 million.

C. Refinancing the Second Lien Notes

Shortly after entering bankruptcy, EFIH declared in an SEC 8–K filing that it “reserve[d] the right to ... redeem ... some or all of the outstanding ... Second Lien Notes” but asserted that it “[wa]s under no obligation to do so.” See *In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222. Aware of this, as well as the First Lien Noteholders’ predicament, the Trustees for the Second Lien Noteholders—Computershare Trust Company, N.A. and Computershare Trust Company of Canada—filed their own adversary proceeding on June 16, 2014.

Like the First Lien Trustee, the Second Lien Trustees sought a declaration that EFIH would have to pay the make-whole if it chose to refinance the Second Lien Notes. The Second Lien Noteholders also issued a notice rescinding acceleration of that debt and requested retroactive relief from the automatic stay so that the rescission could take effect.

With the Bankruptcy Court's permission, EFIH refinanced a portion of the Second Lien Notes on March 10, 2015—again without paying the yield-protection amount.

D. First Lien Make–Whole Litigation

Nine months after granting leave to refinance the First Lien Notes, the Bankruptcy Court considered whether EFIH had to pay the make-whole. [!\[\]\(5361750c22c4e047a52f4eac1ec2d4cc_img.jpg\) *In re Energy Future Holdings Corp.*, 527 B.R. at 191–95](#). The holding was that it did not. [!\[\]\(f276343e5e0d2402c20fdc9e8443c0dd_img.jpg\) *Id.*](#)

*253 Although EFIH's obligation to pay the make-whole appears in § 3.07 of the First Lien Indenture, the Court focused its reasoning on the acceleration provision in § 6.02. Because it took effect when EFIH entered bankruptcy but made no mention of the make-whole, the Court concluded that none was due.¹

It further held that the automatic stay prevented the First Lien Noteholders’ attempt to rescind the Notes’ acceleration. *Id.* at

197. Finally, after trial in 2015, it denied the Trustee's motion to lift the stay retroactively “to a date on or before June 19, 2014, to allow the Trustee to ... decelerate the Notes.” [!\[\]\(0d5ec72f61334709c3fc9450209b754f_img.jpg\) *In re Energy Future Holdings Corp.*, 533 B.R. 106, 116 \(Bankr. D. Del. 2015\)](#).

These rulings put the First Lien Noteholders in a Catch–22. When EFIH filed for bankruptcy, the maturity of its debt accelerated. This, according to the Bankruptcy Court, cut off the First Lien Noteholders’ right to yield-protection. Rescission of the acceleration would have restored that right. But rescission was blocked by the automatic stay, which the Court refused to lift.

The District Court for the District of Delaware affirmed the Bankruptcy Court's rulings in February 2016. [!\[\]\(7d1d6890825e83a6a4a51febe2dcc7f3_img.jpg\) *In re Energy Future Holdings Corp.*, No. CV 15–620 RGA, 2016 WL 627343, at *1–3 \(D. Del. Feb. 16, 2016\)](#).

E. Second Lien Make–Whole Litigation

The Second Lien Noteholders fared no better than the First Lien Noteholders. Six months after EFIH refinanced a portion of the Second Lien Notes, the Court considered the Second Lien Noteholders’ entitlement to the make-whole. In construing the Second Lien Indenture's provisions, the Court adopted its findings and conclusions from the make-whole litigation for the First Lien Noteholders. After rejecting arguments based on the few differences between the First and Second Lien Indentures’ texts, the Court held that the Second Lien Noteholders also were not entitled to yield-protection.

[!\[\]\(84f47badaad7772cd95667a7c387a639_img.jpg\) *In re Energy Future Holdings Corp.*, 539 B.R. 723, 733 \(Bankr. D. Del. 2015\)](#). The District Court again affirmed.

[!\[\]\(28f72b996fc97883dfd9d4e8b1b16b4e_img.jpg\) *In re: Energy Future Holdings Corp.*, No. CV 15–1011–RGA, 2016 WL 1451045, at *4 \(D. Del. Apr. 12, 2016\)](#).

* * * * *

The First and Second Lien Trustees brought appeals on behalf of their respective Noteholders, which we consolidated. They argue the Bankruptcy and District Courts erred by holding that the Indentures did not require payment of the make-whole when EFIH redeemed the Notes after their maturity had accelerated.

II. JURISDICTION AND GOVERNING LAW

[1] We have jurisdiction to hear appeals from the Bankruptcy and District Courts in this Circuit under [28 U.S.C. §§ 158 and 1291](#). Statutory construction and contract interpretation are legal questions reviewed anew by us. The contracts at issue—the Indentures that control the Notes—are governed by New York law. First Lien Indenture § 13.08; Second Lien Indenture § 13.08.

[2] [3] “When interpreting state law, we follow a state’s highest court; if that state’s ^{*254} highest court has not provided guidance, we are charged with predicting how that court would resolve the issue.” *Illinois Nat. Ins. Co. v. Wyndham Worldwide Operations, Inc.*, 653 F.3d 225, 231 (3d Cir. 2011). “To do so, we must take into consideration: (1) what that court has said in related areas; (2) the decisional law of the state intermediate courts; (3) federal cases interpreting state law; and (4) decisions from other jurisdictions that have discussed the issue.” *Id.*

[4] [5] [6] [7] Here we look to the New York Court of Appeals, which has held that “[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties’ intent.” [Greenfield v. Philles Records, Inc.](#), 98 N.Y.2d 562, 750 N.Y.S.2d 565, 780 N.E.2d 166, 170 (2002) (internal citations and quotation marks omitted). “The best evidence of what parties to a written agreement intend is what they say in their writing.” *Id.* “It is the role of the courts to enforce the agreement made by the parties—not to add, excise or distort the meaning of the terms they chose to include, thereby creating a new contract under the guise of construction.” [NML Capital v. Republic of Argentina](#), 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 489–90 (2011). “Adherence to these principles is particularly appropriate in a case like this involving interpretation of documents drafted by sophisticated, counseled parties and involving the loan of substantial sums of money.” *Id.*

III. ANALYSIS

A. The First Lien Indenture

Although both Indentures contain many provisions, this case centers on the words of but two: §§ 3.07 and 6.02.² The former, noted earlier as titled “Optional Redemption,” states when the make-whole is due: “At any time prior to December 1, 2015, the Issuer may redeem all or a

part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium [*i.e.*, the make-whole] ... and accrued and unpaid interest” (emphasis in original). Indenture § 3.07. The premium decreases annually on a sliding scale between December 1, 2015 and November 30, 2018. From December 1, 2018 until the Notes’ maturity date in 2020, the Notes may be optionally redeemed without payment of a premium. *See* Indenture §§ 1.01 (defining “Applicable Premium” and providing formula for its application) & 3.07(d) (setting premium amount for redemptions after December 1, 2015).

Section 6.02 provides that on the filing of a bankruptcy petition by EFIH “all outstanding Notes shall be due and payable immediately without further action or notice.” Indenture § 6.02; *see also id.* § 6.01 (defining bankruptcy as an event of default).

Any duty to pay the make-whole comes from § 3.07. It leaves us with three questions: was there a redemption; was it optional; and if yes to both, did it occur before December 1, 2015?

Section 3.07 does not define “redemption.” As a redemption “usu[ally] refers to the repurchase of a bond before maturity,” Black’s Law Dictionary 1390 (9th ed. 2009), EFIH contends that we should limit the term to mean only repayments of debt ^{*255} that pre-date the debt’s maturity. Section 6.02 accelerated the Notes’ maturity to the date EFIH entered bankruptcy—April 29, 2014. It refinanced the Notes several weeks later. Thus it argues that its post-maturity refinancing was not a redemption.

[8] But contrary to that position, New York and federal courts deem “redemption” to include both pre- and post-maturity repayments of debt. *See e.g., Chesapeake Energy Corp. v. Bank of N.Y. Mellon*, 773 F.3d 110, 116 (2d Cir. 2014) (in interpreting New York law, to “redeem” is to “repay[] ... a debt security ... at or before maturity” (quoting *Barron’s Dictionary of Finance and Investment Terms* 587 (8th ed. 2010))); [Treasurer of New Jersey v. U.S. Dep’t of Treasury](#), 684 F.3d 382, 388 (3d Cir. 2012) (discussing regulations permitting bondholders to “present ... long-matured savings bond[s] for redemption”); *Fed. Nat’l Mortg. Ass’n v. Miller*, 123 Misc.2d 431, 473 N.Y.S.2d 743, 744 (N.Y. Sup. Ct. 1984) (“debtor may redeem” mortgage by “pay[ing] ... accelerated debt”); *see also N.Y. U.C.C. § 9–623*, Official Comment No. 2 (“To redeem the collateral ... of a secured obligation [that] has been accelerated, it would be necessary to tender the entire

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balance.”). Accordingly, EFIH’s June 19, 2014 refinancing was a “redemption” within the meaning of § 3.07.

[9] Whether the redemption was “[o]ptional” is next up. EFIH argues that refinancing the Notes was not optional because § 6.02 made them “due and payable immediately without further action or notice” once it was in bankruptcy. EFIH, however, filed for Chapter 11 protection voluntarily. Once there, it had the option, per its plan of reorganization, to reinstate the accelerated Notes’ original maturity date under [Bankruptcy Code § 1124\(2\)](#) rather than paying them off immediately. It chose not to do so, and instead followed the path laid out six months before in its SEC 8–K filing.

EFIH contends nonetheless that any redemption was mandatory rather than optional. But this contention does not match the facts. Indeed “a chapter 11 debtor that has the capacity to refinance secured debt on better terms ... is in the same position within bankruptcy as it would be outside bankruptcy, and cannot reasonably assert that its repayment of debt is not ‘voluntary.’ ” Scott K. Charles & Emil A. Kleinhaus, *Prepayment Clauses in Bankruptcy*, 15 *Am. Bankr. Inst. L. Rev.* 537, 552 (2007).

Events leading up to the post-petition financing on June 19, 2014 demonstrate that the redemption was very much at EFIH’s option. To repeat, months before its Chapter 11 filing EFIH announced its plan to redeem the Notes before their stated maturity date.  [In re Energy Future Holdings Corp.](#), 527 B.R. at 189. And after filing for bankruptcy, it produced another 8–K stating that it may, “but [wa]s under no obligation” to, redeem the similarly situated Second Lien Notes. *In Re Energy Future Holdings Corp.*, No. 14–50363 (Bankr. D. Del.), Docket Entry 181, A–222.

The irony is that the Noteholders did not want to be paid back on June 19, 2014. They attempted to rescind the Notes’ acceleration on June 4, 2014, but were blocked by the automatic stay.  [In re Energy Future Holdings Corp.](#), 533 B.R. at 108. When EFIH redeemed the Notes, it did so “on a non-consensual basis,” that is, over the Noteholders’ objection. J.A. 1214. Logic leaves no doubt this redemption of the Notes was “[o]ptional” under § 3.07.

[10] And, only to close the loop, all this occurred before December 1, 2015. Hence § 3.07 on its face requires that EFIH pay *256 the Noteholders the yield-protection payment.

B. The Relationship Between §§ 3.07 And 6.02 (Or Whether § 6.02, Once Triggered, Annuls § 3.07)

[11] At oral argument, EFIH’s counsel described §§ 3.07 and 6.02 as “different pathways” that we must choose between. Only the latter is relevant, the argument goes, because it addresses post-maturity payment more specifically than § 3.07, and specific contract provisions govern over more general ones. See [Muzak Corp. v. Hotel Taft Corp.](#), 1 N.Y.2d 42, 150 N.Y.S.2d 171, 133 N.E.2d 688, 690 (1956).

It is not obvious why EFIH believes § 6.02 addresses the consequences of the June 2014 redemption more specifically than § 3.07 or why we must choose between them. The two sections simply address different things: § 6.02 causes the maturity of EFIH’s debt to accelerate on its bankruptcy, and § 3.07 causes a make-whole to become due when there is an optional redemption before December 1, 2015. Rather than “different pathways,” together they form the map to guide the parties through a post-acceleration redemption. In any event, § 3.07 is the only provision that specifically addresses redemptions.

To support its position, EFIH looks primarily to  [In re AMR Corp.](#), 730 F.3d 88 (2d Cir. 2013). It focused on an indenture’s acceleration provision to determine whether a make-whole was due. Crucially, however, that provision addressed outright whether a make-whole would be due following acceleration.

“[I]f an Event of Default referred to in ... Section 4.01(g) [*i.e.*, the voluntary filing of a bankruptcy petition] ... shall have occurred and be continuing, then and in every such case the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (**but for the avoidance of doubt, without Make–Whole Amount**), shall immediately and without further act become due and payable without presentment, demand, protest or notice, all of which are hereby waived.”

 [Id.](#) at 99 (emphasis added).

 [AMR](#) is the easy case; just follow the text. The litigants took a route suggested by the New York Court of Appeals in  [NML Capital v. Republic of Argentina](#): parties that want obligations to cease when accelerated should say so in their agreement.  [928 N.Y.S.2d 666, 952 N.E.2d at 490](#) (“Had

Argentina intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways.”).

[12] In our case, § 6.02 makes no mention of the make-whole. EFIH argues that this silence saps § 3.07's effect. On a general note, that reading would cross cords with our duty to “give full meaning and effect to all of [the Indenture's] provisions.” *Chesapeake Energy Corp.*, 773 F.3d at 113–14 (internal quotation marks omitted). “Contracts are ... to be interpreted to avoid inconsistencies and to give meaning to all [their] terms.” *Barrow v. Lawrence United Corp.*, 146 A.D.2d 15, 18, 538 N.Y.S.2d 363 (N.Y. App. Div. 1989). More specifically, EFIH's interpretation conflicts with the New York Court of Appeals' statement that “[w]hile it is understood that acceleration advances the maturity date of the debt,” there is no “rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration.” *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. *257 Accordingly, § 3.07 stands on its own, unswayed by the Indenture's other provisions.

EFIH alternatively argues that §§ 6.02 and 3.07 are in conflict, so that only one may apply to the June 2014 redemption. Subsection 3.07(e) prescribes detailed notice procedures for EFIH to follow before redeeming the Notes, while § 6.02 makes the Notes “due and payable immediately without further action or notice.” If the notice procedures were not followed, no redemption could follow. Yet EFIH offers no reason why it could not have complied with § 3.07(e)'s notice procedures. In any event, it cannot use its own failure to notify to absolve its duty to pay the make-whole. Any conflict between the two provisions in this instance is illusory.

We know no reason why we should choose between §§ 3.07 and 6.02 when both plainly apply. By its own terms, § 3.07 governs the optional redemption embedded in the refinancing and requires payment of the make-whole. It surpasses strange to hold that silence in § 6.02 supersedes § 3.07's simple script.

C. The Second Lien Indenture's Additional Language

[13] As mentioned above, the Second Lien Indenture's acceleration provision contains words not present in the First Lien Indenture. These additions make explicit in the Second Lien Indenture the link between acceleration under § 6.02 and the make-whole for an optional redemption per § 3.07. While for the First Lien Indenture these concepts

are without cross-reference and separate, in the Second Lien Indenture they are tied together. Sections 3.07 and 6.02 are not merely compatible but complementary. In any event, the result is the same no matter the Indenture—there were optional redemptions before a date certain, thereby triggering make-whole premiums.

When EFIH filed its bankruptcy petition, Second Lien Indenture § 6.02 caused “all principal of and *premium, if any*, interest ... [,] and any other monetary obligations on the outstanding [Second Lien] Notes [to] be[come] due and payable immediately” (emphasis added). Compare First Lien Indenture § 6.02 (“all outstanding Notes shall be due and payable immediately”). The words “premium, if any,” are most naturally read to reference § 3.07's “Applicable Premium”—that is, the make-whole.

The most EFIH musters is that the Second Lien Indenture could have been even more specific by replacing “premium, if any,” with “a premium owed under section 3.07” or “Applicable Premium or other premium owed as if repayment under this section were an Optional Redemption under section 3.07.” EFIH's Br. at 24–25. But we see no reason to demand such exactness. Indeed, EFIH has not suggested any other “premium” the drafters could have had in mind.

True, in a case called *Momentive*, the Bankruptcy Court for the Southern District of New York held the words “premium, if any,” were not specific enough to require payment of a make-whole in similar circumstances. *In re MPM Silicones, LLC*, No. 14-22503-RDD, 2014 WL 4436335, at *13 (Bankr. S.D.N.Y. Sept. 9, 2014), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015) (“*Momentive*”). We believe, however, the result in *Momentive* conflicts with that indenture's text and fails to honor the parties' bargain. For these and additional reasons discussed below, we find it unpersuasive.

By including the words “premium, if any,” in its acceleration provision, the Second Lien Indenture leaves no doubt that §§ 3.07 and 6.02 work together. The latter is explicit that a premium is in play, and *258 the only relevant premium provision is the former. Thus both remained applicable following bankruptcy, and, pursuant to the agreement struck with the Second Lien Noteholders, they are entitled to the make-whole.

D. The Effect of Acceleration on Make-Whole Provisions

[14] Notwithstanding the result dictated by § 3.07's text in both Indentures, EFIH asserts that it should not have to pay the make-whole because § 6.02 caused the Notes' maturity to accelerate before it paid them off. Citing a New York trial court opinion, [*Nw. Mut. Life Ins. Co. v. Uniondale Realty Assocs.*, 11 Misc.3d 980, 816 N.Y.S.2d 831, 836 \(N.Y. Sup. Ct. 2006\)](#) ([*Northwestern*](#)), it argues that courts must close their eyes to make-whole provisions once a debt's maturity has accelerated.

[15] In interpreting laws of a state, we need not follow the judgments of its trial courts. See [*MRL Dev. I, LLC v. Whitecap Inv. Corp.*, 823 F.3d 195, 203 \(3d Cir. 2016\)](#) ("The Superior Court of the Virgin Islands ... is not the highest court of the Territory or even an intermediate appellate court, but rather a trial court. Accordingly, we are not bound by Superior Court decisions" (internal brackets, citations, and quotation marks omitted)). But even if we were inclined to do so here, EFIH's interpretation of [*Northwestern*](#) conflicts with the pronouncements of New York's highest court, which we follow on questions of New York law. See [*Illinois Nat. Ins. Co.*, 653 F.3d at 231](#).

[16] As we noted above, the New York Court of Appeals stated unequivocally in [*NML Capital v. Republic of Argentina*](#) that "[w]hile it is understood that acceleration advances the maturity date of the debt, [it was] unaware of any rule of New York law declaring that other terms of the contract not necessarily impacted by acceleration ... automatically cease to be enforceable after acceleration." [928 N.Y.S.2d 666, 952 N.E.2d at 492](#). Put differently, contract terms like § 3.07 that are applicable before acceleration remain so afterward.

In [*NML Capital*](#), New York's highest Court answered several questions certified to it by the U.S. Court of Appeals for the Second Circuit. [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486](#). Among them was "whether Argentina's obligation to make [certain contractually established interest] payments to bondholders continued after maturity or acceleration of the indebtedness[.]" [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 486](#). Argentina contended that, after the maturity of its debt had accelerated, bondholders were entitled only to their

principal and any accrued interest. [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490](#). Acceleration, it argued, terminated its duty to make biannual interest payments mandated by the bond documents. [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 487](#).

In rejecting those assertions, the New York Court of Appeals held that "in New York the consequences of acceleration of the debt depend on the language chosen by the parties in the pertinent loan agreement." [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 492](#). "Had Argentina ... intended that its responsibility to pay interest twice a year cease upon maturity, it could easily have clarified that intent in any number of ways." [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 490](#). For example, the bond documents could have specified that the payment "obligation continued 'until' the maturity date" or could have provided "that interest payments were to be made until the principal was due, thereby referring back to the loan maturity date." [*Id.*](#) However, because the bond language that Argentina pay biannual interest payments made no reference *259 to acceleration or maturity, it remained effective following the bonds' acceleration. [*Id.*, 928 N.Y.S.2d 666, 952 N.E.2d at 493](#). The takeaway for us is that § 3.07 applies no less following acceleration of the Notes' maturity than it would to a pre-acceleration redemption.

Despite the New York Court of Appeals' holding in [*NML Capital*](#) and still riding the [*Northwestern*](#) horse, EFIH contends that we should decline to require payment of the make-whole because the trial court declared that a "prepayment premium will not be enforced under default circumstances in the absence of a clause which so states[.]" [*Northwestern*, 816 N.Y.S.2d at 836](#). It held that a mortgage lender who chose to foreclose following default was not entitled to a "prepayment premium" because foreclosure had advanced the debt's maturity date. [*Id.*](#) "[P]repayment is a payment *before* maturity[.]" but after foreclosure prepayment is impossible as the debt has become due and payable immediately. [*Id.* at 837](#) (emphasis in original).

According to EFIH, [*Northwestern*](#) sets a rule that, unless an agreement clearly provides for it, no make-whole payment is due after a note's acceleration.

[17] No doubt prepayment premiums are the price of "an option voluntarily to prepay the loan and terminate the

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mortgage before the maturity.”  [In re S. Side House, LLC](#), 451 B.R. 248, 267 (Bankr. E.D.N.Y. 2011), *aff’d sub nom.*,  [U.S. Bank Nat. Ass’n v. S. Side House, LLC](#), No. 11–CV–4135 ARR, 2012 WL 273119 (E.D.N.Y. Jan. 30, 2012); *accord*  [Northwestern](#), 816 N.Y.S.2d at 836. “[A]cceleration, by definition, advances the maturity date of the debt so that payment thereafter is not prepayment but instead is payment made after maturity[.]” and logically the option to prepay can no longer be exercised after maturity.  [Matter of LHD Realty Corp.](#), 726 F.2d 327, 330–31 (7th Cir. 1984); [D.I.S., LLC v. Sagos](#), 38 A.D.3d 543, 832 N.Y.S.2d 581, 582 (2007) (“prepayment” penalty did not apply to tender of mortgage principal and interest following acceleration because post-acceleration payments are not “prepayments”).

[18] [19] Unlike prepayment, however, “redemption” of “a debt security” may occur “at or before maturity.” [Chesapeake Energy Corp.](#), 773 F.3d at 116 (emphasis added). Thus, while a premium contingent on “prepayment” could not take effect after the debt’s maturity,² a premium tied to a “redemption” would be unaffected by acceleration of a debt’s maturity.

Our understanding of New York law is that it follows a logical path: prepayments cannot occur when payment is now due by acceleration of the debt’s maturity. If parties want to mandate a “prepayment” premium following acceleration, they must clearly state it in their agreement. This is the  [Northwestern](#) rule.

Recently, however, bankruptcy courts, including the Bankruptcy Court here, have stretched  [Northwestern](#) beyond its language and applied its clear-statement rule to yield-protection payments not styled as prepayment premiums. In the  [Momentum](#) case we mentioned in our discussion of the Second Lien Indenture, a Bankruptcy Court considered language similar to that of both Indentures and nearly identical to the text of the Second Lien Indenture. Like the Indentures here, the  [Momentum](#) indenture required payment of a make-whole on optional redemptions occurring *260 before a particular date.  [Momentum](#), 2014 WL 4436335, at *13. The Court, however, disallowed the lenders’ claim for a make-whole, declaring it “well-settled law in New York” that a make-whole, like a prepayment premium, will only be due on a default and acceleration “when a

clear and unambiguous clause calls” for it.  [Momentum](#), 2014 WL 4436335, at *12–*13 (citing  [Northwestern](#)). The Delaware Bankruptcy Court followed the same line, declining to enforce the make-whole provision because “an indenture must contain express language requiring payment of a prepayment premium upon acceleration; otherwise, it is not owed.”  [In re Energy Future Holdings Corp.](#), 527 B.R. at 192 (construing First Lien Indenture); *accord*  [In re Energy Future Holdings Corp.](#), 539 B.R. at 733 (construing Second Lien Indenture).

By denying the make-whole after the Notes’ acceleration, the Bankruptcy Court pushed the  [Northwestern](#) rule beyond its language and underlying policy concerns. First, its application of the rule is off point because § 3.07 in the Indentures does not use the word “prepayment.”  [Northwestern](#) responds, in part, to the linguistic paradox created by the idea of a prepayment following acceleration. “Once the maturity date is accelerated to the present, it is no longer possible to prepay the debt before maturity.”  [Northwestern](#), 816 N.Y.S.2d at 834. That is why, if parties want a “prepayment” premium to survive acceleration and maturity, they must clearly state it.

The Indentures here present no linguistic tension to resolve. Nothing in § 6.02 negates the premium § 3.07 requires if an optional redemption occurs before a stated date. Acceleration here has no bearing on whether and when the make-whole is due.

[20] EFIH argues that, even though § 3.07 does not use the word “prepayment,” the make-whole is in substance a prepayment premium, and thus the  [Northwestern](#) rule should apply. But we must give effect to the “words and phrases” the parties chose. [Chesapeake Energy Corp.](#), 773 F.3d at 113–14;  [NML Capital](#), 928 N.Y.S.2d 666, 952 N.E.2d at 489–90. By avoiding the word “prepayment” and using the term “redemption,” they decided that the make-whole would apply without regard to the Notes’ maturity.

Moreover, beneath the  [Northwestern](#) holding was a policy concern that lenders should not be permitted “to recover prepayment premiums after default and acceleration in order to preserve an income stream ... absent any ‘voluntary’ prepayment.”  [Northwestern](#), 816 N.Y.S.2d at 836. There

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the mortgagee seeking the prepayment premium had elected to foreclose in order to recoup its investment immediately.

 *Id.* at 833. Ordinarily, by electing to accelerate the debt, a lender forgoes its right to a stream of payments in favor of immediate repayment.  *Matter of LHD Realty Corp.*,

726 F.2d at 331 & n.4. The  *Northwestern* Judge was concerned that lenders should not be able to seek immediate repayment and pile on by also receiving a premium. Here, by contrast, the Noteholders did not seek immediate payment. EFIH voluntarily redeemed the Notes over the Noteholders' objection. Hence even the policy guiding  *Northwestern* does not reach this case.

Finally, to repeat what we said at the outset, by declining to enforce § 3.07 after acceleration, the Bankruptcy Court ran afoul of New York authority by failing to enforce a contract provision—§ 3.07—not affected by acceleration.  *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 492. To reach its conclusion, it followed  *Momentive*, which described “automatic acceleration clauses” as “negating” the effect of make-whole redemption provisions.  *Momentive*, 2014 WL 4436335, at *14. That is not what  *NML Capital* tells us.

*261 EFIH answers that the Noteholders should have taken note of bankruptcy courts' novel application of  *Northwestern* and insisted on clearer language in the Indenture. See e.g.,  *In re Anchor Resolution Corp.*, 221 B.R. 330, 334 (Bankr. D. Del. 1998) (“If the maturity of any Series B Note shall be accelerated ... [,] there shall become due and payable ... as compensation to the holders ... a premium equal to the Make-Whole Amount.”). But this puts the burden backward; if EFIH wanted its duty to pay the make-whole

on optional redemption to terminate on acceleration of its debt, it needed to make clear that § 6.02 trumps § 3.07. See

 *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 490. The burden to make that showing is with EFIH. To place it on the Noteholders for EFIH's decision to redeem the Notes is a bridge too far.

* * * * *

Our “primary objective ... is to give effect to the intent of the parties as revealed by the language of their agreement.” *Chesapeake Energy Corp.*, 773 F.3d at 113–14. The language of the First Lien Indenture requires EFIH to pay a make-whole if it redeems the First Lien Notes at its option before December 1, 2015, and the Second Lien Indenture requires the same for redemptions of Second Lien Notes before May 15, 2016 or March 1, 2017 (depending on the initial maturity date of the particular debt instruments). EFIH redeemed the First Lien Notes at its option on June 19, 2014 and redeemed a portion of the Second Lien Notes on March 10, 2015. Redemptions, not prepayments, occurred here, they were at the election of EFIH, and they occurred before the respective dates noted. Statements of New York law by its highest Court and the federal Circuit Court in New York reinforce our conclusion that EFIH must pay the make-whole per the Indenture language before us.⁴

The judgments of the District Court are reversed with instructions to remand to the Bankruptcy Court for further proceedings consistent with this opinion. Any future appeals shall return to this panel.

All Citations

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Footnotes

* Honorable D. Brooks Smith, United States Circuit Judge for the Third Circuit, assumed Chief Judge status on October 1, 2016.

1 For the purpose of determining EFIH's duty to pay any make-whole, the Bankruptcy Court assumed that it was “solvent and able to pay all allowed claims of [its] creditors in full.”  *In re Energy Future Holdings Corp.*,

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- [527 B.R. at 183](#). We do the same. Because we do not have any briefing on the matter even without that assumption, we do not consider whether insolvency might have affected EFH's obligations.
- [2](#) In Sections A and B, we refer for convenience to the First Lien Indenture simply as the "Indenture." Likewise, we mean the First Lien Notes and First Lien Noteholders when we refer to "the Notes" or "the Noteholders" in these Sections. Thereafter the two terms mean all debt instruments and their holders under both the First Lien and Second Lien Indentures, which themselves may be referred to collectively as the "Indentures."
- [3](#) Even though a debtor cannot prepay what is already due, courts have enforced prepayment premiums after acceleration when the debtor has intentionally defaulted in order to avoid the premium. See e.g., [In re S. Side House, LLC, 451 B.R. at 269](#); [Northwestern, 816 N.Y.S.2d at 836](#).
- [4](#) Because we hold that the Noteholders are entitled to the make-whole, we do not reach the Trustees' alternative arguments that the Bankruptcy Court should have lifted the automatic stay to permit rescission of the Notes' acceleration or that the Court should have allowed the Noteholders a contingent claim for the make-whole or a claim for contract damages.

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United States Bankruptcy Court, D. Delaware.

IN RE: The HERTZ CORP., et al., Debtors.
Wells Fargo Bank, N.A., as Indenture Trustee, Plaintiffs,
and
US Bank, as Indenture Trustee, Intervenor-Plaintiff,
v.
The Hertz Corp., et al., Defendants.

Case No. 20-11218 (MFW) Jointly Administered
|
Adv. No. 21-50995 (MFW)
|
Signed December 22, 2021

Synopsis

Background: Indenture trustee brought adversary complaint on behalf of unsecured noteholders, seeking declaratory judgment that Chapter 11 debtors, which had issued notes prepetition, were required to pay redemption premium and/or postpetition interest allegedly due under notes. Debtors filed motion to dismiss for failure to state claim.

Holdings: The Bankruptcy Court, [Mary F. Walrath, J.](#), held that:

- [1] whether debtors were required to pay redemption premium depended on terms of redemption provision, not acceleration clause;
- [2] debtors' redemption of notes was optional, as required for liability for redemption premium;
- [3] term “maturity,” as used in redemption provision, referred to acceleration caused by bankruptcy filing;
- [4] notes were redeemed after “maturity,” so that debtors were not required to pay redemption premium;
- [5] debtors were required to pay premium for second set of notes for which governing redemption provision did not mention “maturity”;
- [6] noteholders plausibly alleged that claim for redemption premium was not economic equivalent of unmatured interest disallowed by Code; and

[7] noteholders were not “impaired” creditors within meaning of Code.

Motion granted in part and denied in part.

Procedural Posture(s): Petition for Declaratory Judgment; Motion to Dismiss for Failure to State a Claim.

West Headnotes (12)

[1] [Bankruptcy](#) ➡ [Pleading: dismissal](#)

In weighing motion to dismiss for failure to state claim, bankruptcy court should undergo three-part analysis: first, court must take note of elements needed for plaintiff to state claim; second, court must separate factual and legal elements of claim, accepting complaint's well-pled facts as true and disregarding any legal conclusions; third, court must determine whether facts alleged are sufficient to show that plaintiff has plausible claim for relief. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[2] [Bankruptcy](#) ➡ [Pleading: dismissal](#)

In ruling on motion to dismiss for failure to state claim, bankruptcy court may consider documents to which complaint refers if they are central to claim and no party questions their authenticity. [Fed. R. Civ. P. 12\(b\)\(6\)](#).

[3] [Commercial Paper](#) ➡ [Acceleration](#)
[Commercial Paper](#) ➡ [Charges, premiums, and penalties](#)

Chapter 11 debtors' liability for redemption premium purportedly owed to unsecured noteholders pursuant to terms of notes that debtors had issued prepetition depended on terms of redemption provision rather than on terms of acceleration clause in notes, which made no mention of payment of redemption premium upon acceleration even, i.e., filing of bankruptcy petition.

[4] [Commercial Paper](#) [Charges, premiums, and penalties](#)

Chapter 11 debtors' redemption of notes it had issued prepetition to unsecured noteholders, which redemption was triggered by acceleration event caused by bankruptcy filing, was optional, as required for debtors to be liable for redemption premium purportedly owed under terms of notes; even if debtors did not file for strategic purposes, and even if filing was brought on by business hardships due to the COVID-19 pandemic, petition itself was voluntary, and debtors had option, once in bankruptcy, to reinstate notes.

[5] [Commercial Paper](#) [Charges, premiums, and penalties](#)

"Maturity," as used in redemption provision of notes that Chapter 11 debtors had issued prepetition, which required payment of premium if notes were redeemed before maturity, meant acceleration caused by bankruptcy filing; redemption provision used term "maturity" standing alone, whereas notes elsewhere used phrase "stated maturity" to refer to specific date that notes became due, and so "maturity," as used in redemption provision, had to reference something broader than specific date.

[6] [Commercial Paper](#) [Charges, premiums, and penalties](#)

Notes that Chapter 11 debtors had issued prepetition were redeemed, by virtue of acceleration event triggered by debtors' filing of bankruptcy petition, after "maturity" within meaning of redemption provision, and thus, under terms of provision, debtors were not liable to unsecured noteholders for redemption premium; under redemption provision, "maturity" referred to acceleration event, not specific date on which obligation under notes became due.

[7] [Commercial Paper](#) [Charges, premiums, and penalties](#)

Chapter 11 debtors were liable to unsecured noteholders for redemption premium under express terms of redemption provision in notes that were issued prepetition; provision made no mention of maturity and instead stated that, at any time prior to specified date on which obligation became due, notes could be redeemed at specific redemption price which included redemption premium.

[8] [Bankruptcy](#) [Interest](#)
[Commercial Paper](#) [Charges, premiums, and penalties](#)

Unsecured noteholders plausibly alleged that their claim for redemption premium, purportedly due under notes that Chapter 11 debtors had issued prepetition, was not economically equivalent to unmatured interest that would be disallowed under Bankruptcy Code; noteholders alleged that redemption provision was much less than present value of unmatured interest, and that provision was very favorable to debtors since it was tied to treasury rate, not contract rate. [11 U.S.C.A. § 502\(b\)\(2\)](#).

[1 Cases that cite this headnote](#)

[9] [Bankruptcy](#) [Interest](#)

In deciding whether charge is unmatured interest, for purposes of claim allowance, courts look to economic substance of transaction to determine what counts as interest. [11 U.S.C.A. § 502\(b\)\(2\)](#).

[10] [Bankruptcy](#) [Impairment of Claims or Interests](#)

Claim by unsecured noteholders, for unmatured interest and/or redemption premium purportedly due under notes that Chapter 11 debtors had issued prepetition, was modified by Bankruptcy Code's disallowance of claims for unmatured interest, rather than modified by operation of Chapter 11 plan itself, and thus noteholders were not "impaired" creditors within meaning of Code. [11 U.S.C.A. §§ 502\(b\)\(2\), 1124\(1\)](#).

[1 Cases that cite this headnote](#)**[11]** [Bankruptcy](#) [Post-petition interest](#)

Both impaired and unimpaired creditor should receive same treatment in event of solvent Chapter 11 debtor: payment of allowed claim plus post-petition interest at federal judgment rate in accordance with Bankruptcy Code. [11 U.S.C.A. §§ 726\(a\)\(5\), !\[\]\(c3d993ca47bfe2a953c700506ce31fa0_img.jpg\) 1129\(a\)\(7\).](#)

[2 Cases that cite this headnote](#)**[12]** [Bankruptcy](#) [Equitable powers and principles](#)

Bankruptcy court cannot use equitable principles to modify express language of Bankruptcy Code.

Attorneys and Law Firms

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Rel. Docs. 5, 15, 16, 17

MEMORANDUM OPINION¹

[Mary F. Walrath](#), United States Bankruptcy Judge

Before the Court is the Debtors' Motion to Dismiss the complaint filed by the Indenture Trustees, on behalf of the holders of a series of unsecured notes issued by the Debtors pre-petition (the "Noteholders"), for recovery of a redemption premium and/or post-petition interest allegedly due under the Notes. For the reasons stated below, the Court will grant in part and deny in part the Debtors' Motion to Dismiss the

redemption premium count and grant the Debtors' Motion to Dismiss the post-petition interest count.

I. BACKGROUND

On May 22, 2020, the Hertz Corporation and its affiliates (collectively "the Debtors") filed voluntary petitions under chapter 11 of the Bankruptcy Code. The filing was due in large part to the disruption caused to travel and its business operations by the Covid-19 pandemic. (D.I. 28 ¶¶ 3-9.)² After a downsizing of their fleet and a sale of a non-core part of their business, the Debtors obtained an offer from a proposed plan sponsor. After designating a stalking horse bidder and conducting an auction process, the Debtors selected a winning bidder and filed the Second Modified Third Amended Plan of Reorganization ("the Plan") to effectuate a reorganization in accordance with that bid. (D.I. 5178.) The Plan provided generally for payment in full in cash on the effective date to creditors plus post-petition interest to the effective date at the federal judgment rate or in the amount necessary to render them unimpaired and a distribution to shareholders of cash and new warrants or subscription rights. (*Id.* at Art. III.B.) The Plan was accepted by the shareholders. (D.I. 5181.) On June 10, 2021, the Court confirmed the Plan. (D.I. 5261.) The Confirmation Order preserved the rights of the Noteholders to assert entitlement to a make-whole premium and additional interest and other claims as necessary to render their claims unimpaired, as well as the Debtors' right to object to those claims. (*Id.* at ¶¶ 26 & 27.) The Plan went effective on June 30, 2021 (the "Effective Date"). (D.I. 5477.)

On July 1, 2021, Wells Fargo Bank, N.A. ("Wells Fargo"), as Indenture Trustee for a series of unsecured notes issued by the Debtors pre-petition (the "Senior Notes"), filed a complaint seeking a declaratory ***784** judgment that, in addition to the principal and pre-petition interest paid to the Senior Noteholders on the Effective Date (in excess of \$2.7 billion), the Debtors must pay approximately \$272 million consisting of (1) a make-whole premium due under the Senior Notes (totaling approximately \$147 million) and (2) post-petition interest on their claims at the contract default rate in excess of the federal judgment rate (approximately \$125 million). (Adv. D.I. 1 at Ex. A.) US Bank, N.A. ("US Bank"), as Indenture Trustee for the 7% Unsecured Promissory Noteholders, intervened as a plaintiff seeking relief only on the second claim. (Adv. D.I. 14.)

On August 2, 2021, the Debtors filed a Motion to Dismiss both counts for failure to state a claim. The Motion was fully briefed and oral argument was held on November 9, 2021. The matter is ripe for decision.

II. JURISDICTION

The Court has subject matter jurisdiction over this adversary proceeding. [28 U.S.C. §§ 157, 1334](#). The Court has the power to enter a final judgment in this adversary because it concerns the allowance of claims against the estate. [28 U.S.C. § 157\(2\)\(A\) & \(O\)](#). [Stern v. Marshall, 564 U.S. 462, 499, 131 S.Ct. 2594, 180 L.Ed.2d 475 \(2011\)](#). In addition, the parties have consented to entry of a final order by this Court. (Adv. D.I. 1 at ¶ 39, 5 at ¶ 12 & 14 at ¶ 15.) [Wellness Int'l Network, Ltd. v. Sharif, 575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911 \(2015\)](#) (holding that even where Article III concerns would preclude the bankruptcy court from entering final judgment over a party's opposition, a court may do so if the parties consent).

III. DISCUSSION

A. Standard of Review

A Rule 12(b)(6) motion challenges the sufficiency of the factual allegations in the complaint. [Kost v. Kozakiewicz, 1 F.3d 176, 183 \(3d Cir. 1993\)](#). To survive a motion to dismiss, the complaint must contain sufficient factual matter, accepted as true, “to state a claim to relief that is plausible on its face.” [Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 \(2007\)](#). A claim is facially plausible when “the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” [Ashcroft v. Iqbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 \(2009\)](#) (citing [Twombly, 550 U.S. at 556, 127 S.Ct. 1955](#)). The court must draw all reasonable inferences in favor of the plaintiff. E.g., [Alpizar-Fallas v. Favero, 908 F.3d 910, 914 \(3d Cir. 2018\)](#).

[1] In weighing a motion to dismiss, the court should undergo a three-part analysis. “First, the court must take note of the elements needed for a plaintiff to state a claim.”

[Santiago v. Warminster Twp., 629 F.3d 121, 130 \(3d Cir.](#)

[2010\)](#) (citing [Iqbal, 556 U.S. at 675, 129 S.Ct. 1937](#)). Second, the court must separate the factual and legal elements of the claim, accepting all of the complaint's well-pled facts as true and disregarding any legal conclusions. [Id.](#); [Fowler v. UPMC Shadyside, 578 F.3d 203, 210 \(3d Cir. 2009\)](#) (citing [Iqbal, 556 U.S. at 679, 129 S.Ct. 1937](#)). Third, the court must determine whether the facts alleged in the complaint are sufficient to show that the plaintiff has a plausible claim for relief. [Santiago, 629 F.3d at 130](#).

[2] The Court may consider documents to which the complaint refers if they are central to the claim and no party questions their authenticity. [Marder v. Lopez, 450 F.3d 445, 448 \(9th Cir. 2006\)](#). See also [Chambers v. Time Warner, Inc., 282 F.3d 147, 153 n.3 \(2d Cir. 2002\)](#).

*785 B. Redemption Premium

In Count 1 of the Complaint, Wells Fargo seeks a declaratory judgment that the Debtors must pay the redemption premium provided in the Senior Notes because they were redeemed prior to their maturity.

The Debtors seek to dismiss this count for failure to state a claim asserting that (a) no redemption premium is allowed under the express language of the Indentures or (b) the redemption premium is unmatured interest which must be disallowed under the Bankruptcy Code. Wells Fargo disputes both of these contentions.

1. Terms of the Indentures³

a. Acceleration Clause

[3] The Debtors rely initially on section 602 of the Indentures which provides that upon the filing of a bankruptcy petition the Senior Notes are automatically accelerated and “the principal of and accrued but unpaid interest on all Outstanding Notes of such series will *ipso facto* become immediately due and payable without any declaration or other act on the part of the Trustee or any Holder.” Because section 602 does not provide for the payment of any redemption premium on acceleration, the Debtors contend that none is due.

Wells Fargo responds that the Debtors' argument must be rejected based on controlling Third Circuit precedent. [In re Energy Future Holdings Corp.](#), 842 F.3d 247 (3d Cir. 2016) (hereafter "[EFH](#)"). In [EFH](#), Wells Fargo contends, the Third Circuit considered similar language in acceleration clauses under New York law⁴ and concluded that the issue of whether a redemption premium was due depended not on the terms of the acceleration clause, but on the terms of the redemption provision. [842 F.3d at 257-60](#).

The Debtors seek to distinguish [EFH](#) by noting that the language in the two series of notes at issue in that case provided that on acceleration all "outstanding Notes" were due or all "principal, interest, and applicable premium" were due. [Id. at 254, 257](#). Therefore, they assert that the Third Circuit held that the acceleration clause and the redemption provision were not in conflict. [Id. at 256](#). In contrast, they contend that the acceleration clause in this case, which provides for payment only of "the principal of and accrued but unpaid interest," cannot be read in harmony with the redemption provision which requires payment of an additional premium.

The Court finds that argument is a distinction without significance. While the Third Circuit rejected the [EFH](#) debtor's argument that the acceleration and redemption provisions in that case were in conflict, it concluded that the two sections "simply address different things: § 6.02 causes the maturity of EFH's debt to accelerate on its bankruptcy, and § 3.07 causes a make-whole to become due when there is an optional redemption before" the maturity date. [Id.](#) The Third Circuit concluded that the redemption provision "is the only provision that specifically addresses redemption." [Id.](#) That conclusion applies to the Senior Notes in this case, as well. Therefore, the Court concludes that the acceleration clause in the Indentures is not the operative provision in determining whether the redemption premium is due.

b. Redemption Provision

The Debtors argue that, even under the language of the redemption provision, no *786 redemption premium is due on the Senior Notes for several reasons.

i. At the Debtors' Option

[4] The Debtors argue, initially, that for any redemption premium to be due, the redemption must have been "at the [Debtors'] option."⁵ They contend that the Senior Notes were not redeemed at the Debtors' option. They assert that they were forced to file bankruptcy because of the collapse of their business due to the pandemic. The Debtors argue that, upon the bankruptcy filing, the Senior Notes were automatically accelerated and required to be paid in full. *E.g.*, [In re MPM Silicones, L.L.C.](#), 874 F.3d 787, 803 (2d Cir. 2017) (holding that payment was mandated by acceleration of the notes on the filing of bankruptcy and therefore that payment was not a voluntary redemption by the debtor).

Wells Fargo disagrees, arguing that the [MPM](#) case on which the Debtors rely is contrary to the decision in [EFH](#) which is binding on this Court. It argues that the Third Circuit in [EFH](#) specifically concluded that the automatic acceleration caused by a bankruptcy filing did not make any later redemption nonvoluntary. [EFH](#), 842 F.3d at 255.

The Court agrees with Wells Fargo. The Third Circuit in [EFH](#) expressly held that the mere acceleration of notes as a result of a bankruptcy filing does not mean that the debtor in that case could not be liable for a redemption premium upon subsequently redeeming the notes. [Id.](#) Although [MPM](#) is to the contrary, it is not the law in this Circuit. The Third Circuit in [EFH](#) disagreed with the bankruptcy court's decision which was upheld in [MPM](#) and distinguished the [AMR](#) decision (on which the Second Circuit relied in [MPM](#)). 842 F.3d at 258-60 (citing [In re AMR Corp.](#), 730 F.3d 88 (2d Cir. 2013)).

The Debtors assert, nonetheless, that [EFH](#) is distinguishable because, unlike the debtor in that case, they did not file bankruptcy in a strategic effort to avoid the payment of a redemption premium. [Id. at 251](#).⁶

Wells Fargo disagrees, noting that there is nothing in [EFH](#) requiring an intent to avoid the make-whole obligation in order to find that a redemption of notes is voluntary. Wells

Fargo argues that no court has held that if an issuer does not have an intent to avoid the redemption provision, its action is not voluntary. Instead, Wells Fargo asserts that the cases which find a redemption involuntary are predominately cases where the acceleration was at the lenders' option.⁷

The Court agrees with Wells Fargo. The  [EFH](#) Court did not conclude that the voluntariness of the redemption was dependent on a finding that the debtor filed bankruptcy to avoid the obligation to pay the noteholders a redemption premium. Instead, the Third Circuit found that the debtor had filed a voluntary petition in bankruptcy and once in bankruptcy, had the option to reinstate the notes.  [*787 EFH, 842 F.3d at 255](#). The other cases cited by the Debtors are similarly distinguishable.⁸ In fact, several cases have found a redemption voluntary even where the issuer acted in the utmost good faith.⁹

Finally, the Debtors argue that any option to reinstate the Senior Notes was hypothetical at best. They contend that they could not continue to operate without filing bankruptcy because they lost over 90% of their revenues as a result of the pandemic. Further, they argue that they had no ability to formulate a plan that reinstated the Senior Notes because they received no offers that allowed that option. Rather, the Debtors assert that, once in bankruptcy, they had a fiduciary duty to accept the highest and best bid they received at the auction, which precluded the reinstatement of the Senior Notes. Therefore, the Debtors argue that the repayment of the Senior Notes pursuant to the terms of the Plan was not a redemption "at the Company's option" which is necessary to trigger the requirement to pay the redemption premium.

Wells Fargo argues that the Debtors' bankruptcy filing was a strategic, voluntary decision and that the Debtors had many options for restructuring their obligations once in bankruptcy, including specifically the choice to reinstate the Senior Notes. [11 U.S.C. § 1124\(2\)](#). It, therefore, contends that the Plan which was filed by the Debtors and ultimately confirmed was a redemption of the Senior Notes at the Debtors' option.

The Court agrees with Wells Fargo. The Third Circuit found, in concluding that the redemption of notes in  [EFH](#) was voluntary, that the debtor there "filed for Chapter 11 protection voluntarily. Once there, it had the option, per its plan of reorganization, to reinstate the accelerated notes' original maturity date under [Bankruptcy Code § 1124\(2\)](#)

rather than paying them off immediately.  [It chose not to do so." EFH, 842 F.3d at 255.](#)

Similarly, in this case the Debtors filed a voluntary petition in bankruptcy. It was perhaps the best option for the Debtors in light of the drastic effects on their business caused by the pandemic, but it was not the only option. Further, while the Debtors chose to conduct an auction for a plan sponsor and ultimately selected the highest and best offer, that too was not the Debtors' only option. At numerous junctures in any bankruptcy case, a debtor in possession has multiple paths from which to choose. That the Debtors here chose a path that resulted in a fantastic result for all of their creditors and shareholders does not mean that it was not a voluntary choice. Even though the Debtors acted in good faith and in the fulfillment of their fiduciary duties, the Court concludes that their actions were voluntary. As noted above, courts have found that even actions taken in good faith and in fulfillment of a [*788](#) debtor's fiduciary duty can be voluntary resulting in liability for a redemption premium. [See](#) cases discussed in note 9, [supra](#).

Therefore, the Court concludes that Wells Fargo has alleged sufficient facts which, accepted as true, state a facially plausible claim that the redemption of the Senior Notes was at the Debtors' option.  [Twombly, 550 U.S. at 570, 127 S.Ct. 1955.](#)

ii. [Applicability of Section 6\(a\)](#)

The Debtors further argue that, even if the redemption is determined to be voluntary, no redemption premium is due under the express terms of the Indentures because they were redeemed after they matured upon the bankruptcy filing. The Debtors rely preliminarily on section 6(a) of the Supplemental Indentures which provides that the "[Senior] Notes will be redeemable, at the Company's option, in whole or in part, at any time and from time to time on or after [a specified date] and [prior to maturity](#) thereof at the applicable redemption price set forth below." (Adv. D.I. 5, Exs. B, D, E & G (emphasis added).)

a. [2022/2024 Senior Notes](#)

[\[5\]](#) [\[6\]](#) Wells Fargo concedes that section 6(a) is the provision applicable to the 2022/2024 Senior Notes. It argues,

however, that the term “prior to maturity” in section 6(a) means prior to the original maturity date of the Senior Notes in 2022 and 2024. Because the Debtors redeemed the Senior Notes before the date that they were due to mature, Wells Fargo contends that the redemption premium is due.

The Debtors respond that the Indentures contained a defined term (the “Stated Maturity”) for the date when each of the series of Senior Notes was originally due. They argue that the failure to use that defined term in section 6(a) establishes that the phrase “prior to maturity” must mean something broader than that specific date. They cite several other sections of the Indentures which distinguish Stated Maturity from maturity arising “on acceleration” or “otherwise.” (Adv. D.I. 5, Exs. A, C, E, G at §§ 1301(a), 601(ii), 301(6).) The Debtors also argue that if “prior to maturity” simply meant the Stated Maturity date, that it would have been unnecessary (and mere surplusage)¹⁰ to include the term at all because the chart in section 6(a) makes reference to what premium is due at all times prior to the Stated Maturity date.

The Court agrees with the Debtors’ analysis. The date when the Senior Notes are due is a defined term, Stated Maturity. If section 6(a) was meant to apply only to redemptions before the Stated Maturity date, rather than prior to a maturity caused by some other event, such as a bankruptcy filing, it would have used the term Stated Maturity. Further, if the phrase simply meant redemption prior to the Stated Maturity it would have been surplusage, because the chart included in that section stated what needed to be paid at any time before the Stated Maturity date.

Accordingly, the Court concludes that the undefined term “maturity” in section 6(a) must refer to the common meaning of maturity, which under the terms of the Senior Notes includes upon the acceleration caused by a bankruptcy filing. E.g., Sapp v. Indus. Action Servs., LLC, C.A. No. 19-912-RGA, 2020 WL 2813176, at *3 (D. Del. May 29, 2020) (“[W]hen the same term appears in different sections of the agreement and is capitalized in one section but not the other, the non-capitalized term will have its ‘ordinary, plain meaning.’”) (citing *789 Derry Finance N.V. v. Christiana Cos., 797 F.2d 1210, 1214 (3d Cir. 1986)). This interpretation is confirmed by sections 601(ii) and 301(6) of the Indentures which use the lower case term “maturity” in reference to acceleration of the Senior Notes on bankruptcy or a default.

Therefore, under the express terms of section 6(a) of the redemption provision, the Court concludes that Wells Fargo

has failed to state a plausible claim that a redemption premium is due on the 2022/2024 Senior Notes because they were redeemed after the initial period stated therein but not prior to the maturity arising as a result of the bankruptcy filing. Therefore, the Court will grant the Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes.

b. 2026/2028 Senior Notes

[7] The Debtors argue that the same result applies to the Senior Notes originally due to mature in 2026 and 2028.

Wells Fargo responds that section 6(a) is not applicable to those Senior Notes because they were not redeemed “on or after” the date specified in that section. Instead, it contends that section 6(c) governs, which provides that “At any time prior to [the specified date], the [Senior Notes] may also be redeemed (by the Company or any other person) in whole or in part, at the Company’s option, at ... the Redemption Price”

The Debtors assert, however, that section 6(a) is incorporated in full into section 6(c) because the latter provides circumstances under which the Senior Notes may “also” be redeemed.

Wells Fargo responds that if “also” meant that all of section 6(a) was incorporated into section 6(c) then there would have been no need to repeat provisions from section 6(a) in section 6(c) such as “at the Company’s option” and “in whole or in part.”

The Court agrees with Wells Fargo that the use of “also” in section 6(c) does not mean that all of section 6(a) is incorporated into section 6(c). If it did, section 6(c) would contain surplusage, which is to be avoided in contract interpretation. E.g., Burlington Ins., 57 N.Y.S.3d 85, 79 N.E.3d at 482. It would also create an internal contradiction: section 6(a) is only applicable if redemption occurs after a specified date, while section 6(c) applies only if redemption occurs before that date, and each section provides a different redemption price. Rather than accept the Debtors’ tortured reading, the Court reads section 6(c) as simply providing the Debtors with the ability to redeem under the circumstances in that section, in addition to their redemption rights under section 6(a). While redemption under section 6(a) requires that it occur before maturity, section 6(c) contains no such requirement.

Therefore, the Court concludes that Wells Fargo has stated a plausible claim, under the express terms of section 6(c) of the redemption provision, that a premium would be due on the 2026/2028 Senior Notes because they were redeemed before the initial period stated therein.

2. Economic Equivalent of Interest

[8] The Debtors argue that, even if the redemption premium is due under the terms of the 2026/2028 Senior Notes, however, it cannot be an allowed claim because [section 502\(b\)\(2\) of the Bankruptcy Code](#) expressly provides that any claim for unmatured interest must be disallowed. Although that term is not defined in the Code, the Debtors assert that courts look to substance over form and have disallowed claims that are the “contractual equivalent” of future interest.¹¹ The Debtors *790 also note that, although the Third Circuit did not directly address this issue in [EFH](#), it characterized a redemption premium as the “contractual substitute for interest lost on Notes redeemed before their expected due date.”
[842 F.3d at 251](#).¹²

Wells Fargo argues that the redemption premium is not interest. It contends that interest is a payment for the “use” of money, while the redemption premium is being paid to the Senior Noteholders for the Debtors’ “failure to use” their money. Wells Fargo asserts that, unlike interest, the redemption premium does not accrue over time but is a fixed one-time charge upon redemption, and, unlike interest, the redemption premium is contingent: it is only due if the Debtors redeem the Senior Notes in accordance with the terms of the redemption provision. Wells Fargo contends that the redemption premium is intended to compensate the Senior Noteholders for the uncertainty and potential losses incurred in reinvesting that money in a different market environment, which implicates numerous factors beyond simply the periodic payment of interest. It argues that the majority of courts agree, holding that redemption premiums are not unmatured interest.¹³

While the cases cited by Wells Fargo are useful, the Court notes that there is a minority of courts who disagree.¹⁴ Further, although the Third Circuit in [EFH](#) described a redemption premium as the “contractual substitute for interest lost on Notes redeemed before their expected due date,” it was

not addressing the issue of whether it could be characterized as such to preclude its payment under [section 502\(b\)\(2\)](#).
[842 F.3d at 251, 253 n.1](#). Similarly, while the Fifth Circuit in [Ultra Petroleum](#) suggested that some make-wholes may be the equivalent of unmatured interest, it did not decide whether the ones in that case were, instead remanding the issue *791 to the bankruptcy court. [943 F.3d at 765](#).¹⁵

[9] The Court is not prepared to conclude, as a legal matter, that make-wholes cannot be disallowed as unmatured interest as Wells Fargo, the cases it cites, and academics¹⁶ suggest. Calling a make-whole a contract right or a liquidated damages provision does not answer the question of whether it is unmatured interest.¹⁷ In deciding whether a charge is unmatured interest “courts look to the economic substance of the transaction to determine what counts as interest.”
[Doctors Hosp., 508 B.R. at 705](#). If it were enough to just label a make-whole claim liquidated damages, damages for breach of contract, or a “separate contract right” from the obligation to pay interest, then a contract providing that on default or redemption “all unmatured interest” would be immediately due and payable could avoid the effect of [section 502\(b\)\(2\)](#) completely. This is contrary to the express provisions of the Code and, consequently, the Court concludes that the characterization of a make-whole as a contract right or liquidated damages is not dispositive.

Instead, the Court concludes that the determination of whether the redemption premium that Wells Fargo seeks in this case is, in fact, the economic equivalent of unmatured interest is not a legal question, but is instead a factual one: namely whether the redemption provision in the 2026/2028 Senior Notes is actually the economic equivalent of unmatured interest.

In considering the actual language of the redemption premium in this case, the Court finds it significant that it is calculated, in large part, on the present value of the unmatured interest due on the Senior Notes as of the Redemption Date.¹⁸ At oral argument, Wells Fargo presented a powerpoint that appeared to suggest, however, that the redemption provision was much less than a simple present value of the unmatured interest and very favorable to the Debtors because it is tied to the Treasury rate. That was, of course, merely *792 argument and no evidence was presented to support that assertion. Nor did the Debtors have an opportunity to rebut the assertion with any evidence. Instead, the Debtors argued that the test is not whether the redemption premium equals the unpaid interest

but whether it is the economic equivalent of the interest which the Senior Noteholders will not receive because of the early redemption of the Senior Notes.  [Doctors Hosp., 508 B.R. at 705-06.](#)

The presentation by Wells Fargo (and the language of the redemption provision itself), however, are sufficient to convince the Court that Wells Fargo has stated a plausible claim for relief.  [Santiago, 629 F.3d at 130.](#) While the redemption premium clearly was not due until the redemption occurred on the Effective Date of the Plan and, therefore, was “unmatured” as of the petition date, the Court concludes that Wells Fargo may be able to present evidence that the redemption premium in the 2026/2028 Senior Notes is not, in fact, the economic equivalent of unmatured interest due under those Senior Notes.

Accordingly, the Court concludes that Count 1 of the Complaint states a claim that is plausible on its face that the Debtors must pay the redemption premium on the 2026/2028 Senior Notes but does not state a plausible claim that the Debtors must pay the redemption premium on the 2022/2024 Senior Notes. Accordingly, the Court will grant the Debtors’ Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes but deny the Debtors’ Motion as to the 2026/2028 Senior Notes.

3. Other Arguments

Wells Fargo also contends, however, that regardless of how the redemption provision is characterized, that portion of the Senior Noteholders’ claim cannot be disallowed because the Debtors treated their class as unimpaired in the Plan, thereby precluding them from voting on the Plan. As a result, Wells Fargo contends that the Debtors cannot impair any of the Senior Noteholders’ legal, contractual, or equitable rights and must pay the Senior Noteholders all that they are entitled to receive under the Indentures and under equity. [11 U.S.C. § 1124\(1\)](#). The failure to pay the Senior Noteholders their contractual entitlement to the redemption premium, Wells Fargo contends, impairs the Senior Noteholders’ contractual and equitable rights. It also argues that, because the Debtors were “wildly solvent” (returning in excess of \$ 1.5 billion to equity holders), the Senior Noteholders are entitled to all of their contract rights (including the make-whole even if it is unmatured interest) under the “solvent debtor exception.”

The Debtors argue that the “impairment” and the “solvent debtor exception” arguments are relevant only if the make-whole is determined to be unmatured interest. If it is not unmatured interest, then the Debtors apparently concede that it is not impaired by the Code or by the Plan and is due to the Senior Noteholders.

The Court agrees with the Debtors that it is only if the redemption premium is determined to be the economic equivalent of unmatured interest that Wells Fargo’s other arguments would be relevant. However, if it is unmatured interest, then the claim would be subject to the same analysis as the claims of all Noteholders’ to post-petition interest. Therefore, the Court considers the parties’ arguments on impairment and the solvent debtor exception together below.

C. Unmatured Interest

In Count 2 of the Complaint, Wells Fargo and US Bank (collectively, the “Indenture Trustees”) seek a declaratory judgment that the Noteholders are entitled to post-petition interest on their claims, from the petition date to the date they were paid in full, at the contract rate. As noted ***793** above, Wells Fargo also asserts that to the extent the Court concludes that the make-whole claim is unmatured interest, the Senior Noteholders are nonetheless entitled to it under the express terms of the Indentures.

The Debtors seek to dismiss both the claim for post-petition interest and any claim for the redemption premium that is properly characterized as unmatured interest, contending that general unsecured claims for unmatured interest are disallowed under the Bankruptcy Code. [11 U.S.C. § 502\(b\)](#). They contend that at most the Noteholders are entitled to interest from the petition date to the date the claims were paid in full only at the federal judgment rate as allowed in section 726(a)(5).

1. Unimpaired

[10] The Indenture Trustees contend, however, that the Noteholders were treated as unimpaired under the Plan and, therefore, their claims for post-petition interest and/or the redemption premium must be paid in accordance with the terms of the Indentures. They rely on [section 1124\(1\)](#) which provides in relevant part that

a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan -

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest

11 U.S.C. § 1124(1).

The Debtors disagree. Because any claim for unmatured interest is disallowed by operation of the Bankruptcy Code, rather than the Plan, the Debtors argue that the Noteholders' claims are not impaired.  In re PPI Enters. (US), Inc., 324 F.3d 197, 204 (3d Cir. 2003) (holding that a creditor is unimpaired if it is the effect of the Bankruptcy Code that modifies its rights, not the debtor's plan).

The Indenture Trustees argue that  PPI is distinguishable because it dealt with the effect of section 502(b)(6) rather than section 502(b)(2). They assert that section 502(b)(6) imposes an absolute cap on a landlord's claim, while section 502(b)(2) is not absolute and, in fact, is not effective where the debtor is solvent as it is here (pursuant to sections 726(a)(5) and 1129(a)(7)).

The Court finds the distinction illusory. Section 502(b) addresses the allowance of claims; sections 1129(a)(7) and 726(a)(5) address the treatment of claims where the debtor is solvent. The Indenture Trustees are conflating the allowance of claims with the treatment of claims. If one considers only the allowance issue, the Court concludes that section 502(b)(2) is as absolute as section 502(b)(6), because it disallows all unmatured interest on general unsecured claims.

It is true that in the rare solvent chapter 11 debtor case, some claims may be entitled to post-petition interest under sections 1129(a)(7) and 726(a)(5).¹⁹ However, those sections do not reinstate the creditors' contract or state law rights to unmatured interest that has been disallowed by section 502(b)(2). Instead as discussed below, sections 1129(a)(7) and 726(a)(5) require the treatment of claims in accordance with the mandates of those sections which courts have concluded require the payment of post-petition interest only at the federal judgment rate.²⁰

*794 In  Ultra Petroleum, the creditors made the same argument as the Indenture Trustees do in this case. They contended that they were impaired because the debtor's plan did not pay their make-whole amount or post-petition interest at their contract rate. The Bankruptcy Court agreed.  In re Ultra Petroleum Corp., 575 B.R. 361, 373 (Bank. S.D. Tex. 2017). On direct appeal, the Fifth Circuit reversed, concluding that "[w]e agree with  PPI, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code - not the plan - is doing the impairing."  Ultra Petroleum, 943 F.3d at 762-64.

Following binding precedent in this Circuit (and the analysis of the Fifth Circuit with respect to claims similar to the Noteholders' claims), the Court concludes that any modification of the Noteholders' claim to unmatured interest or to the redemption premium (if it is the economic equivalent of unmatured interest) is an impairment of the Noteholders' contract claims by operation of section 502(b)(2) of the Bankruptcy Code, not the Debtors' Plan. Consequently, the Noteholders' claims are not impaired within the meaning of section 1124(1). E.g.,  PPI, 324 F.3d at 204;  Ultra Petroleum, 943 F.3d at 765;  PG&E, 610 B.R. at 315.

2. Solvent Debtor Exception

[11] The Indenture Trustees argue, nonetheless, that they are entitled to their contract rate of interest under the equitable doctrine known as the "solvent debtor exception." They contend that the Bankruptcy Code incorporated that equitable concept which arose under the Bankruptcy Act and provided that creditors were entitled to their full contract rights, if a debtor was solvent. The Indenture Trustees assert that the equities of this case clearly support their claims: the Debtors are awash in cash, paid all creditors in full, and provided a substantial return on investment to equity (in cash and warrants).

a. Express Terms of the Code

The Debtors argue that equitable principles cannot override express provisions of the Code, such as section 502(b)(2) which disallows all unmatured interest on general unsecured

claims, without regard to whether a debtor is solvent. They contend that, while sections 726(a)(5) and 1129(a)(7) ²¹ require the payment of post-petition interest on general unsecured claims where the debtor is solvent, courts have held that the interest is set at the federal judgment rate, not at the contract rate. ²²

The Indenture Trustees respond that section 1129(a)(7) only incorporates section 726(a)(5) in chapter 11 cases with respect to impaired claims. Because the Noteholders' claims are unimpaired under the Debtors' Plan, they assert that any limitation of post-petition interest to the federal judgment rate contained in those sections is not applicable to them.

The Court agrees with the Indenture Trustees, in part. By their express terms,  sections 1129(a)(7) and 726(a)(5) provide *795 what treatment impaired creditors are entitled to receive, not what treatment unimpaired claims are entitled to receive in a solvent chapter 11 debtor case. In essence, the Code is silent on what treatment unimpaired creditors must receive in a solvent chapter 11 debtor case.

b. Repeal of § 1124(3)

The Indenture Trustees argue, however, that Congress has made it clear that unimpaired creditors are entitled to receive post-petition interest at their contract rate by its repeal of [section 1124\(3\)](#). Before it was repealed, [section 1124\(3\)](#) had provided that a creditor is unimpaired if “the holder of such claim ... receive[s] ... cash equal to the allowed amount of such claim” on the effective date of the plan. [11 U.S.C. § 1124\(3\) \(1988\)](#). Its repeal was prompted by the decision of a Bankruptcy Court that because [sections 726\(a\)\(5\) and 1129\(a\)\(7\)](#) were only applicable to impaired creditors and because [section 1124\(3\)](#) required only the payment of the allowed amount of their claims, unimpaired creditors were not entitled to post-petition interest.  [In re New Valley Corp., 168 B.R. 73, 79-81 \(Bankr. N.J. 1994\)](#). The Indenture Trustees contend that the Legislative History makes it clear that denial of post-petition interest to unimpaired creditors in the  [New Valley](#) case was “unfair.” ²³ Thus, the Indenture Trustees conclude that the repeal of [section 1124\(3\)](#) makes it clear that unimpaired creditors must receive interest at their contract rate.

The Debtors argue that the repeal of [section 1124\(3\)](#) is irrelevant to the issue at hand. They note that the repeal occurred before the Third Circuit's decision in  [PPI](#) and did not affect its conclusion that creditors are unimpaired if their rights are altered by the Bankruptcy Code rather than the plan.  [PPI, 324 F.3d at 206-07](#). Thus, they contend that the repeal of [section 1124\(3\)](#) does not alter the fact that [section 502\(b\)\(2\)](#) does not permit the payment of post-petition interest on the Noteholders' claim.

The Court disagrees with the Debtors' analysis of  [PPI](#). The Third Circuit in  [PPI](#) agreed with the bankruptcy court's conclusion in that case that the repeal of [section 1124\(3\)](#) meant that unimpaired creditors were entitled to the payment of postpetition interest if the debtor was solvent.  [Id.](#) However, the Court does not read the repeal of [section 1124\(3\)](#) as expansively as the Indenture Trustees to mandate that unimpaired creditors must receive their contract rate of interest. Congress explained the repeal's effect, as follows:

The principal change in this section is set forth in subsection (d) and relates to the award of postpetition interest. In a recent Bankruptcy Court decision in  [In re New Valley Corp., 168 B.R. 73 \(Bankr. D.N.J. 1994\)](#), unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent.... In order to preclude this unfair result in the future, the Committee finds it appropriate to delete [section 1124\(3\)](#) from the Bankruptcy Code.

As a result of this change, if a plan proposed to pay a class of claims in cash in the full allowed amount of the claims, the class would be impaired, entitling creditors to vote for or against the plan of reorganization. If creditors vote for the plan of reorganization, it can be confirmed over the vote of dissenting class of creditors only if it complies with the “fair and equitable” test under  [section 1129\(b\)\(2\) of the Bankruptcy Code](#) *796 and it can be confirmed over the vote of dissenting individual creditors only if it complies with the “best interests of creditors” test under  [section 1129\(a\)\(7\) of the Bankruptcy Code](#).

The words “fair and equitable” are terms of art that have a well established meaning under the case law of the Bankruptcy Act as well as under the Bankruptcy Code. Specifically, courts have held that where an estate is

solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors' claims must be paid in full, including postpetition interest, before equity holders may participate in any recovery.

H.R. Rep. No. 103-835, at 48 (1994) (emphasis added), reprinted in 1994 U.S.C.C.A.N. 3340, 3356-57.

Thus, in its repeal of [section 1124\(3\)](#), Congress did express its belief that the Bankruptcy Code contained an exception in cases where the debtor is solvent to the principle that creditors are not entitled to post-petition interest. The Legislative History, however, suggests that Congress believed that this solvent debtor exception is embodied in the “fair and equitable” and “best interests of creditors” tests contained in [sections 1129\(b\) and 1129\(a\)\(7\)](#).

While Congress stated that it would be unfair in a solvent chapter 11 debtor case for unimpaired creditors to receive no interest, it did not point to any provision of the Code that would allow interest to be paid to unimpaired creditors. Instead, it suggested that the failure to pay any interest to unsecured creditors in a solvent chapter 11 debtor would make them impaired and thus eligible to be paid interest by application of [sections 1129\(a\)\(7\) and 1129\(b\)\(2\)](#).

The Indenture Trustees argue, however, that Congress made it clear that unimpaired creditors under [section 1124\(1\)](#) would not be limited to the interest due under [sections 1129\(a\)\(7\) and 726\(a\)\(5\)](#).²⁴ While the Court agrees that Congress did state that the repeal of [section 1124\(3\)](#) was not meant to modify the 1984 amendment to [section 1129\(a\)\(7\)](#) which excluded unimpaired creditors, the Court does not conclude that it was intended to suggest that any interest due to unimpaired creditors cannot be capped at the federal judgment rate applicable under [section 726\(a\)\(5\)](#). *Id.* The 1984 amendment to [section 1129\(a\)\(7\)](#) was made in conjunction with an amendment of [section 1129\(a\)\(10\)](#) to require the vote of “impaired” claims, rather than all claims.²⁵ The Legislative History to those amendments reveals that they were meant to require that debtors only need obtain the requisite vote (or satisfaction of the best interest of creditors test) with respect to “real” creditors, i.e., those impaired by the plan, rather than intended to assure that unimpaired creditors get more than the federal judgment rate in the case of the debtor's solvency. *See* S. Rep. No.

98-65, at 80 (1983) (“Paragraph (10) makes clear the intent of [section 1129\(a\)\(10\)](#) that one “real” class of creditors must vote for the plan of reorganization.”)

Nowhere in the repeal of [section 1124\(3\)](#) or its Legislative History did Congress state what the Indenture Trustees argue, namely that unimpaired creditors must be ***797** paid their contract rate of interest in a solvent chapter 11 debtor case. Congress could have so provided (1) by amending [section 1124\(3\)](#) to require that unimpaired creditors receive their contract rate of interest, in addition to payment in full of their allowed claim, or (2) by amending [section 502\(b\)\(2\)](#) to provide that unmatured interest is disallowed “except in the case of a solvent debtor.” It did neither.

Thus, the repeal of [section 1124\(3\)](#) does not support the Indenture Trustees’ argument that an unimpaired creditor must receive post-petition interest at its full contract rate.

c. Solvent Debtor Exception Cases

The Indenture Trustees argue that, because there is no express answer in the Bankruptcy Code or Legislative History, the answer lies in the solvent debtor exception articulated by the courts. While that concept arose under the Bankruptcy Act, they contend that it survives under the Bankruptcy Code because it has not been repudiated by any of the provisions of the Code. *E.g.*, [Cohen v. de la Cruz](#), 523 U.S. 213, 221, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (interpreting dischargeability provisions consistently with practice under the Bankruptcy Act because the Court “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure”). The Indenture Trustees assert that the solvent debtor exception (as articulated by courts under the Act and the Code) mandates that, because the Debtors are solvent, all of the Noteholders’ contract rights must be preserved, including the right to be paid post-petition interest at their contract rate.²⁶

The Debtors contend that none of the Supreme Court cases cited by the Indenture Trustees support their contention, because they were all cases dealing with the entitlement of secured creditors to post-petition interest.²⁷ The Debtors further argue that the Bankruptcy Code expressly incorporated the rulings of those cases in [sections 506\(b\)](#)

and [1129\(b\)\(2\)\(A\)](#). They contend that cases granting secured creditors post-petition interest cannot be extended to unsecured creditors in the face of specific provisions of the Code, such as [sections 502\(b\)](#) and [506\(b\)](#). [Law v. Siegel](#), 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) (holding that “equitable powers [that] remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code”).

The Court agrees with the Debtors that cases cited by the Indenture Trustees which mandate the payment of interest to secured creditors at their contract rate when a debtor is solvent²⁸ are not applicable to the instant case which concerns *798 unsecured creditors’ rights. [Timbers of Inwood](#), 484 U.S. at 379, 108 S.Ct. 626 (holding that the right to post-petition interest provided under [section 506\(b\)](#) is not applicable to undersecured creditors but that, instead, [section 726\(a\)\(5\)](#) provides the rule for treatment of unsecured creditors in the rare solvent debtor case).

The other Supreme Court case cited by the Indenture Trustees is [Saper](#), which is also not supportive of their argument. [City of New York v. Saper](#), 336 U.S. 328, 331, 69 S.Ct. 554, 93 L.Ed. 710 (1949) (holding that interest on tax claims, like other unsecured claims, stopped accruing on the bankruptcy filing date). The Court in [Saper](#) relied on English law from which the Bankruptcy Act was derived and did note, albeit in dicta, that English law had an exception to that rule, in the event that a debtor was solvent. [Id.](#) at 330 n.7, 69 S.Ct. 554 (1949). The Supreme Court made no comment, however, on what post-petition interest was required by that exception.

Although the Indenture Trustees cite Circuit Court cases which hold that unsecured creditors in solvent chapter 11 debtor cases are also entitled to post-petition interest at their contract rate, a closer reading of those cases show that many of them (1) relied on Supreme Court and other authority mandating such treatment for secured creditors, without explaining why it applies to unsecured creditors,²⁹ (2) relied on the fair and equitable test embodied in [section 1129\(b\)](#) which on its face is not applicable to unimpaired creditors,³⁰ and/or (3) expressly acknowledged that any right of an unsecured creditor to interest is subject to [section 502\(b\)](#).³¹

In a recent case, the Bankruptcy Court on remand in [Ultra Petroleum](#) also concluded that the passage of the Bankruptcy Code did not abolish the solvent debtor exception. [624 B.R. at 196-200](#). The [Ultra Petroleum](#) Court determined that under that exception, unimpaired creditors in a solvent chapter 11 debtor case were entitled to post-petition interest at the default rates provided in their contracts because they were entitled to have their equitable rights fully enforced under [section 1124\(1\)](#). [Id.](#) at 203-04.

[12] The [Ultra Petroleum](#) Court’s analysis is not persuasive. A bankruptcy court cannot use equitable principles to modify express language of the Code. [*799 United States v. Noland](#), 517 U.S. 535, 538, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996). [Section 502\(b\)\(2\)](#) expressly disallows claims of unsecured creditors for unmatured interest. When a debtor is solvent, the Bankruptcy Code does not waive the application of [section 502\(b\)\(2\)](#). The Third Circuit has held that [section 1124\(1\)](#) does not mandate that unimpaired creditors receive all of their contract rights where those rights are expressly disallowed by [section 502\(b\)](#) of the Code. [PPI](#), 324 F.3d at 202-03.³² Therefore, under Third Circuit precedent, this Court cannot agree with the Bankruptcy Court in [Ultra Petroleum](#) that being unimpaired mandates that the Noteholders receive their contract rate of interest in contravention of [section 502\(b\)\(2\)](#).

The Indenture Trustees also rely on the Bankruptcy Court’s decision in [Energy Future](#). [In re Energy Future Holdings Corp.](#), 540 B.R. 109 (Bankr. D. Del. 2015). In that case the Bankruptcy Court was considering an objection to the unsecured PIK noteholders’ claims to post-petition interest and concluded that any claim for post-petition interest must be disallowed as a result of [section 502\(b\)](#). [Id.](#) at 111. The Court, however, then elaborated on what the debtors’ plan would have to provide in order for those creditors to be unimpaired. It concluded that the “plan in this case need not provide for the payment in cash on the effective date of post-petition interest at the contract rate in order for the PIK Noteholders to be unimpaired.” [Id.](#) (citing [PPI](#), 324 F.3d at 205). Nonetheless, the Court concluded that under the equitable concepts embodied in the fair and equitable test under [section 1129\(b\)](#), “the Court has the

discretion to exercise its equitable power to require, among other things, the payment of post-petition interest, which may be at the contract rate or such other rate as the Court deems appropriate.”  [Id. at 124.](#)

The Court finds the test articulated by the Bankruptcy Court in  [Energy Future](#), however, to be problematic. First, the Court relied on the fair and equitable test of  [section 1129\(b\)](#), which by its express terms does not apply to unimpaired creditors.³³ Further, it provides no guidance to debtors or creditors as to precisely how unimpaired creditors must be treated and thus will result in endless litigation. Finally, leaving the determination of what interest, if any, an unimpaired creditor is entitled to receive in a solvent chapter 11 debtor case completely within the discretion of the bankruptcy court also runs counter to recent Supreme Court jurisprudence (and Congressional amendments) that have sought to curb the bankruptcy court's exercise of equitable discretion.³⁴

***800** d. Proper Treatment of Unimpaired
Creditors in Solvent Chapter 11 Debtor Cases

The Court is not persuaded that the Bankruptcy Code incorporated the solvent debtor exception to the extent suggested by the Bankruptcy Courts in [Ultra Petroleum](#) (to mandate the reinstatement of all contract rights to interest notwithstanding their disallowance by [section 502\(b\)](#)) and in [Energy Future](#) (to permit the exercise of broad equitable discretion by the bankruptcy court to determine what interest, if any, unimpaired creditors are entitled to receive). Rather, after consideration of the cases cited by the parties, the express language of the Bankruptcy Code, and its Legislative History, the Court is convinced that the solvent debtor exception survived passage of the Bankruptcy Code only to a limited extent. The Bankruptcy Code expressly codified the solvent debtor exception in  [section 506\(b\)](#) as to oversecured creditors and in  [section 1129\(a\)\(7\)](#) and [726\(a\)\(5\)](#) as to unsecured creditors. While the latter sections currently only apply to impaired creditors, when the Bankruptcy Code was originally enacted they applied to all unsecured creditors, impaired and unimpaired.³⁵ As the Court concluded above, when the 1984 amendment made  [section 1129\(a\)\(7\)](#) applicable to impaired creditors only, Congress was motivated by the desire to require voting only

by impaired creditors, rather than by a desire to assure that unimpaired creditors get their contract rate of interest.³⁶

Significantly, neither the Bankruptcy Code nor the Legislative History expressly state that unimpaired creditors are entitled to their contract rate of interest or even to more than impaired creditors in the case of a solvent debtor. Instead the Legislative History provides strong evidence Congress intended that unimpaired creditors in a solvent chapter 11 debtor case should receive post-petition interest only in accordance with  [sections 1129\(a\)\(7\)](#) and [726\(a\)\(5\)](#).³⁷ That is what the Debtors contend the Noteholders are entitled to receive in this case.

The Indenture Trustees complain, however, that the Debtors treated the Noteholders not as impaired, but as unimpaired, thereby depriving them of the right to vote. The Court finds that the result would have been no different. If the Noteholders had been treated as impaired and if they had voted against the Plan, they would have received the same treatment: payment in full in cash of their allowed claim plus post-petition interest in accordance with  [sections 1129\(a\)\(7\)](#) and [726\(a\)\(5\)](#).³⁸

It is important to emphasize that the Court's ruling in this case is limited to the issue of what post-petition interest unimpaired creditors must receive in the rare case when a chapter 11 debtor proves to be solvent and their claims are being paid in full in cash on the effective date of the plan. Concluding that  [sections 1129\(a\)\(7\)](#) and [726\(a\)\(5\)](#) apply to both impaired and unimpaired unsecured creditors where the debtor is solvent does not offend the basic policy of the Bankruptcy Code to assure that creditors of the same priority generally receive like treatment. While [section 726\(a\)\(5\)](#) is made applicable in chapter 11 cases only to impaired creditors, when a ***801** debtor is solvent, impaired creditors essentially are unimpaired, in the sense that they are entitled to payment in full of their allowed claims and postpetition interest, albeit at the federal judgment rate, before any distribution can be made to equity. [11 U.S.C. §§ 726\(a\)\(5\) & 1129\(a\)\(7\)](#). The Legislative History to [section 1124\(3\)](#)'s repeal suggests that Congress believed that there is no legitimate reason when a debtor is solvent to distinguish between impaired and unimpaired unsecured creditors who are receiving payment of their claims in cash in full. Consequently, the Court concludes that both should receive the same treatment: payment of their allowed claim

plus post-petition interest at the federal judgment rate in accordance with [section 726\(a\)\(5\)](#).

Such a rule promotes several important policies of the Bankruptcy Code. First, as noted, it is consistent with the underlying principle of the Bankruptcy Code that creditors with the same priority (such as unsecured creditors) should be similarly treated. Providing that all general unsecured creditors are entitled to the same post-petition interest in a solvent chapter 11 debtor case prevents a debtor from paying preferred creditors more than others simply by classifying them as unimpaired.

Second, it is an easy and predictable rule to apply (as opposed to determining interest based on each creditor's contract rights or relying on discretion exercised by the court on a case by case basis). This promotes predictability and the efficient administration of the bankruptcy estate.³⁹

The Court in [PG&E](#) reached a similar conclusion. 610 B.R. at 315. That Court addressed the arguments of numerous unimpaired creditors that they were entitled to post-petition interest at various rates, determined by contracts between the debtors and the respective claimants, different state's judgment rates, or some other rate. [Id.](#) at 310. It rejected those arguments noting that

[Cardelucci](#), in answering the narrow question [of what the proper

rate of post-petition interest is in a solvent chapter 11 debtor case], drew no distinction as to whether the rule it announced was confined only to impaired claims. The clear and unequivocal analysis based on [section 726\(a\)\(5\)](#) is obvious: it applies to all unsecured and undersecured claims in a surplus estate.

[Id.](#) at 315.

Consequently, the Court concludes that the Indenture Trustees have not stated a plausible claim that the Debtors must pay post-petition interest on the Notes at the rates specified in the Indentures rather than at the federal judgment rate. As a result, the Court will grant the Debtors' Motion to Dismiss Count 2 of the Complaint.⁴⁰

IV. CONCLUSION

For the reasons set forth above, the Court will grant the Debtors' Motion to Dismiss Count 1 as to the 2022/2024 Senior Notes, but deny it as to the 2026/2028 Senior Notes, and grant the Debtors' Motion to Dismiss Count 2.

All Citations

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Footnotes

- ¹ The Court is not required to state findings of fact or conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure. Instead, the facts recited are those averred in the Complaint, which must be accepted as true for the purposes of the Motion to Dismiss. [Ashcroft v. Iqbal](#), 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009).
- ² References to the docket in this adversary proceeding are to "Adv. D.I. #" while references to the docket in the main case are to "D.I. #."
- ³ The Indentures and Supplemental Indentures for the Senior Notes contain substantially identical terms for purposes of the issues at bar. (Adv. D.I. 5 at Exs. A-H.)

- 4 The Indentures in this case are also governed by New York law. (Adv. D.I. 5, Exs. A & C, § 115, Exs. E & G, § 113.)
- 5 Adv. D.I. 5, Exs. B, D, F, H at § 6.
- 6 See also  [Sharon Steel Corp. v. Chase Manhattan Bank, N.A.](#), 691 F.2d 1039, 1053 (2d Cir. 1982) (enforcing make-whole where debtor filed a voluntary plan of liquidation in an attempt to substitute the buyer for the debtor as obligor under low interest debentures);  [Wilmington Sav. Fund Soc'y v. Cash Am. Int'l, Inc.](#), No. 15-CV-5027 (JMF), 2016 WL 5092594, at *7 (S.D.N.Y. Sept. 19, 2016) (enforcing make-whole where issuer breached indenture in connection with a spin-off).
- 7 E.g., [In re Granite Broad. Corp.](#), 369 B.R. 120, 144 (Bankr. S.D.N.Y. 2007) (citing  [In re LHD Realty Corp.](#), 726 F.2d 327, 330 (7th Cir. 1984)). See also  [EFH](#), 842 F.3d at 260 (noting that “by electing to accelerate the debt, a lender forgoes its right to a stream of payments in favor of immediate repayment” and cannot claim a redemption premium).
- 8 E.g.,  [Sharon Steel](#), 691 F.2d at 1053 (simply holding that where issuer breached the indenture, the trustee had the option to enforce the redemption provision rather than accelerate the notes);  [WSFS](#), 2016 WL 5092594, at *7 (concluding that cases interpreting  [Sharon Steel](#) as requiring bad faith intent to avoid redemption premium were incorrect and no such intent was necessary to allow enforcement of redemption clause).
- 9 E.g., [Chesapeake Energy Corp. v. Bank of N.Y. Mellon Tr. Co. N.A.](#), 837 F.3d 146 (2d Cir. 2016) (enforcing redemption provision even though company acted in good faith, in reliance on a declaratory judgment, later reversed on appeal, that its actions would not trigger the provision);  [In re Imperial Coronado Partners, Ltd.](#), 96 B.R. 997, 1000 (9th Cir. BAP 1989) (concluding that decision to sell property was voluntary even though debtor did not have the financial means to reinstate the note and the sale made good business sense).
- 10 E.g.,  [Burlington Ins. Co. v. NYC Transit Auth.](#), 29 N.Y.3d 313, 57 N.Y.S.3d 85, 79 N.E.3d 477, 482 (2017) (holding that courts should interpret contracts in a manner that does not render a portion of a provision superfluous or meaningless).
- 11 E.g.,  [In re Chateaugay Corp.](#), 961 F.2d 378, 380 (2d Cir. 1992) (concluding that unamortized portion of original issue discount was unmatured interest disallowed by § 502(b)(2));  [In re Doctors Hosp. of Hyde Park, Inc.](#), 508 B.R. 697, 705-06 (Bank. N.D. Ill. 2014) (holding that yield maintenance premium was a liquidated damages provision in the nature of disallowable unmatured interest);  [In re Ridgewood Apts.](#), 174 B.R. 712, 721 (Bank. S.D. Ohio 1994) (prepayment penalty could be disallowed as unmatured interest because it was meant to compensate lender for loss of interest income). See also  [In re Ultra Petroleum Corp.](#), 943 F.3d 758, 765 (5th Cir. 2019) (noting that make-whole premium could be unmatured interest and remanding to bankruptcy court for determination based on the unique dynamics of the case).
- 12 See also  [MPM](#), 874 F.3d at 802 (noting that a make-whole premium “was intended to ensure that the Senior-Lien Note holders received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to the maturity date.”)

- 13 E.g.,  [In re Ultra Petroleum Corp.](#), 624 B.R. 178, 188-95 (Bankr. S.D. Tex. 2020) (on remand, concluding that make-whole premium was not the economic equivalent of unmatured interest and not disallowed under § 502(b)(2));  [In re School Specialty, Inc.](#), Bank. No. 13-10125 (KJC), 2013 WL 1838513, at *5 (Bank. D. Del. 2013) (agreeing with [Trico](#) and holding that make-whole premium should not be disallowed as unmatured interest);  [In re Trico Marine Servs. Inc.](#), 450 B.R. 474, 481 (Bank. D. Del. 2011) (reviewing cases and concluding that “Th[e] Court is persuaded by the soundness of the majority’s interpretation of make-whole obligations, and therefore finds that the Indenture Trustee’s claim on account of the Make-Whole Premium is akin to a claim for liquidated damages, not for unmatured interest.”). See also 4 Collier on Bankruptcy ¶ 502.03 (16th ed 2021) (collecting cases).

- 14 E.g.,  [Doctors Hosp.](#), 508 B.R. at 706 (disagreeing with the [Trico](#) analysis because liquidated damages may well include unmatured interest);  [In re MPM Silicones LLC](#), Bankr. No. 14-22503 (RDD), 2014 WL 4436335, at *17-18 (Bankr. S.D.N.Y. Sept. 9, 2014) (concluding that noteholders claim to a make-whole based on debtor’s breach of no call provision was unmatured interest disallowed under § 502(b)(2)), *aff’d in part and rev’d in part on other grounds*,  874 F.3d 787 (2d Cir. 2017).

- 15 Although the Bankruptcy Court held on remand that make-whole premium was not unmatured interest, that decision is currently on appeal. [Ultra Petroleum Corp. v. Ad Hoc Comm. of OpCo Unsecured Creditors](#), Case No. 21-20008 (oral argument was held before the Fifth Circuit on 10/04/2021).

- 16 See Douglas Baird, [Making Sense of Make-Wholes](#), 94 Am. Bankr. L.J. 567 (2020).

- 17  [In re Long John Silver’s Rests., Inc.](#), 230 B.R. 29, 33 n.4 (Bankr. D. Del. 1999) (quoting William Shakespeare, *Romeo & Juliet*, Act II, scene ii).

- 18 The Supplemental Indenture provides in relevant part that prior to the stated date, the Debtors may redeem the 2028 Senior Notes for a price “equal to 100.0% of the principal amount thereof plus the Applicable Premium (as defined below) as of, and accrued but unpaid interest, if any, to, but not including, the Redemption Date.” (Adv. D.I. 5, Ex. H, § 6(c)). That section further defines the Applicable Premium to mean

with respect to a 2028 Note at any Redemption Date, the greater of (i) 1.00% of the principal amount of such 2028 Note and (ii) the excess of (A) the present value at such Redemption Date, calculated as of the date of the applicable redemption notice, of (1) the redemption price of such 2028 Note on January 15, 2023 (such redemption price being that described in Section 6(a)), plus (2) all required remaining scheduled interest payments due on such 2028 Note through such date (excluding accrued and unpaid interest to the Redemption Date), computed using a discount rate equal to the Treasury Rate plus 50 basis points, over (B) the principal amount of such 2028 Note on such Redemption Date, as calculated by the Company in good faith (which calculation shall be conclusive) or on behalf of the Company by such Person as the Company shall designate; provided that such calculation shall not be a duty or obligation of the Trustee.

(*Id.* (emphasis added)).

- 19  [United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs.](#), 484 U.S. 365, 379, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988).

- 20 E.g.,  [In re Cardelucci](#), 285 F.3d 1231, 1234 (9th Cir. 2002) (concluding that post-petition interest on general unsecured claims is payable under sections 726(a)(5) and 1129(a)(7) only at the federal judgment rate, not at the contract rate);  [In re PG&E Corp.](#), 610 B.R. 308, 315 (Bank. N.D. Cal. 2019) (same);  [In re Washington](#)

- [Mutual, Inc.](#), 461 B.R. 200, 242 (Bank. D. Del. 2011) (same), vacated on other grounds, [2012 WL 1563880](#) (Bank. D. Del. Feb. 24, 2012).
- 21 [11 U.S.C. §§ 726\(a\)\(5\)](#) (providing payment of postpetition interest at “the legal rate” to creditors, before any distribution to the debtor (or equity), in the event there are funds left after paying all other claims in a chapter 7 liquidation case), & [1129\(a\)\(7\)](#) (providing that with respect to each impaired class of claims or interests, each holder of such claim has either accepted the plan or will receive at least what it would have received in a liquidating chapter 7 case).
- 22 E.g., [Cardelucci](#), 285 F.3d at 1234; [PG&E](#), 610 B.R. at 315; [Washington Mutual](#), 461 B.R. at 242.
- 23 [H.R. Rep. No. 103-835](#), at 48 (1994) (emphasis added), reprinted in 1994 U.S.C.C.A.N. 3340, 3356-57.
- 24 [H.R. Rep. 103-835](#), 48 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3357 (“With respect to [section 1124\(1\)](#) and [\(2\)](#), [subsection \(d\)](#) would not change the beneficial 1984 amendment to [section 1129\(a\)\(7\) of the Bankruptcy Code](#), which excluded from application of the best interests of creditors test classes that are unimpaired under [section 1124](#).”).
- 25 See An Act to amend title 28 of the United States Code regarding jurisdiction of bankruptcy proceedings, to establish new Federal judicial positions, to amend title 11 of the United States Code, and for other purposes, [Pub. L. 98-353](#), § 512(a)(7) & (10), 98 Stat. 333 (1984) (amending [11 U.S.C. § 1129\(a\)\(7\) & \(10\)](#)).
- 26 E.g., [City of New York v. Saper](#), 336 U.S. 328, 330 n.7, 69 S.Ct. 554, 93 L.Ed. 710 (1949); [Vanston Bondholders Protective Comm. v. Green](#), 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946); [Consolidated Rock Prods. Co. v. Du Bois](#), 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941); [Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.](#), 233 U.S. 261, 264, 34 S.Ct. 502, 58 L.Ed. 949 (1914); [In re Ultra Petroleum](#), 943 F.3d at 765; [Gen. Elec. Capital Corp. v. Future Media Prods., Inc.](#), 547 F.3d 956, 961 (9th Cir. 2008); [In re Gencarelli](#), 501 F.3d 1, 7 (1st Cir. 2007); [In re Dow Corning Corp.](#), 456 F.3d 668, 679-80 (6th Cir. 2006); [In re Terry Ltd. P'ship](#), 27 F.3d 241, 243 (7th Cir. 1994); [In re Laymon](#), 958 F.2d 72, 75 (5th Cir. 1992).
- 27 [Vanston Bondholders](#), 329 U.S. 156, 67 S.Ct. 237; [Consolidated Rock](#), 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982; [Am. Iron](#), 233 U.S. 261, 34 S.Ct. 502.
- 28 [Vanston Bondholders](#), 329 U.S. 156, 67 S.Ct. 237; [Consolidated Rock](#), 312 U.S. 510, 61 S.Ct. 675; [Am. Iron](#), 233 U.S. 261, 34 S.Ct. 502; [GECC](#), 547 F.3d at 961; [Gencarelli](#), 501 F.3d at 5, 8; [Terry Ltd.](#), 27 F.3d at 242-43; [Laymon](#), 958 F.2d at 75; [Ruskin v. Griffiths](#), 269 F.2d 827, 830-832 (2d Cir. 1959).
- 29 [Dow Corning](#), 456 F.3d at 679 (relying on [In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.](#), 791 F.2d 524, 528 (7th Cir. 1986), [Ruskin](#), 269 F.2d at 831, and [Debentureholders Protective Comm. of Cont'l Inv. Corp. v. Cont'l Inv. Corp.](#), 679 F.2d 264, 269 (1st Cir. 1982)); [Chicago](#), 791 F.2d at 528 (simply stating the solvent debtor exception applied to unsecured creditors without citation to any caselaw in support, while also acknowledging that “[t]he fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those

- views may be.”); [Debentureholders](#), 679 F.2d at 269 (relying on [Vanston](#), 329 U.S. 156, 67 S.Ct. 237 and [Ruskin](#), 269 F.2d 827).
- 30 [Dow Corning](#), 456 F.3d at 678-80 (ruling was premised on [section 1129\(b\)](#), because the court was considering the rights of impaired creditors, not unimpaired creditors, in a solvent chapter 11 debtor case). Further, [Dow Corning](#) is contrary to the many cases that conclude that impaired creditors are only entitled to post-petition interest at the federal judgment rate under [sections 1129\(a\)\(7\)](#) and [726\(a\)\(5\)](#). E.g., [Cardelucci](#), 285 F.3d at 1234; [PG&E](#), 610 B.R. at 315; [Washington Mutual](#), 461 B.R. at 242.
- 31 In [Gencarelli](#), the First Circuit held that the contractual claims of unsecured creditors should be enforced in solvent chapter 11 debtor cases “unless one of the [section 502](#) exceptions applies” and remanded the case to determine if any provision of that section did apply. [501 F.3d at 5, 8](#).
- 32 Significantly, in [PPI](#), the Third Circuit held that a landlord's claim was capped by [section 502\(b\)\(6\)](#) even though that conclusion meant that the debtor's equity would be getting a distribution (i.e., it was a solvent chapter 11 debtor case). [324 F.3d at 200-04](#).
- 33 [11 U.S.C. § 1129\(b\)](#) (mandating that the court “shall confirm the plan ... 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.”) (emphasis added). See also [PPI](#), 324 F.3d at 205 n.14.
- 34 E.g., [Norwest Bank Worthington v. Ahlers](#), 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (rejecting equitable arguments that absolute priority rule did not apply to the case at bar, the Court concluded that “whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.”); [In re Frederickson](#), 545 F.3d 652, 658 (8th Cir. 2008) (“In enacting BAPCPA, Congress reduced the amount of discretion that bankruptcy courts previously had over the calculation of an above-median debtor's income and expenses to eliminate what it perceived as widespread abuse of the system. ...”).
- 35 An Act to Establish a uniform Law on the Subject of Bankruptcies, [Pub. L. No. 95-598](#), [§ 1129\(a\)\(7\)](#), 92 Stat. 2549 (1978).
- 36 See discussion in Part C.2.b, *supra*.
- 37 Id.
- 38 Of course, even unimpaired creditors have the right to object to confirmation of the plan. It appears that the Indenture Trustees agreed that, rather than object to confirmation of the Debtors’ Plan in this case, their objection to treatment of the Noteholders’ claims would be decided in this adversary (or the claims resolution process). (D.I. 5261 at ¶¶ 26 & 27.)
- 39 While the Indenture Trustees assert that the calculation of their contract interest claim is a relatively simple math exercise, in large cases with multiple unimpaired creditors that would not be true. E.g., [PG&E](#), 610 B.R. at 310.

In re Hertz Corp., 637 B.R. 781 (2021)

[40](#) As a result of this conclusion, to the extent that the Court determines that the redemption premium is the economic equivalent of interest, that claim too would be limited by the application of the federal judgment rate.

End of Document

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In re PPI Enterprises (U.S.), Inc., 324 F.3d 197 (2003)

49 Collier Bankr.Cas.2d 1749, 41 Bankr.Ct.Dec. 16, Bankr. L. Rep. P 78,824



KeyCite Yellow Flag - Negative Treatment

Disagreed With by [In re Ultra Petroleum Corp.](#), Bankr.S.D.Tex., September 21, 2017

324 F.3d 197

United States Court of Appeals,
Third Circuit.

In re: PPI ENTERPRISES (U.S.), INC.
and Polly Peck Produce, Inc., Debtors
Sheldon H. Solow, d/b/a Solow Building Company
v.
PPI Enterprises (U.S.), INC., Polly Peck Produce,
Inc., Arvi Limited and PPI Holdings, B.V.
Sheldon H. Solow, d/b/a Solow
Building Company, Appellant.

No. 01-4140.

|
Argued July 15, 2002.

|
Filed March 28, 2003.

Synopsis

Debtor's former landlord objected to debtor's proposed Chapter 11 plan and moved to dismiss bankruptcy petition as not having been filed in good faith. The United States Bankruptcy Court for the District of Delaware, [Peter J. Walsh](#), Chief Judge, [228 B.R. 339](#), denied motion and overruled objections, and landlord appealed. The District Court, Roderick, R., McKelvie, J., affirmed. On further appeal, the Court of Appeals, Scirca, Circuit Judge, held that: (1) landlord's statutorily capped damages claim was not "impaired," for purposes of deciding whether debtor's proposed plan had been accepted by at least one impaired class, simply because it was capped; (2) statutory cap on landlord's claim for termination damages was properly reduced by sums it had drawn on letter of credit that it held in lieu of security deposit; and (3) petition was filed in "good faith," though filed primarily to cap landlord's damages.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (18)

- [1] [Bankruptcy](#) [Conclusions of Law; De Novo Review](#)
- [Bankruptcy](#) [Discretion](#)
- [Bankruptcy](#) [Clear Error](#)

Court of Appeals reviews bankruptcy court's legal determinations de novo, its factual findings for clear error, and its exercises of discretion for abuse thereof. [Fed.Rules Bankr.Proc.Rule 8013, 11 U.S.C.A.](#)

[4 Cases that cite this headnote](#)

- [2] [Bankruptcy](#) [Eligibility to Vote; Impairment](#)

Term "impairment," as used in bankruptcy statute defining when claim or interest is impaired under debtor's proposed Chapter 11 plan, is term of art, that was crafted by Congress to determine creditor's standing at plan confirmation stage. Bankr.Code, [11 U.S.C.A. § 1124](#).

[4 Cases that cite this headnote](#)

- [3] [Bankruptcy](#) [Eligibility to Vote; Impairment](#)

If debtor's proposed Chapter 11 plan does not leave creditor's rights entirely unaltered, creditor's claim is "impaired," and creditor will have vote upon whether plan should be confirmed. Bankr.Code, [11 U.S.C.A. § 1124](#).

[21 Cases that cite this headnote](#)

- [4] [Bankruptcy](#) [Eligibility to Vote; Impairment](#)

There is a presumption that proposed Chapter 11 plan impairs creditor's claim, so as to give creditor a vote on whether plan should be confirmed, and burden is on debtor to demonstrate that plan leaves creditor's rights unaltered. Bankr.Code, [11 U.S.C.A. § 1124](#).

[16 Cases that cite this headnote](#)

[5] **Bankruptcy** [Eligibility to Vote: Impairment](#)

Statutory cap on claim that lessor could assert for damages resulting from termination of its lease with Chapter 11 debtor-lessee was not “impairment” of its rights, but part of rights that it possessed in bankruptcy, so that where debtor’s Chapter 11 plan proposed to pay lessor’s statutorily capped claim in full, together with postpetition interest, lessor’s claim was not “impaired,” and it had no right to vote upon whether plan should be confirmed. Bankr.Code, [11 U.S.C.A. §§ 502\(b\)\(6\), 1124](#).

[9 Cases that cite this headnote](#)

[6] **Bankruptcy** [Eligibility to Vote: Impairment](#)

Creditor’s claim outside of bankruptcy is not relevant barometer for whether proposed Chapter 11 plan “impairs” its rights, for purposes of deciding whether creditor has right to vote on confirmation of plan. Bankr.Code, [11 U.S.C.A. § 1124](#).

[6 Cases that cite this headnote](#)

[7] **Bankruptcy** [Eligibility to Vote: Impairment](#)

To determine whether creditor’s claim is “impaired,” so as to give it standing to vote upon confirmation of proposed Chapter 11 plan, court must examine whether plan itself is source of limitation on creditor’s legal, equitable, or contractual rights. Bankr.Code, [11 U.S.C.A. § 1124](#).

[16 Cases that cite this headnote](#)

[8] **Bankruptcy** [Eligibility to Vote: Impairment](#)

Creditors that will receive cash equal to their “allowed claims,” together with postpetition interest, under debtor’s proposed Chapter 11 plan are not “impaired,” and have no right to vote on

whether plan should be confirmed. Bankr.Code, [11 U.S.C.A. § 1124](#).

[12 Cases that cite this headnote](#)

[9] **Bankruptcy** [Rejection of Executory Contract or Lease](#)

Statutory cap on claim that landlords may assert for damages resulting from termination of their leases with debtor-tenants is designed to limit such lease termination claims to prevent landlords from receiving a windfall at other creditors’ expense. Bankr.Code, [11 U.S.C.A. § 502\(b\)\(6\)](#).

[10 Cases that cite this headnote](#)

[10] **Bankruptcy** [Rejection of Executory Contract or Lease](#)

Though debtor-tenant’s bankruptcy filing does not relieve landlord of its duty to mitigate its damages for debtor-tenant’s breach of lease, statutory cap on landlord’s claim for termination damages is not reduced by amount that landlord receives from reletting premises and mitigating its damages. Bankr.Code, [11 U.S.C.A. § 502\(b\)\(6\)](#).

[11 Cases that cite this headnote](#)

[11] **Bankruptcy** [Rejection of Executory Contract or Lease](#)

Statutory cap on landlord’s claim for termination damages was properly reduced by sums that it had drawn upon letter of credit that it held in lieu of security deposit. Bankr.Code, [11 U.S.C.A. § 502\(b\)\(6\)](#).

[11 Cases that cite this headnote](#)

[12] **Bankruptcy** [Good Faith: Motive](#)

Debtor’s bad faith in filing for Chapter 11 relief constitutes “cause” for dismissal of Chapter 11 petition. Bankr.Code,  [11 U.S.C.A. § 1112\(b\)](#).

[7 Cases that cite this headnote](#)

[13] Bankruptcy **Proceedings**

On motion to dismiss Chapter 11 case as not having been filed in good faith, debtor bears burden of establishing its good faith.

Bankr.Code,  [11 U.S.C.A. § 1112\(b\)](#).

[11 Cases that cite this headnote](#)

[14] Bankruptcy **Good Faith; Motive**

Court must consider totality of circumstances in deciding whether Chapter 11 petition is subject to dismissal as not having been filed in good faith.

Bankr.Code,  [11 U.S.C.A. § 1112\(b\)](#).

[6 Cases that cite this headnote](#)

[15] Bankruptcy **Discretion**

Bankruptcy court's decision not to dismiss Chapter 11 petition as "bad faith" filing, despite fact that debtor-tenant had filed for bankruptcy primarily for purposes of taking advantage of statutory cap upon landlord's claim for lease termination damages, would be reviewed for abuse of discretion. Bankr.Code, [11 U.S.C.A. § 502\(b\)\(6\)](#).

[4 Cases that cite this headnote](#)

[16] Bankruptcy **Discretion**

Abuse of discretion can occur when no reasonable person would adopt lower court's view.

[4 Cases that cite this headnote](#)

[17] Bankruptcy **"Bad Faith"**

Bankruptcy court's decision not to dismiss, as "bad faith" filing, a liquidating Chapter 11 petition filed by debtor with no ongoing business, only one so-called employee, and no assets other than stock certificates was not abuse of discretion, though debtor filed petition primarily to cap lessor's damages claim for debtor's breach of lease, so as to create value for equity holders at lessor's expense; in filing bankruptcy petition to cap lessor's damages claim, debtor was taking

advantage of right specifically granted under the Bankruptcy Code. Bankr.Code, [11 U.S.C.A. §§ 502\(b\)\(6\)](#),  [1112\(b\)](#).

[10 Cases that cite this headnote](#)

[18] Bankruptcy **Good Faith; Motive**

Determination, for case dismissal purposes, of whether Chapter 11 petition was filed in "good faith" requires fact-intensive, case-by-case inquiry. Bankr.Code,  [11 U.S.C.A. § 1112\(b\)](#).

[8 Cases that cite this headnote](#)

Attorneys and Law Firms

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[Charlene D. Davis](#) (Argued), The Bayard Firm, Wilmington, DE, for Appellees, Arvi Limited and PPI Holdings, B.V.

Before [SCIRICA](#), ALITO and [FUENTES](#), Circuit Judges.

OPINION OF THE COURT

[SCIRICA](#), Circuit Judge.

This is an appeal by a commercial landlord who contends a Chapter 11 bankruptcy was filed only to frustrate his collection of rent. At issue is an interpretation of [Bankruptcy Code § 502\(b\)\(6\)](#) and the Code's good faith requirements.

I.

Sheldon Solow owns a Manhattan office tower at 9 West 57th Street. On August 9, 1989, he leased 10,000 square

In re PPI Enterprises (U.S.), Inc., 324 F.3d 197 (2003)

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feet to PPI Enterprises (“PPIE”), a Delaware corporation, for its corporate headquarters. The lease ran for ten years, requiring annual payments (in monthly installments) of \$620,000 for five years and \$650,000 thereafter. Polly Peck International, PLC, a United Kingdom corporation and the indirect corporate parent of PPIE, guaranteed these commercial lease obligations.¹ Sanwa Bank issued a standby letter of credit to Solow, on behalf of PPIE, in the amount of \$650,000.

Over time, Polly Peck’s financial status unraveled and insolvency proceedings commenced in Great Britain. On October 25, 1990, the Chancery Division of the High Court of Justice entered an administration order² for Polly Peck and appointed three administrators for the company. As Polly Peck’s subsidiary, PPIE faced credit cancellations and defaults exceeding \$17 million.³

In September 1991, PPIE abandoned its corporate headquarters in Manhattan and ceased paying rent to Solow. On October 8, 1991, Solow delivered PPIE written notice of default under the lease. After PPIE failed to cure the default, Solow *201 gave notice on October 21, 1991, of his intent to terminate the lease. Remaining rent due under the leasehold agreement totaled approximately \$5.86 million. Solow subsequently drew on Sanwa Bank’s letter of credit, applying it in lieu of monthly rent payments between October 1991 and July 31, 1992. By the latter date, the letter of credit was exhausted.

On October 25, 1991, Solow sued PPIE and Polly Peck in the United States District Court for the Southern District of New York. On November 13, 1992, the district court granted Solow partial summary judgment, holding PPIE wrongly terminated its lease, but did not address possible damages. On March 4, 1996, almost four and one half years after filing its initial lawsuit and after the failure of settlement negotiations, Solow asked the district court to schedule a damages trial. On the eve of that proceeding, PPIE filed for Chapter 11 bankruptcy in Delaware. PPIE stated it had four objectives: (1) concluding the Polly Peck “wind-down”; (2) “liquidating” PPIE; (3) invoking provisions to reject a restriction on its ability to sell the Del Monte stock; and (4) limiting Solow’s lease termination damages under [Bankruptcy Code § 502\(b\)\(6\)](#).

On August 9, 1996, Solow filed a proof of claim with the Bankruptcy Court, reducing his alleged damages to

\$4,757,824.94.⁴ Then, in December 1996, Solow moved to dismiss the Chapter 11 filing for bad faith. Solow alleged PPIE’s bankruptcy was a sham filing designed to create value for Polly Peck and its creditors at his expense, and that the bankruptcy served no legitimate purpose. According to Solow, PPIE did not intend its bankruptcy filing to effectuate a corporate reorganization, because the company had no ongoing business, only one remaining employee, and “no assets other than stock certificates representing a 2% interest in Del Monte Foods Company.” After an evidentiary hearing, the Bankruptcy Court in January 1997 denied the motion without prejudice.⁵

On March 31, 1998, PPIE filed its bankruptcy plan (“Plan”), dividing administrative claims and priority tax claims into four classes.⁶ After providing for the four-class division, the Plan stated: “The treatment of and consideration to be received by holders of Allowed Claims and Interests pursuant to this Article IV of the Plan shall be in full and complete satisfaction, settlement, release and discharge of such Claims and Interests. The Debtors’ obligations in respect of such Claims and Interests shall be satisfied in accordance with the terms of this Plan.”

*202 The Plan treated Solow’s claim as a “Class 2 non-insider general unsecured claim.” PPIE contended Plan approval by the classes of creditors was unnecessary since none were impaired. Nonetheless, PPIE solicited votes from Classes 1, 2, and 3. Only two of seven ballots were returned from Class 2 –Solow’s “no” vote and one “yes” vote. With no clear majority, Solow contends Class 2 effectively rejected the Plan.⁷

Solow renewed his motion to dismiss on April 6, 1998, contending his vote against the Plan had not counted because his claim was improperly classified as “unimpaired.” Over a four-day period, the Bankruptcy Court heard evidence on the debtors’ objection to Solow’s claim; Solow’s renewed motion to dismiss; and Solow’s objections to the Plan’s confirmation. On December 30, 1998, the Bankruptcy Court determined Solow’s claim was subject to the statutory cap of [11 U.S.C. § 502\(b\)\(6\)](#) and reduced by application of the letter of credit; the bankruptcy was filed in good faith; and as an “unimpaired creditor,” Solow was deemed to have accepted the plan. [In re PPI Enters.](#), 228 B.R. 339 (Bankr.D.Del.1998) (Walsh, J.).

The United States District Court for the District of Delaware affirmed without opinion and this appeal followed.⁸

II.

[1] The Bankruptcy Court had subject matter jurisdiction under [28 U.S.C. §§ 1334](#) and [§ 157](#). The District Court had jurisdiction over the Bankruptcy Court's order under [28 U.S.C. § 158\(a\)](#). We have jurisdiction under [28 U.S.C. § 158\(d\)](#). We review the Bankruptcy Court's "legal determinations de novo, its factual findings for clear error, and its exercises of discretion for abuse thereof." *In re Cont'l Airlines*, 203 F.3d 203, 208 (3d Cir.2000).

III.

The central issue on appeal is whether the doctrine of impairment precludes Solow from having voting rights against PPIE's Chapter 11 bankruptcy plan.

[2] [3] "Impairment" is a term of art crafted by Congress to determine a creditor's standing in the confirmation phase of bankruptcy plans. *In re L & J Anaheim Assoc.*, 995 F.2d 940, 942–43 (9th Cir.1993). Each creditor has a set of legal, equitable, and contractual rights that may or may not be affected by bankruptcy. If the debtor's Chapter 11 reorganization plan does not leave the creditor's rights entirely "unaltered," the creditor's claim will be labeled as impaired under [§ 1124\(1\) of the Bankruptcy Code](#). If the creditor's claim is impaired, the Code provides the creditor with a vote that, depending on the value of the creditor's claim, may be sufficient to defeat confirmation of the bankruptcy plan.

*203 [4] The Bankruptcy Code creates a presumption of impairment "so as to enable a creditor to vote on acceptance of the plan." *In re Monclova Care Ctr., Inc.*, 254 B.R. 167, 178–79 (Bankr.N.D. Ohio 2000); *In re Seasons Apartments, L.P.*, 215 B.R. 953, 958 (Bankr.W.D. La.1997). Under [11 U.S.C. § 1124\(1\)](#), the presumption of impairment is overcome only if the plan "leaves unaltered the [creditor's] legal, equitable, and contractual rights."² The burden is placed on the debtor to demonstrate the plan leaves the creditor's rights unaltered.

The Bankruptcy Court here began by reviewing [11 U.S.C. § 502\(b\)\(6\)](#). The court determined the Plan did not

impair Solow's legal, equitable, and contractual rights, since the limitation on Solow's potential recovery was dictated by [§ 502\(b\)\(6\)](#), which was independent of the Plan. Solow contends application of [§ 502\(b\)\(6\)](#) alters his claim and entitles him to vote against the Plan's confirmation. The question is whether the impairment sections of the Bankruptcy Code require such a result.

A.

1.

[5] We begin with the language of the Bankruptcy Code. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). As noted, [§ 1124\(1\)](#) provides that a claim is impaired unless the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder of such claim." Under [§ 101\(5\)](#), a "claim" refers broadly to a creditor's right to recovery.¹⁰ See also *Johnson v. Home State Bank*, 501 U.S. 78, 83, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991) ("We have previously explained that Congress intended by this language to adopt the broadest available definition of 'claim.'") (citations omitted).

Solow contends a broad definition of "claim" requires a finding of impairment whether the source of impairment is the plan or a statute. The Bankruptcy Court rejected Solow's argument, finding he "confuse[d] two distinct concepts: (i) plan impairment, under which the debtor alters the 'legal, equitable, and contractual rights to which [the] claim entitles the holder of such claim,' and (ii) statutory impairment, under which the operation of a provision of the Code alters the amount that the creditor is entitled to under nonbankruptcy law." *PPI Enters.*, 228 B.R. at 353.

The Bankruptcy Court relied on *In re American Solar King Corp.*, 90 B.R. 808 (Bankr.W.D. Tex.1988), to reach its conclusion. In *Solar King*, a Chapter 11 corporate debtor sought confirmation of a modified reorganization plan. Certain parties already involved in litigation with the bankrupt company – doubtless concerned about reduced recoveries – challenged the plan. *Id.* at 812–13. The court recognized the operation of [§ 510\(b\)](#)¹¹ in altering the *204 petitioning creditors' claims, but found the reduction in the

creditors' potential, nonbankruptcy recovery did not result in impairment. *Id.* at 819–22. The court reasoned:

A closer inspection of the language employed in [Section 1124\(1\)](#) reveals “impairment by statute” to be an oxymoron. Impairment results from what the *plan* does, not what the statute does. A plan which “leaves unaltered” the legal rights of a claimant is one which, by definition, does not impair the creditor. A plan which leaves a claimant subject to other applicable provisions of the Bankruptcy Code does no more to alter a claimant's legal rights than does a plan which leaves a claimant vulnerable to a given state's usury laws or to federal environmental laws. The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons, just as surely as it limits contractual rights. Any alteration of legal rights is a consequence not of the plan but of the bankruptcy filing itself.

Id. at 819–20; see also *In re Smith*, 123 B.R. 863, 867 (Bankr.C.D.Cal.1991) (“[A] plan may limit payment of claims to ‘the extent allowed,’ without impairing them; for until claims are allowed, or deemed allowed, the holders thereof are not entitled to distribution from the bankruptcy estate.”). ¹²

[6] [7] Generally, we agree with the *Solar King* analysis. The relevant impairment language requires bankruptcy plans to leave unaltered those rights to which the creditor's “claim or interest entitles the holder of such claim or interest.” 11 U.S.C. § 1124(1). This language in § 1124(1) does not address a creditor's claim “under nonbankruptcy law.” The use of a present-tense verb suggests a creditor's rights must be ascertained with regard to applicable statutes, including the § 502(b)(6) cap. In other words, a creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights.

Under Solow's interpretation, every landlord-creditor's capped claim under § 502(b)(6) would be impaired and entitled to a vote. Yet this would make § 502(b)(6) a nullity, since, unlike some other Code sections, the limitation on damages under § 502(b)(6) is “absolute” and “is a limit based on fairness rather than a rule of convenience.” 4 *Collier on Bankruptcy*, § 502.03, at 7a (Alan N. Resnick & Henry J. Sommer, eds., 15th ed.2002). Thus, PPIE could not offer a plan that departed from the § 502(b)(6) limitation. Accordingly, we hold that where § 502(b)(6) alters a creditor's nonbankruptcy claim, there is no alteration of the claimant's

legal, equitable, and contractual rights for the purposes of impairment under [§ 1124\(1\)](#).

2.

The *Solar King* court adopted a similar rationale when interpreting [§ 510\(b\)](#), *205 which automatically subordinates security purchase and sale claims to the claims of general, unsecured creditors. The rationale for this Code section is that general creditors should not share in the risk of an unlawful issuance of securities. See 4 *Collier on Bankruptcy*, § 510.04, at 1. Like [§ 502\(b\)\(6\)](#), this Code section is mandatory, not discretionary. To hold that its mere application in a bankruptcy proceeding causes impairment would nullify its meaning.

Further, as the Bankruptcy Court here noted, Solow's interpretation would create “perverse incentives” for all creditors, effectively urging them to file “inflated claims, disputed claims, or claims of questionable validity.” Once those claims were reduced by operation of the Bankruptcy Code, under Solow's analysis, creditors would succeed in having their claims “impaired” and would receive a vote to defeat the plan.

In sum, PPIE's Chapter 11 Plan intends to pay Solow his “legal entitlement” and provide him with “full and complete satisfaction” of his claim on the date the Plan becomes effective. Solow is only “entitled” to his rights under the Bankruptcy Code, including the [§ 502\(b\)\(6\)](#) cap. Solow might have received considerably more if he had recovered on his leasehold claims before PPIE filed for bankruptcy. But once PPIE filed for Chapter 11 protection, that hypothetical recovery became irrelevant. Solow is only entitled to his “legal, equitable, and contractual rights,” as they now exist. Because the Bankruptcy Code, not the Plan, is the only source of limitation on those rights here, Solow's claim is not impaired under [§ 1124\(1\)](#). ¹³

B.

[8] Solow also contends Congress's 1994 repeal of [11 U.S.C. § 1124\(3\)](#), a separate exception to the presumption of impairment, supports his broad definition of “claim.” Before 1994, [§ 1124\(3\)](#) specified that a creditor receiving full payment of an “allowed claim” was not impaired. This subsection, eliminated in 1994, provided:

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Except as provided in section 1123(a) (4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan —(3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to —(A) with respect to a claim, the allowed amount of such claim....

[11 U.S.C. § 1124\(3\)](#) (repealed).

Interpreting this statute in 1994, one bankruptcy court held that [§ 1124\(3\)](#) allowed a solvent debtor to pay the “allowed” claims of unsecured creditors in full, excluding postpetition interest, without risking impairment.  [In re New Valley Corp.](#), 168 B.R. 73, 77–80 (Bankr.D.N.J.1994).¹⁴ The *New Valley* court held that a portion of a creditor's claim that was not “allowed” under the Bankruptcy Code need not be paid after a bankruptcy filing, even if the claim would be recoverable in a non-bankruptcy context. *Id.* This decision contrasted with several cases holding that unsecured creditors of a solvent debtor *206 must be paid in full, including postpetition interest, under the “fair and equitable” test of [§ 1129\(b\)\(2\)](#). E.g.,  [Consol. Rock Prods. Co. v. du Bois](#), 312 U.S. 510, 61 S.Ct. 675, 85 L.Ed. 982 (1941); *Debentureholders Protective Comm.*, 679 F.2d at 264.

After the *New Valley* decision, Congress repealed [§ 1124\(3\)](#). Relevant legislative history recited:

The principal change in this section is set forth in subsection (d) and relates to the award of post petition interest. In a recent Bankruptcy Court decision (*New Valley*), unsecured creditors were denied the right to receive post petition interest.... In order to preclude this unfair result in the future, the Committee finds it appropriate to delete [section 1124\(3\)](#) from the Bankruptcy Code. As a result

of this change, if a plan proposed to pay a class of claims in cash in the full allowed amount of the claims, the class would be impaired, entitling creditors to vote for or against the plan of reorganization.

[H.R.Rep. No. 103–835, at 47–48 \(1994\)](#), reprinted in 1994 U.S.C.C.A.N. 3340, 3356–57.

Solow contends this repeal established that creditors receiving cash equal to their “allowed claims,” even including postpetition interest, were still impaired by bankruptcy filings. He claims the repeal was not limited to fact situations involving postpetition interest and that Congress “went beyond” the *New Valley* “problem,” providing creditors with voting rights if a bankruptcy plan alters their nonbankruptcy rights in any manner. Some bankruptcy courts appear to have adopted this rationale. See, e.g.,  [Seasons Apartments](#), 215 B.R. at 955–56 (“While the Congressional Record reveals that Congress was most concerned about solvent debtors avoiding post-petition interest on unsecured claims, Congress repealed the entire subsection.”);  [In re Crosscreek Apartments, Ltd.](#), 213 B.R. 521, 536 (Bankr.E.D.Tenn.1997) (“In light of the deletion of subsection (3) to [§ 1124](#) by the Bankruptcy Reform Act of 1994, the court concludes that it is no longer a valid argument to assert that the plan proponent can render a claim unimpaired by paying the claim in full at confirmation.”);  [Equitable Life Ins. Co. of Iowa v. Atlanta–Stewart Partners](#), 193 B.R. 79, 80 (Bankr.N.D.Ga.1996) (concluding Congress's repeal of [§ 1124\(3\)](#) was an “extreme remedy” for the *New Valley* issue but that legislative history demonstrates “Congress intended to do away with the concept that a creditor receiving payment in full is unimpaired”).¹⁵

The Bankruptcy Court here rejected such a broad reading of the 1994 repeal, concluding, “[M]y reading of the legislative history indicates that Congress merely intended to eliminate the anomalous result created by the *New Valley* decision. Thus, I conclude that Congress did not intend to eliminate unimpairment for purely money claims. It intended that to be unimpaired, the claim must receive postpetition interest.”  [PPI Enters.](#), 228 B.R. at 352 (citation omitted); see also  [In re Rocha](#), 179 B.R. 305, 307 n. 1 (Bankr.M.D.Fla.1995) (“[A] solvent debtor must now pay post-petition and pre-confirmation interest on a claim to have a class considered

‘unimpaired.’ [Section 1124\(3\)](#) has been deleted in its entirety, which had previously allowed a class of creditors to be considered ‘unimpaired’ without paying interest on the claim.”). The Bankruptcy Court also held that [§§ 1124\(1\)](#) and [*207 1124\(3\)](#) offered different tests for nonimpairment: “[Section 1124\(3\)](#) created nonimpairment status by a cash payment equal to the allowed amount of the claim but without postpetition interest. Such treatment could not qualify for nonimpairment under [§ 1124\(1\)](#) because the failure to pay postpetition interest does not leave unaltered the contractual or legal rights of the claim.”  [PPI Enters., 228 B.R. at 352.](#)

In other words, [§ 1124\(1\)](#) and [§ 1124\(3\)](#) were different exceptions to the presumption of impairment, and the repeal of one should not affect the other. We agree with the Bankruptcy Court's analysis. Contrary to Solow's representations, the legislative history does not reflect a sweeping intent by Congress to give impaired status to creditors more freely outside the postpetition interest context. Instead, as the Bankruptcy Court noted, the legislative history accompanying the repeal of [§ 1124\(3\)](#) indicated the “principal change” in the repeal “relates to the award of post petition interest.” The congressional committee specifically referenced the *New Valley* decision without referencing the text of [§ 1124\(1\)](#) or the many cases addressing its provisions, including *Solar King*. Therefore, the legislative history supports our holding.

IV.

Having determined Solow's claim is not impaired, we must consider the operation of [§ 502\(b\)\(6\)](#). As the Bankruptcy Court noted, PPIE asserts that Solow's claim under [§ 502\(b\)\(6\)](#) entitles him to \$100,612.07. Solow counters that capping his claim still would award him \$863,937.67. These disparate views are due to conflicting interpretations of [§ 502\(b\)\(6\)](#).

A.

[9] [10] [Section 502\(b\)\(6\)](#) caps a landlord's claim in bankruptcy for damages resulting from the termination of a real property lease.¹⁶ Under [§ 502\(b\)\(6\)](#), a landlord-creditor is entitled to rent reserved from the greater of (1) one lease year or (2) fifteen percent, not to exceed three years, of the remaining lease term. The cap operates from the earlier of the petition filing date or “the date on which [the] lessor

repossessed or the lessee surrendered, the leased property.” The landlord also retains a claim for any unpaid rent due under such lease prior to the earlier of those dates. This language reflects Congress's intent to limit lease termination claims to prevent landlords from receiving a windfall over other creditors. See [H.R.Rep. No. 95–595, at 353 \(1977\)](#), reprinted in 1978 U.S.C.C.A.N. 5963, 6309 (“[The cap] limits the damages allowable to a landlord of the debtor.... It is designed to compensate the landlord for his loss while not permitting a claim so large (based on a long-term lease) as to prevent other general unsecured creditors from recovering [*208](#) a dividend from the estate. The damages a landlord may assert from termination of a lease are limited....”); 4 *Collier on Bankruptcy*, § 502.03 at 7a (“[The cap is] designed to compensate the landlord for his loss while not permitting a claim so large as to prevent other general unsecured creditors from recovering a dividend from the estate.”).¹⁷

Just over two years into the parties' ten-year lease, PPIE breached the leasehold agreement by failing to pay rent. Solow gave PPIE ten days to cure its breach. When PPIE did not respond, Solow initiated termination proceedings and filed suit seeking damages for the term of the lease. Since Solow terminated the lease long before PPIE filed its bankruptcy petition, the Bankruptcy Court correctly fixed the date on which Solow accepted PPIE's surrender of the leased property as the starting point for its [§ 502\(b\)\(6\)](#) calculation.¹⁸

B.

[11] Once the [§ 502\(b\)\(6\)](#) calculation is complete, the prevailing view, and the view adopted by the Bankruptcy Court here, favors deduction of a security deposit from the [§ 502\(b\)\(6\)](#) cap of a landlord's claim. E.g.,  [Atl. Container, 133 B.R. at 988](#) (“[It is] well-settled that a security deposit held by a lessor on a rejected lease must be applied against the maximum claim for lease termination damages allowed to the lessor under [§ 502\(b\)\(6\)](#).”). Equating a letter of credit with a security deposit, the Bankruptcy Court held that “because Solow drew down the letter of credit for \$650,000 subsequent to termination of the lease, Solow's [§ 502\(b\)\(6\)](#) claim should be reduced by that amount.”¹⁹  [PPI Enters., 228 B.R. at 350.](#)

The Bankruptcy Court relied upon  [Oldden v. Tonto Realty Corp., 143 F.2d 916, 921 \(2d Cir.1944\)](#), which established

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the pre-Code practice of deducting security deposits from [§ 502\(b\)\(6\)](#) calculations. See also [H.R.Rep. No. 95-595, at 354 \(1977\)](#), reprinted in 1978 U.S.C.C.A.N. 5963, 6310 (“[A landlord] will not be permitted to offset his actual damages against his security deposit and then claim for the balance under [\[§ 502\(b\)\(6\)\]](#). Rather, his security deposit will be applied in satisfaction of the claim that is allowed under [the statute].”). *Oldden* stands for the proposition that a bankruptcy filing limits damages for breach of a leasehold agreement and requires a return of the tenant's security deposit. [143 F.2d at 921](#). Nonetheless, it bears noting that *Oldden* involved a security deposit given directly to the creditor from the debtor, not from a third party. We must consider whether this factor *209 requires different treatment under [§ 502\(b\)\(6\)](#).

Solow contends [§ 502\(b\)\(6\)](#) applies only to funds collected by the landlord directly from the tenant, and that any other funds recovered by a landlord, whether from a letter of credit or a new tenant, are immaterial. Accord [Atl. Container, 133 B.R. at 990](#) (post-petition rent, use, and occupancy payments “should not be applied against the Landlord's maximum allowable lease termination claim”); see also [In re Conston Corp., 130 B.R. 449, 453-54 \(Bankr.E.D.Pa.1991\)](#). In this context, Solow suggests a security deposit and a letter of credit are fundamentally different. Solow argues he never had the functional equivalent of a security deposit and instead simply maintained contractual rights to the letter of credit's proceeds, which should not affect his recovery under [§ 502\(b\)\(6\)](#).

This distinction is important because if Sanwa Bank had defaulted on its letter of credit to Solow, Solow would have pursued a separate legal action against Sanwa Bank; he would have no claim against PPIE based on the letter of credit. Because the letter of credit allegedly is independent of his claim against PPIE, Solow contends the \$650,000 should not be deducted from the [§ 502\(b\)\(6\)](#) cap calculation.

Under similar circumstances, some courts have adopted the “independence principle” to separate proceeds from a letter of credit from the debtor's estate. E.g., [Kellogg v. Blue Quail Energy Inc., 831 F.2d 586, 589-90 \(5th Cir.1987\)](#) (holding that “the independence principle [is] the cornerstone of letter of credit law”); [Musika v. Arbutus Shopping Ctr., L.P., 257 B.R. 770, 772 \(Bankr.D.Md.2001\)](#) (determining the [§ 502\(b\)\(6\)](#) cap without regard to the letter of credit); see also 5 Collier

on Bankruptcy, § 549.04[1] (“Property of the estate does not include the proceeds of a letter of credit paid to a creditor of the debtor who is a beneficiary of the letter.”); Geoffrey L. Berman et al, *Last in Line: Landlords Use Letters of Credit to Bypass the Claim Cap of § 502(b)(6)*, 20 Am. Bankr.Inst. J. 16 (Dec.2001). Under this view, the independence principle should generally govern in situations where a third-party issuer, not the tenant itself, provides the letter of credit.

Yet there is another view. PPIE argues that once the letter of credit is drawn down, Sanwa Bank, as guarantor, will pursue recovery of its \$650,000 loss directly against PPIE. Under Solow's interpretation, this means Solow would keep the \$650,000 and PPIE would be liable for that same amount to Sanwa Bank. In effect, this result would be an end run around [§ 502\(b\)\(6\)](#), since Solow would receive a windfall at PPIE's, and other creditors', expense, and PPIE would be liable twice for the same amount of money. The more appropriate outcome under the relevant case law and legislative history, PPIE contends, is to treat the letter of credit as a payment from PPIE to Solow, thus reducing PPIE's burden under [§ 502\(b\)\(6\)](#) in bankruptcy.

Chapter 11 is intended to permit the debtor to rehabilitate itself while simultaneously protecting creditors. The parties here posit competing legal and equitable arguments that reflect the dual purposes of bankruptcy. Although there are reasons to the contrary, we are not inclined to disturb the rationale followed since *Oldden*. As the Second Circuit explained in *Oldden*:

Although the instant case is admittedly different in that the tenant here pledged his own property to cover the possibility of default, and the rights of a third party are in no way involved, yet in both situations there is an attempt on the part of the landlord to insure performance by *210 the tenant. The difference is purely technical.... [I]n one case the insurance is security put up by the tenant himself, while in the other it is the credit standing of a third party procured by the tenant; this difference is insufficient to justify divergent rules as to the respective allowable claims. If the total damages are limited in the

one instance, they should likewise be limited in the other instance.

 [143 F.2d at 921.](#)

Nonetheless, we need not decide the underlying question because it is clear the parties intended the letter of credit to operate as a security deposit. Article 33A of the parties' lease required PPIE to give Solow a security deposit in the amount of \$650,000. Article 50 of the rider attached to the lease clarified PPIE's obligation:

50. *Cash Security: Letter of Credit*

A. In lieu of the cash security provided for in Article 33A, Tenant may deliver to Landlord, as security pursuant to Article 33A, an irrevocable, clean, commercial letter of credit in the amount of \$650,000 issued by a bank ..., which shall permit Landlord (a) to draw thereon up to the full amount of the credit evidenced thereby in the event of any default by Tenant ... or (b) to draw the full amount thereof to be held as cash security pursuant to Article 33A hereof if for any reason the Letter is not renewed....

B. If Landlord shall use or apply any of the cash security deposited pursuant to Article 33A or any of the cash drawn by Landlord under the Letter of Credit ..., Tenant shall, promptly on Landlord's demand therefor, deposit with Landlord the amount of cash required to restore the cash security deposited with Landlord to the level specified in Article 33A or in lieu thereof, shall deliver to Landlord a Letter of Credit in the amount and complying with the requirements specified in Part A above.

Interpreting this language, we find the parties intended the letter of credit to serve as a security deposit. Entitled "Cash Security: Letter of Credit," the rider expressly provided the letter of credit was "in lieu" of PPIE's cash security obligation in the leasehold agreement. The rider also provided that PPIE would be liable to Solow for replenishment of the security if he was forced to draw upon the letter of credit. We will affirm the Bankruptcy Court's treatment of the letter of credit under [§ 502\(b\)\(6\)](#).

V.

[12] [13] Finally, we consider whether PPIE's Chapter 11 bankruptcy filing met certain legal prerequisites. Under [§ 1112\(b\)](#), bankruptcy courts may dismiss Chapter 11 filings for "cause" if a petition is filed in "bad faith." The Bankruptcy Court denied Solow's motion to dismiss for alleged bad faith²⁰ and his objection to the confirmation of PPIE's plan under § 1129(a)(3).²¹ At issue is whether this bankruptcy filing contravened the purposes of the Bankruptcy Code under its [*211](#) good faith requirements. The debtor bears the burden of establishing good faith.  [In re SGL Carbon Corp., 200 F.3d 154, 162 n. 10 \(3d Cir.1999\).](#)

[14] [15] [16] In *SGL Carbon*, we recognized that "no list is exhaustive of all the factors which could be relevant when analyzing a particular debtor's good faith."  [200 F.3d at 166](#) & n. 10 (internal quotations omitted). We directed courts to consider the totality of the circumstances in assessing the good faith of a Chapter 11 petition.  [Id. at 165](#). Although *SGL Carbon* was decided a year after the Bankruptcy Court's decision, the Bankruptcy Court properly assumed an implicit good-faith requirement for Chapter 11 filings.  [PPI Enters., 228 B.R. at 344-45; accord](#)  [SGL Carbon, 200 F.3d at 162](#). As noted, the Bankruptcy Court conducted four days of evidentiary hearings on this matter and made factual findings.²² We review for abuse of discretion.  [SGL Carbon, 200 F.3d at 159](#) (abuse exists upon clearly erroneous finding of fact, errant legal conclusions, or improper application of fact to law). "An abuse of discretion can occur when no reasonable person would adopt the ... [lower] court's view."  [Rode v. Dellarciprete, 892 F.2d 1177, 1182 \(3d Cir.1990\).](#)

[17] The Bankruptcy Court determined it was not necessarily "bad faith" for debtors to file for bankruptcy to avail themselves of certain Code provisions.  [PPI Enters., 228 B.R. at 345](#) ("[I]n evaluating a debtor's good faith, the court's only inquiry is to determine whether the debtor seeks to abuse the bankruptcy law by employing it for a purpose for which it was not intended."); see, e.g.,  [In re W & L Assocs., Inc., 71 B.R. 962, 967-68 \(Bankr.E.D.Pa.1987\)](#) (§ 365);  [In re Bofill, 25 B.R. 550, 552 \(Bankr.E.D.N.Y.1982\)](#) (rejection of contract). The Bankruptcy Court found "the primary purpose of the petition was to cap Solow's claim pursuant to [§ 502\(b\)\(6\)](#)."  [PPI Enters., 228 B.R. at 343.](#)

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“Because PPI[E]’s intention to cap Solow’s claim using § 502(b)(6) [was] not a use of the Code for a purpose for which it was not intended – indeed, PPI[E] [was] using § 502(b)(6) for exactly its intended purpose – ... PPI[E]’s filing does not violate the good faith filing doctrine.” *Id.* at 345 (internal quotations omitted).²³ The Bankruptcy Court also noted that PPIE filed its Chapter 11 petition in an attempt to divide its assets during the dissolution of its parent company. The Court found this an appropriate use of Chapter 11 since the Code clearly contemplates liquidating plans under  11 U.S.C. § 1123(b)(4), whereby a debtor may develop a Chapter 11 plan to sell off all of its assets.

[18] A good faith determination must be a fact-intensive, case-by-case inquiry. *212 Here, the Bankruptcy Court

analyzed the purpose of § 502(b)(6) and the totality of the circumstances, and determined that PPIE’s bankruptcy filing did not contravene the good faith requirement. Under the circumstances, we see no abuse of discretion.

VI.

For the foregoing reasons, we will affirm the District Court.

All Citations

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Footnotes

- 1 There are two debtors in these jointly administered cases: PPIE and Polly Peck Produce, Inc., a wholly owned subsidiary of PPIE. The joint Chapter 11 plan, and the order confirming it, contemplate that these two estates will be consolidated upon the effective date of the plan. Therefore, we will jointly refer to the two entities as “PPIE.”
- 2 Administration under the Insolvency Act of 1986 is the closest analogue in British law to Chapter 11 bankruptcy relief.
- 3 Meanwhile, Solow contends PPIE engaged in transactions designed to reduce his eventual damages claim. In January 1990, PPIE acquired a two percent interest in Del Monte Food Co. for \$12.6 million. PPIE transferred the stock to Polly Peck for an accounting credit. In January 1991, Polly Peck’s administrators sold Standard Fruit capital stock owned by PPI Holdings B.V., PPIE’s direct parent, to a third party, conveying the \$15 million in proceeds to Sanwa Bank. Although PPIE owed no obligation to Sanwa Bank, the payment was treated as an intercompany “loan” to PPIE. Solow suggests no legitimate lender would have made such a loan, given PPIE’s inability to repay. In July 1991, allegedly to avoid paying \$87,000 in withholding taxes, the administrators “sold” Polly Peck’s interest in Del Monte to PPIE for \$12.6 million, the same amount Polly Peck had paid PPIE two years earlier. PPIE’s vice president for finance then reduced the balance sheet value of the Del Monte stock to \$3.5 million. But the inter-company “indebtedness” of \$12.6 million remained unchanged, so it continued to accumulate interest. PPIE eventually owed \$50 million in “inter-company debt” to BV and Polly Peck.
- 4 The reduction is attributable to two factors: (1) Solow had re-let a portion of the Manhattan premises, mitigating his potential relief, and (2) as noted, Solow had received \$650,000 under the Sanwa Bank letter of credit.
- 5 In the meantime, Del Monte agreed to re-purchase its stock from PPIE for \$1.6 million, subject to higher offers. Solow objected, arguing stock transfer restrictions inhibited bidding by third parties. After Del Monte lifted the restriction, Del Monte and Solow engaged in an exchange of bids, with Solow eventually winning at

a price of \$11 million. A few months later, Solow resold the Del Monte stock for at least \$30 million to Texas Pacific Group, generating a profit that exceeded \$19 million.

[6](#) Class 1 consisted of “priority claims”; Class 2 included “non-insider general unsecured claims.” Members of Classes 1 and 2 were to be paid, at 100 cents on the dollar, in “cash and other consideration as required.” Class 3, encompassing “affiliate claims,” and Class 4, encompassing “interests,” were to be paid in “remaining cash and the assignment of certain debtor claims or causes of action.” Those with Class 3 “affiliate claims,” Solow alleges, were the “insiders” owing more than \$50 million to PPI Holdings B.V., PPIE’s direct corporate parent, and Polly Peck.

[7](#) Once claims have been formed and certain classes have been identified as “impaired,” at least one impaired class must vote in favor of a Chapter 11 plan. Otherwise, the court will not confirm the plan. Section 1129(a) provides: “The court shall confirm a plan only if all of the following requirements are met ... (10)[i]f 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.” Within the impaired class voting for the plan, “creditors holding at least two-thirds in amount and more than half in number of the allowed claims” must approve it. [11 U.S.C. § 1126\(c\)](#).

[8](#) Under the Amended and Restated PPIE Memorandum of Agreement, the debtors and the “insiders” settled to “avoid litigation.” BV (PPIE’s direct corporate parent) and Arvi Ltd. (an affiliate of BV) will receive all remaining cash and an assignment of causes of action.

[9](#) A second exception to the presumption is found in [11 U.S.C. § 1124\(2\)](#) but it is not relevant here.

[10](#) The section defines “claim” as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured ...

 [11 U.S.C. § 101\(5\)](#).

[11](#) That section provides:

For the purposes of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or an affiliate of the debtor, for damages arising from the purchase or sale of such a security, for reimbursement or contribution allowed under [section 502](#) on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

[11 U.S.C. § 510\(b\)](#).

[12](#) Solow contends *Solar King* is inapposite. Because *Solar King* was decided six years before the repeal of [11 U.S.C. § 1124\(3\)](#), he suggests the court did not have “the benefit of history demonstrating Congress’s intent to enfranchise claimants not fully returned to non-bankruptcy status.” But, as we discuss, the legislative history surrounding the 1994 repeal of [§ 1124\(3\)](#) does not support this view.

[13](#) Because we hold the Plan did not impair Solow’s claim, we need not reach whether the proceedings required a vote of the creditors to confirm the Plan.

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- 14 An impaired creditor in a solvent debtor case can demand postpetition interest under the “fair and equitable” test of § 1129(b)(2). See  [*Debentureholders Protective Comm. of Cont. Inv. Corp. v. Cont. Inv. Corp.*, 679 F.2d 264, 269 \(1st Cir.1982\)](#). “Unimpaired” creditors have no such rights.
- 15 The *Atlanta–Stewart Partners* and *Seasons Apartments* courts did not discuss the plain language of [§ 1124](#), at issue here, focusing instead almost exclusively on the statute’s legislative history.
- 16 [Section 502\(b\)\(6\)](#) provides:

[I]f an objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim ... and shall allow such claim in such amount, except to the extent that if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or fifteen percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

[11 U.S.C. § 502\(b\)\(6\)](#).
- 17 The landlord retains a duty to mitigate the tenant’s breach, but any mitigation of damages secured by reletting the premises will offset only the landlord’s overall potential recovery, and does not affect the [§ 502\(b\)\(6\)](#) cap. The “overwhelming majority of courts” have held that the [§ 502\(b\)\(6\)](#) statutory cap is not reduced by any amount a landlord has received by reletting the leased premises and mitigating its damages. *5th Ave. Jewelers*, 203 B.R. at 381; see also  [*In re Atl. Container Corp.*, 133 B.R. 980, 990 \(Bankr.N.D.Ill.1991\)](#).
- 18 In determining the final [§ 502\(b\)\(6\)](#) calculation, the Bankruptcy Court should make a finding of fact as to the exact date of Solow’s termination or PPIE’s formal surrender of the leasehold agreement, and start the calculation from that point.
- 19 Solow also contends that even if he had a security deposit, and not a letter of credit, the Bankruptcy Court’s application of the security deposit rule was erroneous because he drew down the letter of credit’s proceeds before the Chapter 11 filing. But the [§ 502\(b\)\(6\)](#) cap starts to operate on the date on which the lessee surrendered the leased property, and the Bankruptcy Court correctly rejected Solow’s argument.
- 20 Solow characterized the filing as:

involv[ing] a struggle between [Solow] and the [Polly Peck] Administrators in their many guises ... over the right to [PPIE]’s remaining asset, the Del Monte stock. Recognizing that Mr. Solow was gaining the upper hand in that struggle, the Administrators retreated to this Court solely to frustrate and delay Mr. Solow’s collection efforts. But such a case involving a debtor with no ongoing business, a single asset and only a few real creditors warrants dismissal.
- 21 That section requires a plan be proposed “in good faith and not by any means forbidden by law.”
- 22 Although the Bankruptcy Court may not have applied the test in a formulaic way, the Court evaluated the relevant factors before reaching its judgment. The Court mirrored our *SGL Carbon* analysis in noting that “courts have not identified with any consistency which circumstances of the debtor’s filing are indicia of good

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49 Collier Bankr.Cas.2d 1749, 41 Bankr.Ct.Dec. 16, Bankr. L. Rep. P 78,824

faith.”  [PPI Enters., 228 B.R. at 344](#); see also Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement*, 85 NW. U.L.Rev. 919, 944 (1991).

23 Moreover, as the Bankruptcy Court noted, Chapter 11 does not require reorganization, and even if PPIE had filed for Chapter 7 protection, it still would have been able to benefit from [§ 502\(b\)\(6\)](#).  [PPI Enters., 228 B.R. at 347](#) (“[Section] 502(b)(6) is not tethered to Chapter 11 cases. It applies equally to Chapter 7 cases.”); 4 *Collier on Bankruptcy*, § 502.03, at 7a (“Under [section 502\(b\)\(6\)](#), whether the landlord's claim arises in the course of a liquidation of a debtor or whether it arises in connection with debtor reorganization under chapter 11, a single standard applies.”).

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In re Ultra Petroleum Corp., 575 B.R. 361 (2017)

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KeyCite Red Flag - Severe Negative Treatment
Reversed in Part, Vacated in Part by [In re Ultra Petroleum Corporation](#), 5th Cir.(Tex.), November 26, 2019

575 B.R. 361

United States Bankruptcy Court,
S.D. Texas, Houston Division.

IN RE: ULTRA PETROLEUM CORP., et al., Ultra Resources, Inc., [Ultra Wyoming, Inc.](#), Ultra Wyoming LGS, LLC, UP Energy Corporation, [UPL Pinedale, LLC](#), UPL Three Rivers Holdings, LLC, Debtor(s)

CASE NO: 16-32202, CASE NO: 16-32204,
CASE NO: 16-32205, CASE NO: 16-32206,
CASE NO: 16-32207, CASE NO: 16-32208,
CASE NO: 16-32209 Jointly Administered

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Signed September 21, 2017

Synopsis

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and interest at contractual default rate.

Holdings: The Bankruptcy Court, Marvin Isgur, J., held that:

[1] debtors, as parties objecting to make-whole premium included in proof of claim filed by noteholders in their surplus case, failed to rebut the prima facie validity of noteholders' claim;

[2] to be unimpaired, noteholders had to be paid all that they are entitled to receive under state law, including make-whole premium; and

[3] postpetition interest to which noteholders were entitled in surplus Chapter 11 case, pursuant to plan providing that they were not impaired and would be paid whatever amount was necessary to make them unimpaired, was default interest at contract rate.

Objection denied.

West Headnotes (19)

[1] [Bankruptcy](#) [Claims or proceedings against estate or debtor; relief from stay](#)

[Bankruptcy](#) [Bankruptcy judges](#)

Bankruptcy court, even as non-Article-III court, had both statutory and constitutional authority to finally resolve Chapter 11 debtors' objections to the make-whole premiums and postpetition interest at contractual default rate included in noteholders' proofs of claim in debtors' surplus Chapter 11 case; dispute stemmed from bankruptcy itself and would necessarily be resolved as part of claims allowance process.

[U.S. Const. art. 3, § 1](#) et seq.; [28 U.S.C.A. § 157\(b\)\(2\)\(B\)](#).

[2] [Bankruptcy](#) [Proof; Filing](#)

Proof of claim is a written statement setting forth a creditor's claim. [Fed. R. Bankr. P. 3001\(a\)](#).

[3] [Bankruptcy](#) [Sufficiency of Filing](#)

Ultimately, a proof of claim must fulfill its essential purpose of providing objecting parties with sufficient information to evaluate the nature of the claim.

[4] [Bankruptcy](#) [Presumptions and burden of proof](#)

[Bankruptcy](#) [Effect of proof of claim](#)

If proof of claim is prima facie valid, as having been filed in accordance with Federal Rules of Bankruptcy Procedure, objecting party must produce evidence rebutting the claim and establishing that claim should be disallowed. [11 U.S.C.A. § 502\(a, b\)](#); [Fed. R. Bankr. P. 3001\(f\)](#).

[1 Cases that cite this headnote](#)

[5] [Bankruptcy](#) [Presumptions and burden of proof](#)

To rebut the presumptive validity of properly filed proof of claim, objecting party must produce rebuttal evidence of equal probative value, which he can do by producing specific and detailed allegations that place the claim into dispute, by presenting legal arguments based on the contents of the claim and its supporting documents, or by submitting pretrial pleadings. [11 U.S.C.A. § 502\(a, b\)](#); [Fed. R. Bankr. P. 3001\(f\)](#).

[6] **Bankruptcy** ➡ [Weight and sufficiency](#)

If objecting party produces evidence equal in probative force to properly filed proof of claim, or if claimant fails to prove its claim's prima facie validity, claimant must present additional evidence to prove validity of its claim by a preponderance of the evidence. [11 U.S.C.A. § 502\(a, b\)](#); [Fed. R. Bankr. P. 3001\(f\)](#).

[1 Cases that cite this headnote](#)

[7] **Bankruptcy** ➡ [Presumptions and burden of proof](#)

Ultimate burden of proof during claims allowance process always rests upon claimant. [11 U.S.C.A. § 502\(a, b\)](#).

[1 Cases that cite this headnote](#)

[8] **Contracts** ➡ [Effect in general; enforcement in general](#)

Generally, New York law requires courts to enforce unambiguous contract terms, especially where contract was negotiated by sophisticated and represented parties in an arms-length and equal negotiation.

[9] **Damages** ➡ [Certainty as to Amount of Actual Damage](#)

Damages ➡ [Proportion of Sum Stipulated to Actual Debt or Damage](#)

Contractual liquidated damages provision is enforceable under New York law if the amount liquidated bears a reasonable proportion to the

probable loss, and if amount of actual loss is incapable or difficult of precise estimation.

[10] **Damages** ➡ [Proportion of Sum Stipulated to Actual Debt or Damage](#)

Under New York law, if amount of damages payable under liquidated damages provision is plainly or grossly disproportionate to the probable loss, then the provision calls for a penalty and will not be enforced.

[11] **Damages** ➡ [Construction of Stipulations](#)

Under New York law, soundness of liquidated damages provision is tested in light of circumstances existing as of the time that agreement was entered into, rather than as of time that damages were incurred or became payable.

[12] **Damages** ➡ [Questions for jury](#)

Damages ➡ [Liquidated damages and penalties](#)

Under New York law, whether liquidated damages provision is in nature of unenforceable penalty is a question of law for the court, and burden of proof is on the party seeking to avoid paying liquidated damages.

[13] **Bankruptcy** ➡ [Penalties, forfeitures, and punitive damages](#)

In order to satisfy burden of showing that noteholders' claim for contractual make-whole premium was unenforceable penalty under New York law, Chapter 11 debtors had to demonstrate either that the damages flowing from a prospective early termination were readily ascertainable at the time, or that the make-whole premium was conspicuously disproportionate to those foreseeable damages. [11 U.S.C.A. § 502\(b\)\(1\)](#).

[1 Cases that cite this headnote](#)

[14] Contracts ➡ [Effect in general; enforcement in general](#)

Under New York law, absent some element of fraud, exploitive overreaching, or unconscionable conduct to exploit a technical breach, there is no warrant, either in law or equity, for court to refuse to enforce agreement of parties.

[15] Damages ➡ [Construction of Stipulations](#)

Under New York law, when there is doubt as to whether provision constitutes an unenforceable penalty or proper liquidated damage clause, it should be resolved in favor of construction which holds the provision to be a penalty.

[16] Bankruptcy ➡ [Penalties, forfeitures, and punitive damages](#)

Chapter 11 debtors, as parties objecting to make-whole premium included in proof of claim filed by noteholders in their surplus case, failed to rebut the prima facie validity of noteholders' claim by proving either that damages resulting from prepayment were readily ascertainable at the time that parties entered into note agreement, or that make-whole premium, while enormous, was conspicuously disproportionate to noteholders' foreseeable losses from prepayment at the time; mere size of make-whole amount claimed by noteholders did not show that it was conspicuously disproportionate to noteholders' foreseeable losses at the time. [11 U.S.C.A. § 502\(a, b\)](#); [Fed. R. Bankr. P. 3001\(f\)](#).

[1 Cases that cite this headnote](#)

[17] Bankruptcy ➡ [Construction, execution, and performance](#)

Under plan confirmed in surplus Chapter 11 case, which provided that noteholders were not impaired and would be paid whatever amount was necessary to make them unimpaired, noteholders had to be paid all that they were entitled to receive under state law,

including make-whole premium, in order to be "unimpaired." [11 U.S.C.A. § 1124\(1\)](#).

[18] Bankruptcy ➡ [Effect as discharge](#)

Extent of debtor's Chapter 11 discharge is governed by plan.

[19] Bankruptcy ➡ [Post-petition interest](#)

Bankruptcy ➡ [Construction, execution, and performance](#)

Interest ➡ [Statement as to rate in contract](#)

Postpetition interest to which noteholders were entitled in surplus Chapter 11 case, pursuant to plan providing that they were not impaired and would be paid whatever amount was necessary to make them unimpaired, was default interest at contract rate, rather than at federal judgment rate; paying interest at federal judgment rate instead of the default rate specified in note agreement would cause the noteholders to be impaired. [11 U.S.C.A. § 1124\(1\)](#); [28 U.S.C.A. § 1961](#).

[1 Cases that cite this headnote](#)

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[Christopher Manuel Lopez](#), [Alfredo R. Perez](#), Weil Gotshal Manges LLP, Houston, TX, for Creditor Committee.

MEMORANDUM OPINION

Marvin Isgur, UNITED STATES BANKRUPTCY JUDGE

The Ad Hoc Committee of Unsecured Creditors of Ultra Resources, Inc. (the “Senior Creditor Committee”) filed a complaint against Debtors Ultra Resources (“OpCo”), Ultra Petroleum Corp. (“HoldCo”), and UP Energy Corporation (“MidCo”) seeking a judgment declaring: (i) that the Debtors’ filing for chapter 11 bankruptcy triggered an obligation under the terms of a Master Note Purchase Agreement (the “Note Agreement”) to pay a Make-Whole Amount to certain noteholders of OpCo; and (ii) the amount of that obligation. The Debtors objected to the Senior Creditor Committee’s claim for the Make-Whole Amount, post-petition interest at the contract default rate, and other related fees and expenses. Debtors’ objection is denied.

Background

OpCo issued multiple series of unsecured notes (the “Notes”) totaling approximately \$1.46 billion pursuant to the Note Agreement dated March 6, 2008, and three Note Agreement supplements dated March 5, 2009, January 28, 2010, and October 12, 2010. (ECF No. 44 at 13; ECF No. 880 at 8; ECF No. 1215 at 15). These Notes, along with funds borrowed under the OpCo RCF Credit Agreement, are known as the “OpCo Funded Debt Claims.” (ECF No. 1393 at 18). HoldCo and MidCo each guaranteed OpCo’s obligations under the Note Agreement and its supplements. (ECF No. 880 at 2; ECF No. 1215–1 at 8).

Pursuant to the Note Agreement, OpCo “may, at its option, upon notice ... prepay *364 ... one or more series or tranches of fixed rate Notes ... at 100% of the principal amount so prepaid, plus the Make-Whole Amount determined for the prepayment date” (ECF No. 1215–1 at 24). Section 8.7 of the Note Agreement defines a “Make-Whole Amount” as “an amount equal to the excess, if any, of the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal of such fixed rate Note over the amount of such Called Principal” (ECF No. 1215–1 at 27). “Called Principal” is “the principal of such Note that ... has become or is declared to be immediately due and payable pursuant to Section 12.1” (ECF No. 1215–1 at 27). “Remaining Scheduled Payments” includes “all payments of such Called Principal and interest thereon that would be due after the Settlement Date,” which is “the date on which such Called Principal ... has become or is declared to be immediately due and payable pursuant to Section 12.1” (ECF No. 1215–1 at 28). The “Discounted Value” of such Remaining Scheduled Payments is comprised of “the amount obtained by

discounting all Remaining Scheduled Payments with respect to such Called Principal from their respected scheduled due dates to the Settlement Date ... in accordance with accepted financial practice and at a discount factor ... equal to the Reinvestment Yield” of 0.5% over the yield to maturity of specified United States Treasury obligations. (ECF No. 1215–1 at 27).

Section 11 of the Note Agreement specifies a number of conditions constituting an “Event of Default” that consequently affects the rights of the parties under the Agreement. (ECF No. 1215–1 at 35–38). If an Event of Default occurs, Section 12.1(a) of the Note Agreement provides that “all the Notes then outstanding shall automatically become immediately due and payable.” (ECF No. 1215–1 at 38). Each Note incorporates by reference the Event of Default, Acceleration, and Make-Whole Amount provisions of the Note Agreement. (ECF No. 1215–1 at 158–59). Under Paragraph (g) of Section 11, OpCo’s filing of a bankruptcy petition constitutes an Event of Default. (ECF No. 1215–1 at 37).

In the event that any of the Notes become due under the Note Agreement, those Notes “mature and the entire unpaid principal amount of such Notes, plus ... all accrued and unpaid interest thereon ... [and] any applicable Make-Whole Amount determined in respect of such principal amount (to the full extent permitted by applicable law) ... shall all be immediately due and payable” (ECF No. 1215–1 at 38). The Note Agreement is governed by New York law. (ECF No. 1215–1 at 47).

On April 29, 2016, OpCo, MidCo, and HoldCo filed chapter 11 bankruptcy petitions. (ECF No. 1). On April 30, 2016, the Court ordered the joint administration of the Debtors’ bankruptcy cases under this case number. (ECF No. 40). The commencement of these chapter 11 bankruptcy cases constituted Events of Default under the Note Agreement that automatically accelerated the balance of the underlying Notes under Section 12.1. The balance following acceleration included the principal, pre-petition interest, post-petition interest, and Make-Whole Amounts. (ECF No. 1215–1 at 37, 38). Consequently, \$1.46 billion of OpCo Notes became due pursuant to the Note Agreement while \$999 million became due under the OpCo Notes. (ECF No. 1215 at 12).

During the course of this case, the Debtors became solvent due in part to commodity prices rising after their petition date. (ECF No. 1215 at 18). Consequently, the Debtors

proposed a chapter 11 plan paying all unsecured claims, in full and in cash, and providing a substantial recovery for *365 their equity owners. (ECF No. 1308; *see also* ECF No. 1215 at 18). The proposed chapter 11 plan treated the OpCo Noteholders as unimpaired. As holders of unimpaired claims, the Noteholders were “conclusively presumed to have accepted the plan.” [11 U.S.C. § 1126\(f\)](#) (*emphasis added*).

The Senior Creditor Committee objected to confirmation of OpCo's proposed plan on the grounds that, for the Noteholders' claims to be unimpaired, OpCo must pay the Make-Whole Amount and post-petition interest on the OpCo Notes at the default rates listed in the Note Agreement until the Noteholders' claims are fully satisfied. (ECF No. 1393 at 25). The Senior Creditor Committee consists of senior unsecured creditors of OpCo that collectively hold or control the various OpCo Notes. (ECF No. 1393 at 14 n. 1).

The Debtors objected to the Senior Creditor Committee's asserted entitlement to the Make-Whole Amount, post-petition interest at the Note Agreement's default rate, and other related fees and expenses on March 3, 2017. (ECF No. 1214). In their memorandum in support of their objection, the Debtors specifically assert that the Senior Creditor Committee's claims for the Make-Whole Amount should be disallowed because: (i) the claims seek unmatured interest, which is expressly barred by [11 U.S.C. § 502\(b\)\(2\)](#); and (ii) the Make-Whole Amount is an unenforceable liquidated damages provision under New York law. (ECF No. 1215 at 21–36).

Debtors also argue that any post-petition interest awarded on the Senior Creditor Committee's claims should be assessed, at most, at the Federal Judgment Rate because: (i) post-petition interest on unsecured claims is awarded, if at all, at the “legal rate,” which is the Federal Judgment Rate; and (ii) the Court should reject the minority view that state law governs post-petition interest. (ECF No. 1215 at 36–47). Should the Court award the OpCo Noteholders both the Make-Whole Amount and post-petition interest at the contract default rate, the Debtors claim that the Noteholders' claims should be disallowed to the extent necessary to avoid a duplicative recovery. (ECF No. 1215 at 47–49). The Ad Hoc Committee of HoldCo Noteholders and the Ad Hoc Equity Committee joined in Debtors' objection. (ECF No. 1216; ECF No. 1217). The Ad Hoc Equity Committee also filed an objection to the Noteholders' claims. (ECF No. 1217).

On March 13, 2017, the Senior Creditor Committee and the Debtors entered into a stipulation. (ECF No. 1314). Pursuant to that stipulation, the parties agreed that, among other things, the quantification of post-petition interest would be addressed in conjunction with the Make-Whole Amount dispute. (ECF 1314 at 7).

The Court confirmed the Debtors' chapter 11 plan on March 14, 2017. (ECF No. 1324). The confirmation order provided that the Noteholders' claims included any amounts necessary to make the holders of the allowed claims unimpaired. (ECF No. 1324 at 69). The plan itself classified the Noteholders' claims as unimpaired and provided that the members of the Committee would receive payment of all outstanding principal on the Notes in cash, pre-petition interest at the rate listed within the Note Agreement, post-petition interest at the Federal Judgment Rate, and a forbearance fee. (ECF No. 1324–1 at 26).

The Senior Creditor Committee filed a response in opposition to Debtors' objection to the Noteholders' claims on March 24, 2017. In its response, the Senior Creditor Committee argued that the Make-Whole Amount must be allowed in its entirety because: (i) for the Noteholders' claims to be unimpaired, Debtors must pay *366 the full Make-Whole Amount due under state law; (ii) [§ 502\(b\)\(2\)](#) is inapplicable to the Noteholders' claims because the Make-Whole Amount is matured rather than unmatured interest; and (iii) the Make-Whole Amount is fully enforceable under New York law. (ECF No. 1393 at 27–65). The Senior Creditor Committee also claims that post-petition interest should be allowed on the Noteholders' claims at the Note Agreement's default rates, not the Federal Judgment Rate, because: (i) [11 U.S.C. § 726\(a\)\(5\)](#) is not applicable in these chapter 11 cases; and (ii) even if [§ 726\(a\)\(5\)](#) were applicable in the Debtors' bankruptcy case, the circumstances of the bankruptcy require that post-petition interest be paid at the contract default rates. (ECF No. 1393 at 65–76). The OpCo Noteholders, consisting of 42 holders of senior unsecured notes issued by OpCo, filed a joint response to the Debtors' claims objections. (ECF No. 1390).

On May 16, 2017, the Court heard oral arguments on the Debtors' claims objections. Following supplemental briefing on the question of whether the Court could rely on its own illustrative calculations as part of its reasoning, the Court took this matter under advisement on June 16, 2017.

Jurisdiction

[1] The district court has jurisdiction over this proceeding pursuant to [28 U.S.C. § 1334](#). The allowance or disallowance of a proof of claim against the estate is a core matter as defined in [28 U.S.C. § 157\(b\)\(2\)\(B\)](#). This case was referred to the Bankruptcy Court pursuant to [28 U.S.C. § 157\(a\)](#). Accordingly, the Court has congressional authority to render a final order on the Debtors' objections to the OpCo Funded Debt and OpCo RCF Claims.

Although subject-matter jurisdiction is proper in this Court, this Court may not issue a final order or judgment in matters within the exclusive authority of Article III courts. [Stern v. Marshall](#), 564 U.S. 462, 502, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). This Court has constitutional authority to enter a final order on the OpCo Funded Debt and OpCo RCF Claims because they stem “from the bankruptcy itself or would necessarily be resolved in the claims allowance process.” [Id.](#) at 499, 131 S.Ct. 2594. As claims against the Debtors' bankruptcy estates, the OpCo Funded Debt and OpCo RCF Claims directly stem from the Debtors' bankruptcy and the adjudication of Debtors' objections will necessarily resolve whether those claims are allowed. See, e.g., [In re Brown](#), 521 B.R. 205, 213 (Bankr. S.D. Tex. 2014), adopted, 2014 WL 7342435 (S.D. Tex. Dec. 23, 2014), *aff'd in part, appeal dismissed in part*, 807 F.3d 701 (5th Cir. 2015). Therefore, this Court possesses constitutional authority to enter a final order with respect to the allowance or disallowance of the OpCo Funded Debt and OpCo RCF Claims. Moreover, the parties have expressly or implicitly consented to the Bankruptcy Court's determination of this dispute. See [Wellness Int'l Network, Ltd. v. Sharif](#), — U.S. —, 135 S.Ct. 1932, 1949, 191 L.Ed.2d 911 (2015).

Analysis

Proof of Claim Standard

[2] A proof of claim is a written statement setting forth a creditor's claim. [FED. R. BANKR. P. 3001\(a\)](#). The filing of “a proof of claim is analogous to the commencement of an action within the bankruptcy proceeding.” [In re Ira Haupt & Co.](#), 253 F.Supp. 97, 98–99 (S.D.N.Y.), modified *sub nom.* [Henry Ansbacher & Co. v. Klebanow](#), 362 F.2d 569 (2d Cir.

[1966](#)). “The filing of a proof of claim effectively commences a proceeding within the bankruptcy proceeding to establish its provability, *367 priority, amount, etc.” *Id.* A party that files a proof of claim in accordance with the Federal Rules of Bankruptcy Procedure is deemed to have established a prima facie case against the debtor's assets. [11 U.S.C. § 502\(a\)](#); [FED. R. BANKR. P. 3001\(f\)](#); see also [In re Fid. Holding Co., Ltd.](#), 837 F.2d 696, 698 (5th Cir. 1988).

[3] A proof of claim must “be executed by the creditor or the creditor's authorized agent.” [FED. R. BANKR. P. 3001\(b\)](#). A proof of claim that conforms substantially to the appropriate Official Form, and that is filed in accordance with [Rule 3001](#), constitutes prima facie evidence of validity of the claim. [11 U.S.C. § 502\(a\)](#); [FED. R. BANKR. P. 3001\(f\)](#). Accordingly, a creditor's proof of claim is prima facie valid if the creditor completes all required portions of the Official Bankruptcy Proof of Claim Form, attaches all supporting documents available for that claim, and meets the requirements of any applicable subparagraph of [FED. R. BANKR. P. 3001](#). See [In re Harris](#), 492 B.R. 225, 227–28 (Bankr. S.D. Tex. 2013) (discussing the required use of the Official Proof of Claim Form under [Rule 3001](#), as well as the Form's requirements). Ultimately, a proof of claim must fulfill its “essential purpose of providing objecting parties with sufficient information to evaluate the nature of the claims.” [In re Wyly](#), 552 B.R. 338, 378 (Bankr. N.D. Tex. 2016).

[4] [5] If a proof of claim is prima facie valid, a party-in-interest may nevertheless object to the claim to disprove its validity. To successfully object to a claim that has prima facie validity, the objecting party must produce evidence rebutting the claim and establish that the claim should be disallowed pursuant to [11 U.S.C. § 502\(b\)](#). [In re Fid. Holding Co., Ltd.](#), 837 F.2d at 698; [In re DePugh](#), 409 B.R. 125, 135 (Bankr. S.D. Tex. 2009). Rebuttal evidence must be equal in probative value to successfully rebut a creditor's proof of claim. [In re Wyly](#), 552 B.R. at 379. “This can be done by the objecting party producing specific and detailed allegations that place the claim into dispute, by the presentation of legal arguments based upon the contents of the claim and its supporting documents, or by the presentation of pretrial pleadings” [In re Fid. Holding Co., Ltd.](#), 837 F.2d at 698.

[6] [7] If the objecting party produces evidence equal in probative force to the claimant's proof of claim, or the claimant fails to prove its claim's prima facie validity, the claimant must present additional evidence to “prove the

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validity of the claim by a preponderance of the evidence.”

 Id. The ultimate burden of proof always rests upon the claimant.  Id.

The OpCo Noteholders have filed proofs of claim seeking amounts under the Note Agreement and the OpCo RCF. (ECF No. 1214–11 at 5–122). Each proof of claim filed by the Noteholders constitutes prima facie evidence of the validity of that claim. Accordingly, as the objecting parties, the Debtors bear the burden of rebutting the Noteholders' claims represented by the valid proofs of claim.

The following issues remain in dispute in this matter:

- i. Whether the Make–Whole Amount is fully enforceable under New York law;
- ii. Whether the Noteholders are entitled to all of their non-bankruptcy rights under [11 U.S.C. § 1124\(1\)](#) because they are treated as unimpaired by Debtors' chapter 11 plan;
- iii. Whether the Make–Whole Amount should be disallowed as unmatured interest under [11 U.S.C. § 502\(b\)\(2\)](#); and
- *368 iv. At what rate should post-petition interest be calculated?

(ECF No. 1478 at 2–3).

Is the Make–Whole Amount Fully Enforceable under New York Law?

In order to carry their burden of rebutting the Noteholders' claims and establishing that those claims should be disallowed, the Debtors argue that the Make–Whole Amount represents an improper liquidated damages provision. (ECF No. 1215 at 32). This argument is made under New York law because the Note Agreement is governed by New York law. (ECF No. 1215–1 at 47). In general, if a claim is not allowed under applicable non-bankruptcy law, it is not allowed as a claim against the estate. [11 U.S.C. § 502\(b\)\(1\)](#). The Debtors argue that the Note Agreement does not provide a reasonable measure of probable actual loss because it is designed to double count any actual harm the Noteholders might suffer upon the automatic acceleration of the Notes. (ECF No. 1215 at 32). The Make–Whole Amount formula is intended to compensate the Noteholders for the difference between the rate stated in the now-accelerated Notes and a hypothetical

reinvestment rate. (ECF No. 1215 at 12; ECF No. 1393 at 40). The Debtors claim that the Make–Whole formula actually overcompensates the Noteholders because they will be able to reinvest their principal at higher rates than that reflected in the formula. (ECF No. 1215 at 33).

Because of the alleged overcompensation, the Debtors argue that the Make–Whole Amount is grossly disproportionate to the Noteholders' probable loss at the time that they entered the Note Agreement and is therefore invalid under New York law.  [Quadrant Structured Prod. Co. v. Vertin](#), 23 N.Y.3d 549, 992 N.Y.S.2d 687, 16 N.E.3d 1165, 1172 (2014).

[8] Typically, New York contract law requires courts to enforce unambiguous contract terms. This principle rings particularly true where the contract was negotiated by sophisticated and represented parties in an arms-length and equal negotiation. [AXA Inv. Managers UK Ltd. v. Endeavor Capital Mgmt. LLC](#), 890 F.Supp.2d 373, 388 (S.D.N.Y. 2012). A narrow exception to this rule of contract interpretation applies where a court is asked to enforce a liquidated damages provision that is proven to be a penalty and thus unenforceable by the party opposing it.  [JMD Holding Corp. v. Cong. Fin. Corp.](#), 4 N.Y.3d 373, 380, 795 N.Y.S.2d 502, 828 N.E.2d 604 (2005).

A liquidated damages provision is a “contractual provision that determines in advance the measure of damages if a party breaches the agreement.” *Liquidated–Damages Clause*, BLACK'S LAW DICTIONARY (10th ed. 2014). Contractual make-whole provisions and other, similar provisions are typically considered liquidated damages provisions. *See, e.g.,*

 [In re United Merchants & Mfrs., Inc.](#), 674 F.2d 134 (2d Cir. 1982) (recognizing a “pre-payment charge” as a liquidated damages provision);  [JMD Holding Corp.](#), 4 N.Y.3d at 380, 795 N.Y.S.2d 502, 828 N.E.2d 604 (equating an early termination fee to a liquidated damages provision). The Note Agreement explicitly lists the Noteholders' remedies that automatically arise upon the occurrence of an Event of Default, including the acceleration of the Make–Whole Amount. (ECF No. 1215–1 at 38–39). Based upon the existence of such provisions in the Note Agreement, as well as the weight of New York case law considering make-whole provisions to be liquidated damages provisions, the Make–Whole Amount constitutes a liquidated damages provision.

[9] [10] [11] A liquidated damages provision is enforceable under New York law “if the *369 amount

liquidated bears a reasonable proportion to the probable loss and the amount of actual loss is incapable or difficult of precise estimation. If, however, the amount fixed is plainly or grossly disproportionate to the probable loss, the provision calls for a penalty and will not be enforced.” [!\[\]\(dfbd6b3763a6d1d9afaa974f64e2e4b5_img.jpg\) *JMD Holding Corp.*, 4 N.Y.3d at 380, 795 N.Y.S.2d 502, 828 N.E.2d 604.](#) “The soundness of such a clause is tested in light of the circumstances existing as of the time that the agreement is entered into rather than at the time that the damages are incurred or become payable.” [!\[\]\(b89ecf30df3dbaee65fa9f1829524a6e_img.jpg\) *Walter E. Heller & Co. v. Am. Flyers Airline Corp.*, 459 F.2d 896, 898 \(2d Cir. 1972\).](#)

[12] [13] [14] [15] Whether damages in a particular case constitute enforceable liquidated damages is a question of law with the burden of proof on the party seeking to avoid paying the liquidated damages. [!\[\]\(e78f798d4ea5c530c9db49e7d26e6b95_img.jpg\) *JMD Holding Corp.*, 4 N.Y.3d at 379–80, 795 N.Y.S.2d 502, 828 N.E.2d 604.](#) In order to meet this burden, the burdened party must demonstrate either that “damages flowing from a prospective early termination were readily ascertainable at the time” the parties entered into the liquidated damages provision, or that the provision is conspicuously disproportionate to those foreseeable damages. [!\[\]\(034433b90593e82e5460e34e3ed48e9b_img.jpg\) *Id.* at 380, 795 N.Y.S.2d 502, 828 N.E.2d 604.](#) “Absent some element of fraud, exploitive overreaching or unconscionable conduct ... to exploit a technical breach, there is no warrant, either in law or equity, for a court to refuse enforcement of the agreement of the parties.” [!\[\]\(5f24500834b50a8307ffe63e419281a9_img.jpg\) *Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 577, 415 N.Y.S.2d 800, 389 N.E.2d 113 \(1979\).](#) Nonetheless, “where there is doubt as to whether a provision constitutes an unenforceable penalty or a proper liquidated damage clause, it should be resolved in favor of a construction which holds the provision to be a penalty.” [!\[\]\(8502790a2fc8970abb55aa7f7a7a6bae_img.jpg\) *Willner v. Willner*, 145 A.D.2d 236, 240–41, 538 N.Y.S.2d 599 \(1989\).](#)

[16] Debtors fail to rebut the Noteholders' claim for the Make-Whole Amount because they fail to prove that the damages resulting from prepayment were readily ascertainable at the time the parties entered into the Note Agreement or that they were conspicuously disproportionate to foreseeable damage amounts. Debtors put forward no evidence or argument claiming that the prepayment damages were easily calculable as of the time the Note Agreement was finalized. As set forth below, the difficulty in forecasting damages in this case is consistent with the difficulty seen in other cases when quantifying damages under long-term

debt instruments and contrasts sharply with cases in which damages could easily have been calculated at the time an agreement was created. See [!\[\]\(c694a3ff3b077d76910920a6a1593ab4_img.jpg\) *In re United Merchants & Mfrs., Inc.*, 674 F.2d at 143](#) (“[I]t is apparent that the potential damages from breach of the loan agreements in this case were difficult to determine.”); [!\[\]\(42fc53a13f008e5bbf67aee5111990a5_img.jpg\) *In re Vanderveer Estates Holdings, Inc.*, 283 B.R. 122, 130 \(Bankr. E.D.N.Y. 2002\)](#) (“Potential losses from prepayment of a large fixed-rate, long-term mortgage are ‘not subject to easy calculation.’ ”). But see [*Evangelista v. Ward*, 308 A.D.2d 504, 505, 764 N.Y.S.2d 705 \(2003\)](#) (finding plaintiff's actual loss susceptible to calculation).

At the point of prepayment (whether as a result of acceleration or otherwise), a lender would lose all future interest under its notes. The loss of that future interest would ordinarily be offset by the reinvestment of the prepaid proceeds in an alternative investment. However, the measurement difficulty comes from determining the selection of an alternative investment. If the perceived risk at issuance of the debt was low, may the lender quantify its *370 reinvestment alternatives by looking at alternatives that have low risk? What if the lender invested in an industry for diversification purposes and offered a lower rate as a result? Would the reinvestment rate, at a low risk, necessarily be in the same industry? How do you measure perceived risks at the date of issuance and the date of prepayment? Other factors are more precise. Market fluctuations in interest rates are easily quantifiable. Nevertheless, changes in the yield curve are constant. See generally Tao Wu, *What Makes the Yield Curve Move?*, FRBSF ECON. LETTER (Fed. Reserve Bank of S.F.), June 6, 2003. How does one calculate a reinvestment rate with a fluctuating yield curve? Additionally, yield curves change based on the general risks of the loans. *Id.* What yield curve would be examined? The parties agreed on a simple measurement. The reinvestment rate was set at 0.5% in excess of the yield reported two business days before the Settlement Date “for the most recently issued actively traded on-the-run U.S. Treasury securities having a maturity” equal to the remaining tenor of the relevant OpCo Note as of the date it was accelerated. (ECF No. 1215–1 at 27).

The Debtors also fail to rebut the Noteholders' claim for the Make-Whole Amount by unsuccessfully proving that the Make-Whole Amount is conspicuously disproportionate to the foreseeable losses at the time the parties entered into the Note Agreement. To prove that the Make-Whole Amount is conspicuously disproportionate by attempting to collect

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both liquidated and actual damages, the Debtors attempt to compare it to the liquidated damages provision invalidated in [Agerbrink v. Model Serv. LLC](#), 196 F.Supp.3d 412 (S.D.N.Y. 2016). The liquidated damages provision in [Agerbrink](#) guaranteed defendants a “‘minimum recovery’ regardless of actual damages, while preserving their right to pursue actual damages if they so desire” [Id. at 418](#). Because of such a double recovery for the same wage-related injury, the district court determined that this provision constituted an unfair penalty and resulted in unjust enrichment of the defendants. [Id. at 418–19](#).

Unlike the liquidated damages provision in [Agerbrink](#), the Make-Whole Amount does not lead to a double recovery of actual and liquidated damages for the same injury. The Make-Whole Amount liquidates the Noteholders' damages stemming from the early termination of their investment in OpCo. (ECF No. 1215–1 at 27, 38). In other words, the Make-Whole Amount is an agreed measure of damages between the parties. The calculation of the Make-Whole Amount is performed as of the date of acceleration. Although the Make-Whole Amount references future payments that would have been due on the Notes, it also references future hypothetical reinvestment rates. It then liquidates the differences in returns as of the acceleration date.

The Debtors argue that the default interest rate double counts the amounts captured through the Make-Whole Amount. This argument fails. Had the Debtors paid the principal, the interest, and the Make-Whole Amount on the date of acceleration, there would have been no default interest due. The post-petition default interest that the Noteholders seek would compensate 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*. (ECF No. 1215–1 at 37). Such interest comports with the fact that the Notes directed that any overdue payment of the Make-Whole Amount would include interest accrued at the Note Agreement's default rate. (ECF No. 1215–1 at 38). Accordingly, these two forms of damages do not represent a double recovery *371 of actual and liquidated damages for the same injury to the Noteholders.

An illustration is in order. This illustration reflects that the Make-Whole Amount captured only excess interest due under the Notes in a hypothetical reinvestment. The default rate only applies to the non-payment of the excess interest and

not to the non-payment of the hypothetical reinvested amount. Assume the following:

- A \$1,000,000,000 loan at a 5% interest rate, with 12 equal monthly installments of \$85,607,482;
- A reinvestment rate of .5% over the treasury rate;
- A treasury rate for securities with a comparable maturity of 1.5%;
- A prepayment after month 6.

The original amortization of the hypothetical loan is represented in this table:

Month	Beginning Principal	Interest	Payment	Ending Principal
1	\$1,000,000,000	\$4,166,667	(\$85,607,482)	\$918,559,185
2	\$918,559,185	\$3,827,330	(\$85,607,482)	\$836,779,033
3	\$836,779,033	\$3,486,579	(\$85,607,482)	\$754,658,131
4	\$754,658,131	\$3,144,409	(\$85,607,482)	\$672,165,058
5	\$672,165,058	\$2,800,813	(\$85,607,482)	\$589,388,389
6	\$589,388,389	\$2,455,785	(\$85,607,482)	\$506,236,692
7	\$506,236,692	\$2,109,320	(\$85,607,482)	\$422,738,530
8	\$422,738,530	\$1,761,411	(\$85,607,482)	\$338,892,458
9	\$338,892,458	\$1,412,052	(\$85,607,482)	\$254,697,028
10	\$254,697,028	\$1,061,238	(\$85,607,482)	\$170,150,784
11	\$170,150,784	\$708,962	(\$85,607,482)	\$85,252,264
12	\$85,252,264	\$355,218	(\$85,607,482)	(\$0)

As shown above, the principal balance would have been \$506,236,692 at the end of 6 months. If the prepayment occurs at that time, and the \$506,236,692 is hypothetically reinvested for the remaining 6 months at 2% (i.e., 0.5% above the 1.5% hypothetical reinvestment rate), the lender would receive monthly payments of only \$84,865,640:

Month	Beginning Principal	Interest	Payment	Ending Principal
1	\$506,236,692	\$843,728	(\$84,865,640)	\$422,214,780
2	\$422,214,780	\$703,691	(\$84,865,640)	\$338,052,832
3	\$338,052,832	\$563,421	(\$84,865,640)	\$253,750,614
4	\$253,750,614	\$422,918	(\$84,865,640)	\$169,307,892
5	\$169,307,892	\$282,180	(\$84,865,640)	\$84,724,432
6	\$84,724,432	\$141,207	(\$84,865,640)	\$0

Because the hypothetical reinvestment rate is lower, the monthly payment is reduced from \$85,607,482 to \$84,865,640. This is a shortfall of \$741,842 per month. The present value of the \$741,842, discounted at a 2% annual rate, is \$4,425,204.

However, the *actual* missed interest payments would have been \$7,408,199. Because the formula recognizes the hypothetical receipt of \$2,957,145 of interest over the 6 months, it does not double count interest. The proof is in the calculation. The difference between \$7,408,199 and *372 \$4,425,204 is \$4,451,054. Because that \$4,451,054 is hypothetically received over 6 months, its present value

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is slightly less and results in a Make-Whole Amount of \$4,425,204 (a difference of \$25,850).

Although this example is for only 6 months, it is intended to provide a straightforward explanation of how the math is performed. Once that understanding is achieved, it is apparent that there is no double counting.

The Make-Whole Amount in this case is enormous. However, the mere size of the Make-Whole Amount fails to prove that the Make-Whole Amount is conspicuously disproportionate to the foreseeable losses at the time the parties entered into the Note Agreement. As stated above, courts applying New York law analyze liquidated damages provisions at the time that the underlying agreement was executed. *JMD Holding Corp. v. Cong. Fin. Corp.*, 4 N.Y.3d 373, 380, 795 N.Y.S.2d 502, 828 N.E.2d 604 (2005). “It thus makes no difference whether the actual damages are ultimately higher or lower than the sum stated in the clause.” *Walter E. Heller & Co. v. Am. Flyers Airline Corp.*, 459 F.2d 896, 899 (2d Cir. 1972). Because the Make-Whole Amount does not lead to a double recovery of actual and liquidated damages for the same injury, there is no reason for the Court to conclude that this provision is in any way disproportionate or invalid only because it is higher than potentially contemplated at the time the parties entered into the Note Agreement.

Accordingly, the Debtors failed to prove that either the Make-Whole Amount or the default interest amounts are unenforceable liquidation damages provisions under New York law.

Are the Noteholders entitled to all of their non-bankruptcy rights under 11 U.S.C. § 1124(1) because they are treated as unimpaired?

[17] The Debtors argue that “impairment” should be applied only to the Noteholders’ “allowed” claims under the Bankruptcy Code, not to their state law claims. (ECF No. 1215 at 21). In this instance, Debtors argue 11 U.S.C. § 502(b)(2) precludes the allowance of the Make-Whole Amount because the Make-Whole Amount is merely a proxy for unmatured interest. (ECF No. 1215 at 21). In opposition, the Noteholders focus on the language of 11 U.S.C. § 1124 to support the position that “unimpairment” under § 1124 requires that the Noteholders receive all that they are entitled to receive under state law. (ECF No. 1390 at 29). The Noteholders also emphasize that Congress amended § 1124 in 1994 to eliminate an “Allowed” claim standard barring full

recovery of their state law rights in a chapter 11 solvent debtor case. (ECF No. 1390 at 35).

This matter was directly addressed by the Third Circuit in *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197 (3d Cir. 2003). *PPI* held that the § 502(b)(6) cap on a landlord’s claim would be applied before determining whether the claim was impaired. *Id.* at 207. In that case, the plan proposed to pay the landlord’s claim in full, but only at the substantially reduced amount set by § 502(b)(6). *Id.* at 205. The Third Circuit ultimately held that the creditor’s loss of payment did not arise as a result of the plan—it arose because of § 502(b)(6). *Id.* at 204.

This Court rejects the reasoning in *PPI*. The *PPI* opinion correctly holds that the disallowance of the lease rejection claim occurs as a result of § 502 rather than as a result of confirmation of the plan. However, the issue confronting the Debtors in this case is whether the Make-Whole Amount will be enforceable following confirmation of the Debtors’ plan. In a chapter 11 case, a discharge is granted under 11 U.S.C. § 1141(d). Under § 1141(d), the extent of the discharge is governed by the terms of the confirmed plan. 11 U.S.C. § 1141(d)(1)(A) (“Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan ... discharges the debtor from any debt that arose before the date of such confirmation”). Because the *PPI* Court failed to analyze the fact that the issue is one of discharge rather than allowance, the Court rejects its conclusions. It is the plan that results in the discharge of the state-law based Make-Whole Amount—not § 502(b)(2).

[18] Because the extent of a chapter 11 discharge is governed by the relevant plan, the issue of the Make-Whole Amount’s post-confirmation enforcement in this case is governed by the Debtors’ confirmed Plan. The Plan provides that the Noteholders’ claims are not impaired and shall be paid whatever amount necessary to make them unimpaired. (ECF No. 1324 at 26). The Debtors’ liability on the Make-Whole claims is thus not discharged under § 1141(d) unless the Make-Whole claims are actually paid in their state law amount. Treating the Noteholders’ claims in this way is far more consistent with the mandate of the Fifth Circuit, which has held that “even the smallest impairment nonetheless entitles a creditor to participate in voting.” *In re Vill. at*

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Camp Bowie I, L.P., 454 B.R. 702, 708 (Bankr. N.D. Tex. 2011), *aff'd*, 710 F.3d 239 (5th Cir. 2013).

Regardless of the application of § 502(b)(2), the Court must determine the date on which acceleration occurred. The Court initially questioned whether, notwithstanding acceleration on account of an *ipso facto* clause, a claim may be unimpaired by the restoration of the creditors' rights pursuant to § 1124(2). However, the Debtors explicitly acknowledge that their chapter 11 plan treats the Noteholders' claims as unimpaired under § 1124(1). (ECF No. 1566 at 21). Because § 1124(1) applies in this case instead of § 1124(2), the prohibition against an *ipso facto* default present in § 1124(2) does not apply to the Make-Whole Amount. Debtors' obligation to pay the Noteholders the Make-Whole Amount thus arose on the Debtors' petition date, the applicable date of the Debtors' default under the Note Agreement. Consequently, interest payments on the outstanding balance of the Notes are calculated based upon the Debtors' petition date.

At what rate should post-petition interest be calculated?

[19] The issue remains as to what post-confirmation rate of interest must apply to the unpaid portion of the Noteholders' claims.

The Debtors argue that any interest on the Noteholders' claims should be assessed, at most, at the "legal rate," as stated in 11 U.S.C. § 726(a)(5). (ECF No. 1215 at 37). Based upon federal case law, the language of § 726, and legal policy, the Debtors claim that the term "legal rate" is defined as the federal judgment rate of interest. (ECF No. 1215 at 39–44). See *In re Gulfport Pilots Ass'n, Inc.*, 434 B.R. 380, 392 (Bankr. S.D. Miss. 2010) (applying the federal judgment rate to a post-petition interest claim); *In re Dow Corning Corp.*, 237 B.R. 380, 401 (Bankr. E.D. Mich. 1999) (" '[I]nterest at the legal rate' was, and is, commonly understood to mean a rate of interest fixed by statute, and not by contract."); see also *In re Cardelucci*, 285 F.3d 1231, 1235 (9th Cir. 2002) ("[U]sing the federal rate promotes uniformity within federal law."). Post-petition interest on unsecured claims is awarded, if at all, at the federal judgment rate because *374 § 502(b)(2) prohibits claims for such unmatured interest. (ECF No. 1215 at 37). *Matter of W. Texas Mktg. Corp.*, 54 F.3d 1194, 1197 (5th Cir. 1995) ("[I]nterest stops accruing at the date of the filing of the petition.").

Debtors recognize that unsecured creditors may receive post-petition interest on their claim if a debtor is solvent. (ECF No.

1215 at 37). *In re Cont'l Airlines Corp.*, 110 B.R. 276, 277 (Bankr. S.D. Tex. 1989). Nonetheless, pursuant to § 726(a)(5), the Debtors argue that such creditors receive interest at the legal or federal judgment rate. (ECF No. 1215 at 38). The Debtors cite to multiple cases—including Fifth Circuit precedent—and legal policy stating that the term "legal rate" in § 726 refers to the federal judgment rate of interest in 28 U.S.C. § 1961. (ECF No. 1215 at 39–42). Additionally, the Debtors argue that state law does not govern the rate of post-petition interest on unsecured claims in a solvent debtor case because such practice relies on pre-Bankruptcy Code practice, which defies the plain language of § 726(a)(5) and thus should not be followed. (ECF No. 1414 at 29). The Debtors finally assert that, pursuant to 11 U.S.C. § 1141(d), the Noteholders' claims were discharged under the Debtors' chapter 11 plan. (ECF No. 1478 at 2). Consequently, the Noteholders are entitled only to what the chapter 11 plan provides them—what the Bankruptcy Code and New York law entitles them to receive. (ECF No. 1478 at 2).

In opposition to the Debtors' position, the Senior Creditor Committee asserts that the Noteholders' unsecured claims fall squarely within the solvent debtor exception to disallowance of post-petition interest on unsecured claims under 11 U.S.C. § 502(b)(2). (ECF No. 1393 at 66). The exception of the Noteholders' post-petition interest claims to disallowance is not limited by § 726(a)(5) because that provision of the Code is not applicable to chapter 11 cases, the claims are unimpaired, and the Debtors are solvent. (ECF No. 1393 at 66–70). Even if § 726(a)(5) were applicable to the Noteholders' post-petition interest claims, the Senior Creditor Committee argues that post-petition interest should still be paid at the Note Agreement's default rates because cases holding that the "legal rate" referred to in that provision are distinguishable as chapter 7 or 11 liquidation cases, as cases where no contract default rate existed, and as cases involving cramdown interest rates. (ECF No. 1393 at 72–74).

Joining the Senior Creditor Committee, the OpCo Noteholders claim that post-petition interest on the Noteholders' claims should be allowed at the Note Agreement's default rate because: Congress's repeal of 11 U.S.C. § 1124(3) in 1994 requires unsecured creditors to receive post-petition interest at the underlying contract rate in order to be unimpaired; this Court ruled in *In re Moody Nat. SHS Houston H. LLC*, 426 B.R. 667 (Bankr. S.D. Tex. 2010) that, for a claim to be unimpaired, interest must be

paid at the contract default rate pursuant to [§ 1124\(2\)](#); the Bankruptcy Code does not supplant the clearly established pre-code practice of awarding default interest at the contract rate in solvent debtor cases; if interest is awarded pursuant to [§ 726\(a\)\(5\)](#), the Court should follow precedent holding that the “legal rate” is the contract rate of interest; and equitable principles merit awarding the contract rate of interest because the claims of the structurally subordinated creditors of the Debtors include post-petition interest at the rate included in the Note Agreement. (ECF No. 1390 at 36–37).

The Debtors fail to rebut the Noteholders' claim for post-petition interest at the rate listed in the Note Agreement because ***375** the Noteholders' claims are treated as unimpaired under the Debtors' chapter 11 plan. Paying post-petition interest on the Make-Whole Amount at the federal judgment rate instead of the rate within the Note Agreement would cause the Noteholders to be impaired.

[Section 726\(a\)\(5\)](#) is not applicable to the Noteholders' post-petition claims because its only application in a chapter 11 case—through the “best interest of creditors” test in [11 U.S.C. § 1129\(a\)\(7\)](#)—limits *impaired*, not unimpaired,

claims. [11 U.S.C. § 1129\(a\)\(7\)](#); see also [In re Energy Future Holdings Corp.](#), 540 B.R. 109, 124 (Bankr. D. Del. 2015) (“[T]he applicability of [Section 726\(a\)](#) is limited to its incorporation in [Section 1129\(a\)\(7\)](#) and does not create a general rule establishing the appropriate rate of post-petition interest.”). The Noteholders are therefore entitled to their contractual rate of interest under the Note Agreement regardless of any disallowance provisions in the Bankruptcy Code. See [In re Moody Nat. SHS Houston H, LLC](#), 426 B.R. at 678 (finding that unimpairment of a creditor's claim requires the payment of interest at the default rate).

Conclusion

The Court will issue an Order consistent with this Memorandum Opinion.

All Citations

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In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

Bankr. L. Rep. P 83,466



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Distinguished by [Ad Hoc Committee of Holders of Trade Claims v. PG&E Corporation](#), N.D.Cal., April 14, 2020

943 F.3d 758

United States Court of Appeals, Fifth Circuit.

IN RE: ULTRA PETROLEUM CORPORATION;
Keystone Gas Gathering, L.L.C.; Ultra Resources,
Incorporated; [Ultra Wyoming, Incorporated](#);
Ultra Wyoming LGS, Incorporated; UP
Energy Corporation; [UPL Pinedale, L.L.C.](#);
UPL Three Rivers Holdings, L.L.C., Debtors,
Ultra Petroleum Corporation; Keystone Gas Gathering,
L.L.C.; Ultra Resources, Incorporated; [Ultra Wyoming,
Incorporated](#); Ultra Wyoming LGS, Incorporated;
UP Energy Corporation; [UPL Pinedale, L.L.C.](#);
UPL Three Rivers Holdings, L.L.C., Appellants,
v.

Ad Hoc Committee of Unsecured Creditors of Ultra
Resources, Incorporated; OPCO Noteholders, Appellees.

No. 17-20793

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FILED November 26, 2019

Synopsis

Background: In surplus case, Chapter 11 debtors objected to noteholders' claim for make-whole premium and postpetition interest at contractual default rate. The United States Bankruptcy Court for the Southern District of Texas, [Marvin P. Isgur, J.](#), [575 B.R. 361](#), denied objection, and subsequently certified a direct appeal to the Court of Appeals, [2017 WL 4863015](#).

[Holding:] The Court of Appeals, [Andrew S. Oldham](#), Circuit Judge, held that as a matter of first impression, a creditor is not “impaired” by a reorganization plan simply because it incorporates the Bankruptcy Code’s disallowance provisions.

Reversed in part, vacated in part, and remanded.

Opinion, [913 F.3d 533](#), superseded.

Procedural Posture(s): On Appeal; Objection to Proof of Claim; Petition for Rehearing.

West Headnotes (12)

[1] **Bankruptcy** [Eligibility to vote; impairment](#)

“Unimpaired” creditors cannot object to Chapter 11 plans. [11 U.S.C.A. § 1126\(f\)](#).

[2] **Bankruptcy** [Conclusions of law; de novo review](#)

On appeal from a bankruptcy court decision, the Court of Appeals reviews legal questions anew.

[2 Cases that cite this headnote](#)

[3] **Bankruptcy** [Impairment of Claims or Interests](#)

A creditor is not “impaired” by a reorganization plan simply because it incorporates the Bankruptcy Code’s disallowance provisions; when a plan refuses to pay funds disallowed by the Code, the Code, not the plan, is doing the impairing. [11 U.S.C.A. §§ 502, 1124\(1\)](#).

[4 Cases that cite this headnote](#)

[4] **Bankruptcy** [Acceptance](#)

Because discharge effected by confirmation of a Chapter 11 plan affects a creditor’s rights, the Bankruptcy Code generally requires a debtor to vie for the creditor’s vote first. [11 U.S.C.A. §§ 1129\(a\)\(8\), 1141\(d\)\(1\)](#).

[1 Cases that cite this headnote](#)

[5] **Bankruptcy** [Eligibility to vote; impairment](#)

Although a creditor generally may vote to accept or reject a Chapter 11 plan, the creditor’s right to vote disappears when the plan doesn’t actually affect his rights; that is, if the creditor is not impaired under the plan, he is conclusively

presumed to have accepted it. [11 U.S.C.A. §§ 1126\(a\), 1126\(f\)](#).

[2 Cases that cite this headnote](#)

[6] **Bankruptcy** ➡ [Impairment of Claims or Interests](#)

A creditor is “impaired” within the meaning of the Bankruptcy Code only if the plan itself alters the creditor's legal, equitable, or contractual rights; the creditor's claim outside of bankruptcy is not the relevant barometer for impairment. [11 U.S.C.A. § 1124\(1\)](#).

[7 Cases that cite this headnote](#)

[7] **Bankruptcy** ➡ [Uniformity requirement](#)
Courts ➡ [Particular questions or subject matter](#)

Court of Appeals is always chary to create a circuit split, especially in the context of bankruptcy, where uniformity is sufficiently important that the Constitution authorizes Congress to establish uniform laws on the subject of bankruptcies throughout the United States. [U.S. Const. art. I, § 8, cl. 4](#).

[3 Cases that cite this headnote](#)

[8] **Bankruptcy** ➡ [Impairment of Claims or Interests](#)

Under the Bankruptcy Code, courts judge Chapter 11 creditor's impairment after considering everything that defines the scope of the right or entitlement, such as a contract's language or state law. [11 U.S.C.A. § 1124](#).

[9] **Bankruptcy** ➡ [Construction and Operation](#)

Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons.

[1 Cases that cite this headnote](#)

[10] **Bankruptcy** ➡ [Remand](#)

Questions of whether the Bankruptcy Code disallowed creditors' claims for the make-whole amount and creditors' request for post-petition interest at the contractual default rates specified in note agreement and revolving credit facility would be determined by bankruptcy court, rather than Court of Appeals, in surplus Chapter 11 case, as bankruptcy court never reached either question but was best equipped to understand the individual dynamics pertinent to post-petition interest question. [11 U.S.C.A. § 502\(b\)\(2\)](#).

[2 Cases that cite this headnote](#)

[11] **Bankruptcy** ➡ [Equitable powers and principles](#)

Bankruptcy ➡ [Debtor's Contracts and Leases](#)

Absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights.

[2 Cases that cite this headnote](#)

[12] **Bankruptcy** ➡ [Carrying out provisions of Code](#)

Equitable powers that remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.

*759 Appeal from the United States Bankruptcy Court for the Southern District of Texas, [Marvin P. Isgur](#), U.S. Bankruptcy Judge

ON PETITION FOR REHEARING

Attorneys and Law Firms

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In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

Bankr. L. Rep. P 83,466

HOC COMMITTEE OF UNSECURED CREDITORS OF
ULTRA RESOURCES, INCORPORATED.

[David Bruce Salmons](#), Esq., Morgan, Lewis & Bockius, L.L.P., Washington, DC, [Peter Sabin Willett](#), Esq., [Amelia C. Joiner](#), Boston, MA, [Andrew J. Gallo](#), Morgan, Lewis & Bockius, L.L.P., New York, NY, for Appellee OPCO NOTEHOLDERS.

[David Andrew Baay](#), [Garrett Gibson](#), [Mark David Sherrill](#), Bankruptcy Counsel, Houston, TX, [Edward P. Christian](#), Eversheds Sutherland (US), L.L.P., Atlanta, GA, Houston, TX, for Intervenor.

Before [DAVIS](#), [ENGELHARDT](#), and [OLDHAM](#), Circuit Judges.

Opinion

[ANDREW S. OLDHAM](#), Circuit Judge:

*760 Treating the Appellees' and Intervenor's Joint Petition for Rehearing En Banc as a Petition for Panel Rehearing, it is GRANTED. The prior opinion,  [In re Ultra Petroleum Corporation](#), 913 F.3d 533 (5th Cir. 2019), is withdrawn, and the following opinion is substituted:

These bankruptcy proceedings arise from exceedingly anomalous facts. The debtors entered bankruptcy insolvent and now are solvent. That alone makes them rare. But second, the debtors accomplished their unlikely feat by virtue of a lottery-like rise in commodity prices. The combination of these anomalies makes these debtors as rare as the proverbial rich man who manages to enter the Kingdom of Heaven.

The key legal question before us is whether the rich man's creditors are "impaired" by a plan that paid them everything allowed by the Bankruptcy Code. The bankruptcy court said yes. In that court's view, a plan impairs a creditor if it refuses to pay an amount the Bankruptcy Code independently disallows. In reaching that conclusion, the bankruptcy court split from the only court of appeals to address the question, every reported bankruptcy court decision on the question, and the leading treatise discussing the question. We reverse and follow the monolithic mountain of authority holding the Code—not the reorganization plan—defines and limits the claim in these circumstances.

Because the bankruptcy court saw things differently, it did not consider whether the Code disallows certain creditors'

contractual claims for a Make-Whole Amount or post-petition interest. Instead, it ordered the debtors to pay both amounts in full. We vacate and remand those determinations for reconsideration.

I.

Ultra Petroleum Corporation ("Petroleum") is an oil and gas exploration and production company. To be more precise, it's a holding company. Petroleum's subsidiaries—UP Energy Corporation ("Energy") and Ultra Resources, Inc. ("Resources")—do the exploring and producing. Resources took on debt to finance its operations. Between 2008 and 2010, Resources issued unsecured notes worth \$1.46 billion to various noteholders. And in 2011, it borrowed another \$999 million under a Revolving Credit Facility. Petroleum and Energy guaranteed both debt obligations.

In 2014, crude oil cost well over \$100 per barrel. But then Petroleum's fate took a sharp turn for the worse. Only a year and a half later, a barrel cost less than \$30. The world was flooded with oil; Petroleum and its subsidiaries were flooded with debt. On April 29, 2016, the companies *761 voluntarily petitioned for reorganization under Chapter 11. See [11 U.S.C. § 301\(a\)](#). No one argues the companies filed those petitions in bad faith. See *id.* § 1112(b).

[1] During bankruptcy proceedings, however, oil prices rose. Crude oil approached \$80 per barrel, and the Petroleum companies became solvent again. So, the debtors proposed a rare creature in bankruptcy—a reorganization plan that (they said) would compensate the creditors in full. As to creditors with claims under the Note Agreement and Revolving Credit Facility (together, the "Class 4 Creditors"), the debtors would pay three sums: the outstanding principal on those obligations, pre-petition interest at a rate of 0.1%, and post-petition interest at the federal judgment rate. *In re Ultra Petroleum Corp.*, No. 4:16-bk-32202, ECF No. 1308-1 at 25–26 (Bankr. S.D. Tex. 2017). Accordingly, the debtors elected to treat the Class 4 Creditors as "unimpaired." Therefore, they could not object to the plan. [11 U.S.C. § 1126\(f\)](#).

The Class 4 Creditors objected just the same. They insisted their claims *were* impaired because the plan did not require the debtors to pay a contractual Make-Whole Amount and additional post-petition interest at contractual default rates.

Under the Note Agreement, prepayment of the notes triggers the Make-Whole Amount. That amount is designed “to provide compensation for the deprivation of” a noteholder’s “right to maintain its investment in the Notes free from repayment.” A formula defines the Make-Whole Amount as the amount by which “the Discounted Value of the Remaining Scheduled Payments with respect to the Called Principal” exceeds the notes’ “Called Principal.” Remaining scheduled payments include “all payments of [the] Called Principal and interest ... that would be due” after prepayment (if the notes had never been prepaid). And the discounted value of those payments is keyed to a “Reinvestment Yield” of 0.5% over the total anticipated return on comparable U.S. Treasury obligations.

Under the Note Agreement, petitioning for bankruptcy automatically renders the outstanding principal, any accrued interest, and the Make-Whole Amount “immediately due and payable.” Failure to pay immediately triggers interest at a default rate of either 2% above the normal rate set for the note at issue or 2% above J.P. Morgan’s publicly announced prime rate, whichever is greater.

The Revolving Credit Facility does not contain a make-whole provision. But it does contain a similar acceleration clause that made the outstanding principal and any accrued interest “automatically ... due and payable” as soon as Resources petitioned for bankruptcy. And it likewise provides for interest at a contractual default rate—2% above “the rate otherwise applicable to [the] Loan”—if Resources delayed paying the accelerated amount.

Under these two agreements, the creditors argued the debtors owed them an additional \$387 million—\$201 million as the Make-Whole Amount and \$186 million¹ in post-petition interest. Both sides chose to kick the can down the road. Rather than force resolution of the impairment issue at the plan-confirmation stage, the parties stipulated the bankruptcy court could resolve the dispute by deeming the creditors unimpaired and confirming the proposed *762 plan. Meanwhile, the debtors would set aside \$400 million to compensate the Class 4 Creditors if necessary “to render [the creditors] Unimpaired.” The bankruptcy court agreed and confirmed the plan.

After confirmation, the parties (and the bankruptcy court) turned back to the question of impairment. The debtors acknowledged the plan did not pay the Make-Whole Amount or provide post-petition interest at the contractual default

rates. But they insisted the Class 4 Creditors were not “impaired” because federal (and state) law barred them from recovering the Make-Whole Amount and entitled them to receive post-petition interest only at the federal judgment rate.

The Bankruptcy Code provides that a class of claims is not impaired if “the [reorganization] plan ... leaves unaltered the legal, equitable, and contractual rights to which such claim ... entitles the holder.” [11 U.S.C. § 1124\(1\)](#). Elsewhere the Code states that a court should disallow a claim “to the extent that [it seeks] unmatured interest.” *Id.* § 502(b)(2). The debtors argued the Make-Whole Amount qualified as unmatured interest. But even if it didn’t, they said, it was an unenforceable liquidated damages provision under New York law. In either case, something *other than* the reorganization plan itself—the Bankruptcy Code or New York contract law—prevented the Class 4 Creditors from recovering the disputed amounts.

The debtors’ argument as to post-petition interest was much the same: The Bankruptcy Code entitles creditors, at most, to post-petition interest at the “legal rate,” not the rates set by contract. [11 U.S.C. § 726\(a\)\(5\)](#). And the legal rate, they said, is the federal judgment rate under [28 U.S.C. § 1961](#). Once again, the Code—not the plan—limited the Class 4 Creditors’ claims.

The bankruptcy court rejected the premise that it must bake in the Code’s provisions before asking whether a claim is impaired. Instead it concluded unimpairment “requires that [creditors] receive all that they are entitled to under state law.”

 [In re Ultra Petroleum Corp.](#), 575 B.R. 361, 372 (Bankr. S.D. Tex. 2017). In other words, if a plan does not provide the creditor with all it would receive under state law, the creditor is impaired even if the Code disallows something state law would otherwise provide outside of bankruptcy. So, the bankruptcy court asked only whether New York law permits the Class 4 Creditors to recover the Make-Whole Amount (concluding it does), and whether the Code limits the contractual post-petition interest rates (concluding it does not).  [Id.](#) at 368–75. It never decided whether the Code disallows the Make-Whole Amount as “unmatured interest” under § 502(b)(2) or what [§ 726\(a\)\(5\)](#)’s “legal rate” of interest means. It ordered the debtors to pay the Make-Whole Amount and post-petition interest at the contractual rates to make the Class 4 Creditors truly unimpaired.

[2] The debtors sought a direct appeal to this Court (rather than the district court) because the case raises important and

In re Ultra Petroleum Corporation, 943 F.3d 758 (2019)

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unsettled questions of law. See [28 U.S.C. § 158\(d\)\(2\)\(A\)](#). The bankruptcy court agreed, and so did we. *In re Ultra Petroleum Corp.*, No. 16-32202, 2017 WL 4863015, at *1 (Bankr. S.D. Tex. Oct. 26, 2017). On appeal, we review those legal questions anew. *In re Positive Health Mgmt.*, 769 F.3d 899, 903 (5th Cir. 2014).

II.

[3] We consider first whether a creditor is “impaired” by a reorganization plan simply because it incorporates the Code’s disallowance provisions. We think not.

*763 A.

[4] [5] Chapter 11 lays out a framework for proposing and confirming a reorganization plan. Confirmation of the plan “discharges the debtor from any debt that arose before the date of such confirmation.” [11 U.S.C. § 1141\(d\)\(1\)](#). Because discharge affects a creditor’s rights, the Code generally requires a debtor to vie for the creditor’s vote first. *Id.* § 1129(a)(8). And when it does, the creditor may vote to accept or reject the plan. *Id.* § 1126(a). But the creditor’s right to vote disappears when the plan doesn’t actually affect his rights. If the creditor is “not impaired under [the] plan,” he is “conclusively presumed to have accepted” it. *Id.* § 1126(f). The question, then, is whether the Class 4 Creditors were “impaired” by the plan.

[6] Let’s start with the statutory text. [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 Class 4 Creditors spill ample ink arguing their rights have been altered. But that’s both undisputed and insufficient. The plain text of [§ 1124\(1\)](#) requires that “the plan” do the altering. We therefore hold a creditor is impaired under [§ 1124\(1\)](#) only if “the plan” itself alters a claimant’s “legal, equitable, [or] contractual rights.”

The only court of appeals to address the question took the same approach. In [In re PPI Enterprises \(U.S.\), Inc.](#), a landlord (creditor) argued the reorganization plan of his former tenant (debtor) impaired his claim because it did not pay him the full \$4.7 million of rent he was owed over the life of the lease. [324 F.3d 197, 201–02 \(3d Cir. 2003\)](#). The Third Circuit disagreed. Because the Bankruptcy Code caps

lease-termination damages under § 502(b)(6), the plan merely reflected the Code’s disallowance. [Id.](#) at 204. At the end of the day, “a creditor’s claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor’s legal, equitable, or contractual rights.” [Id.](#) It simply did not matter the landlord “might have received considerably more if he had recovered on his leasehold claims before [the debtor] filed for bankruptcy.” [Id.](#) at 205. The debtor’s plan gave the landlord everything the law entitled him to once bankruptcy began, so he was unimpaired.

Decisions from bankruptcy courts across the country all run in the same direction. See, e.g., *In re Tree of Life Church*, 522 B.R. 849, 861–62 (Bankr. D.S.C. 2015); *In re RAMZ Real Estate Co.*, 510 B.R. 712, 717 (Bankr. S.D.N.Y. 2014); *In re K Lunde, LLC*, 513 B.R. 587, 595–96 (Bankr. D. Colo. 2014); *In re Mirant Corp.*, No. 03-46590, 2005 WL 6440372, at *3 (Bankr. N.D. Tex. May 24, 2005); [In re Coram Healthcare Corp.](#), 315 B.R. 321, 351 (Bankr. D. Del. 2004); [In re Monclova Care Ctr., Inc.](#), 254 B.R. 167, 177 (Bankr. N.D. Ohio 2000), *rev’d on other grounds*, 266 B.R. 792 (N.D. Ohio 2001); [In re Am. Solar King Corp.](#), 90 B.R. 808, 819–22 (Bankr. W.D. Tex. 1988). All agree that “[i]mpairment results from what the plan does, not what the [bankruptcy] statute does.” [Solar King](#), 90 B.R. at 819.

[7] The creditors cannot point to a single decision that suggests otherwise. That’s presumably why Collier’s treatise states the point in unequivocal terms: “Alteration of Rights by the Code Is Not Impairment under [Section 1124\(1\)](#).” 7 COLLIER ON BANKRUPTCY ¶ 1124.03[6] (16th ed. 2018). “We are always chary to create a circuit split.” *United States v. Graves*, 908 F.3d 137, 142 (5th Cir. 2018) (quotation omitted). That’s especially true “in the context of bankruptcy, where uniformity is sufficiently important that our Constitution *764 authorizes Congress to establish ‘uniform laws on the subject of bankruptcies throughout the United States.’ ” [In re Marciano](#), 708 F.3d 1123, 1135 (9th Cir. 2013) (Ikuta, J., dissenting) (quoting [U.S. CONST. art. I, § 8, cl. 4](#)). We refuse to create one today.

B.

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The Class 4 Creditors' counterarguments do not move the needle. First, they focus on [§ 1124\(1\)](#)'s use of the word "claim." They note the Code elsewhere speaks of "allowed claims." See, e.g., [11 U.S.C. §§ 506\(a\)\(1\), 506\(a\)\(2\), 510\(c\)\(1\), 1126\(c\)](#). Then they suggest the absence of "allowed" in [§ 1124\(1\)](#) means "claim" there refers to the claim *before* the Code's disallowance provisions come in and trim its edges.

[8] [9] But the broader statutory context cuts the other way. [Section 1124](#) is not just (or even primarily) about the allowance of claims. It is about rights—the "legal, equitable, and contractual rights to which [the] claim ... entitles the holder." *Id.* [§ 1124\(1\)](#). That means we judge impairment after considering everything that defines the scope of the right or entitlement—such as a contract's language or state law. See [In re Energy Future Holdings Corp.](#), 540 B.R. 109, 121 (Bankr. D. Del. 2015); [11 U.S.C. § 502\(b\)\(1\)](#). Even the bankruptcy court recognized this to some extent because it asked whether New York law permitted the Noteholders to recover the Make-Whole Amount. See [Ultra Petroleum](#), 575 B.R. at 368–72. "The Bankruptcy Code itself is a statute which, like other statutes, helps to define the legal rights of persons." [Solar King](#), 90 B.R. at 819–20.

Finding no help in [§ 1124\(1\)](#)'s statutory text, the Class 4 Creditors turn to the legislative history of a different provision. In 1994, Congress repealed [§ 1124\(3\)](#), which provided that a creditor's claim was not impaired if the plan paid "the *allowed amount* of such claim." [11 U.S.C. § 1124\(3\) \(1988\)](#) (emphasis added). This proves, they say, that disallowance should now play no role in the impairment analysis.

Even for those who think legislative history can be relevant to statutory interpretation, this particular history is not. It does not say that every disallowance causes impairment. Rather, Congress repealed [§ 1124\(3\)](#) in response to a specific bankruptcy court decision. See [In re New Valley Corp.](#), 168 B.R. 73 (Bankr. D.N.J. 1994). That decision held unsecured creditors who received their allowed claims from a solvent debtor, but who did not receive post-petition interest, were unimpaired. *Id.* at 77–80. In debating the proposed repeal of [§ 1124\(3\)](#), the House Judiciary Committee singled out [New Valley](#) by name as the justification for the repeal. See [H.R. Rep. No. 103-835, at 47–48](#) (1994) (citing [New](#)

[Valley](#) and explaining the intent to repeal [§ 1124\(3\)](#) "to preclude th[e] unfair result" of "den[ying] the right to receive postpetition interest"). It is noteworthy the committee report does not cite other bankruptcy cases—such as [Solar King](#)—that addressed Code impairment under [§ 1124\(1\)](#). That is why the Third Circuit rejected appellees' legislative-history argument in [PPI](#) and held the repeal of [§ 1124\(3\)](#) "does not reflect a sweeping intent by Congress to give impaired status to creditors more freely outside the postpetition interest context." [324 F.3d at 207](#) (noting the committee report cited [New Valley](#) but not [Solar King](#)).

Next, the Class 4 Creditors attempt to distinguish [PPI](#). True, that case involved disallowance under [§ 502\(b\)\(6\)](#), not [§ 502\(b\)\(2\)](#). But that's a distinction without a difference. See [In re W.R. Grace & Co.](#), 475 B.R. 34, 161–62 (Bankr. D. Del. 2012); [Energy Future](#), 540 B.R. at 122. [Section 502](#) states that "the court ... shall allow *765 [a] claim in [the requested] amount, *except to the extent that*" any one of nine conditions apply. If any of the enumerated conditions applies, the court shall not allow the relevant portion of the claim. [PPI](#) reasoned that where one of those conditions applies, the Code—not the plan—impairs the creditors' claims. See [324 F.3d at 204](#). That reasoning applies with equal force to [§ 502\(b\)\(2\)](#).

The Class 4 Creditors (like the bankruptcy court) also point to the mechanics of Chapter 11 discharge to suggest the plan itself, not the Code, is doing the impairing. They note the Code's disallowance provisions are carried into effect only if the plan is confirmed, and "confirmation of the plan ... discharges the debtor from any debt that arose before" confirmation. [11 U.S.C. § 1141\(d\)](#). In one sense, plan confirmation limits creditors' claims for money by discharging underlying debts. But in another sense, the Code limits the creditors' claims for money and imposes substantive and procedural requirements for plan confirmation. The Class 4 Creditors' argument thus begs the critical question: What is doing the work here? We agree with [PPI](#), every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code—not the plan—is doing the impairing.

III.

That leaves the questions of whether the Code disallows the creditors' claims for the Make-Whole Amount and the creditors' request for post-petition interest at the contractual default rates specified in the Note Agreement and the Revolving Credit Facility. The creditors say their contracts entitle them to both amounts, and that their contracts should be honored under bankruptcy law's longstanding "solvent-debtor" exception. The debtors argue no such exception exists in modern bankruptcy law. And the debtors further argue both claims are governed by the Bankruptcy Code, not the pre-Code law or the parties' contracts.

[10] The bankruptcy court never reached either question. The issue of make-whole premiums, like the Make-Whole Amount, has become "[a] common dispute" in modern bankruptcy. DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 84 (6th ed. 2014). Sometimes it is "comparatively easy to tell" whether such premiums are effectively unmatured interest, and therefore disallowed under § 502(b)(2). *Id.* at 84–85. Other times, "it is much harder." *Id.* at 85. Accordingly, "much depends on the dynamics of the individual case." *Ibid.* The bankruptcy court is often best equipped to understand these individual dynamics—at least in the first instance. Cf. [U.S. Bank Nat'l Ass'n ex rel. CWC Capital Asset Mgmt. LLC v. Village at Lakeridge, LLC](#), — U.S. —, 138 S. Ct. 960, 968 n.6, 200 L.Ed.2d 218 (2018) (noting a bankruptcy court is often best equipped to consider "multifarious, fleeting, special, narrow facts that utterly resist generalization"). So too is the bankruptcy court best able to consider the postpetition interest question. *See ibid.*

[11] [12] Our review of the record reveals no reason why the solvent-debtor exception could not apply. As other circuits have recognized, "absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors' contractual rights."

[In re Dow Corning Corp.](#), 456 F.3d 668, 679 (6th Cir. 2006); *see also* [*766 In re Chicago, Milwaukee, St. Paul and Pac. R.R. Co.](#), 791 F.2d 524, 528 (7th Cir. 1986).

That might be the case here.² But "mindful that we are a court of review, not of first view," we will not make the choice ourselves or weigh the equities on our own. [Cutter v. Wilkinson](#), 544 U.S. 709, 718 n.7, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005).

Accordingly, the bankruptcy court should consider the Make-Whole Amount, the appropriate post-petition interest rate, and the applicability of the solvent-debtor exception on remand.

* * *

As we have explained, Code impairment is not the same thing as plan impairment. Because the bankruptcy court found otherwise, it did not address whether the Code disallows the Make-Whole Amount or post-petition interest, and if not, how much the debtors must pay the Class 4 Creditors. The bankruptcy court, therefore, must consider these issues on remand. For that reason and others explained above, we REVERSE in part, VACATE in part, and REMAND for further proceedings consistent with this opinion.

All Citations

943 F.3d 758, Bankr. L. Rep. P 83,466

Footnotes

¹ This amount includes \$106 million in interest on the outstanding principal under the notes, \$14 million in interest on the Make-Whole Amount, and \$66 million in interest on the outstanding principal under the Revolving Credit Facility, all accruing after the debtors filed their petitions.

² Of course, we follow the Supreme Court's command that any "equitable powers [that] remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." [Law v. Siegel](#), 571 U.S. 415, 421, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014) (quotation omitted). While we express no view on the matter, it is possible a bankruptcy court's equitable power to enforce the solvent-debtor exception is moored

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in [11 U.S.C. § 1124](#)'s command that a “plan leave[] unaltered ... equitable ... rights.” See, e.g.,  [In re Energy Holdings](#), 540 B.R. 109, 123–24 (Bankr. D. Del. 2015).

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In re Cardelucci, 285 F.3d 1231 (2002)

39 Bankr.Ct.Dec. 110, Bankr. L. Rep. P 78,658, 02 Cal. Daily Op. Serv. 3146...



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Declined to Follow by [In re Fast](#), Bankr.D.Colo., December 21, 2004

285 F.3d 1231

United States Court of Appeals, Ninth Circuit.

In re Samuel Duke CARDELUCI, Debtor.

Willem Onink, Marsha Onink, Appellants,

v.

Samuel Duke Cardelucci, Appellee.

No. 00-56541

|

Argued and Submitted Jan. 16, 2002.

|

Filed April 12, 2002.

Synopsis

Unsecured creditor objected to confirmation of solvent Chapter 11 debtor's proposed plan, as failing to provide for payment of postpetition interest at appropriate rate. The United States Bankruptcy Court for the Central District of California ruled that creditor was entitled to postpetition interest only at federal judgment rate, and creditor appealed. The District Court, [Dean D. Pregerson](#), J., affirmed. On further appeal, the Court of Appeals, Zilly, United States District Judge for the Western District of Washington, sitting by designation, held that "legal rate" of interest to which unsecured creditor was entitled on its claim, from date that petition was filed, in Chapter 11 case of solvent debtor, was federal judgment, rather than state statutory, rate.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (9)

- [1] **Bankruptcy** 📌 [Conclusions of law; de novo review](#)

Court of Appeals reviews de novo the district court's decision on appeal from bankruptcy court, and applies same standard of review as standard applied by district court.

[16 Cases that cite this headnote](#)

- [2] **Bankruptcy** 📌 [Conclusions of law; de novo review](#)

Bankruptcy court's conclusions on questions of statutory interpretation are conclusions of law subject to de novo review.

[16 Cases that cite this headnote](#)

- [3] **Interest** 📌 [What law governs](#)

Interest 📌 [Computation of rate in general](#)

"Legal rate" of interest to which unsecured creditor was entitled on its claim, from date that petition was filed, in Chapter 11 case of solvent debtor, was federal judgment, rather than state statutory, rate. Bankr.Code, [11 U.S.C.A. § 726\(a\)\(5\)](#); [28 U.S.C.A. § 1961\(a\)](#).

[33 Cases that cite this headnote](#)

- [4] **Statutes** 📌 [Language](#)

When interpreting statute, court assumes that Congress carefully selected and intentionally adopted the language used.

[2 Cases that cite this headnote](#)

- [5] **Interest** 📌 [Computation of rate in general](#)

In using definite article "the," instead of indefinite "a" or "an," to specify that unsecured creditors are entitled to postpetition interest "at the legal rate" when debtor is solvent, Congress indicated its intent that single source be used to calculate postpetition interest. Bankr.Code, [11 U.S.C.A. § 726\(a\)\(5\)](#).

[21 Cases that cite this headnote](#)

- [6] **Interest** 📌 [Computation of rate in general](#)

In using terms "legal rate," in requiring solvent debtors to pay postpetition interest "at the legal rate" to their unsecured creditors, Congress manifested its intent that the one source used to calculate appropriate rate of interest should be statutory; commonly understood meaning of "at the legal rate" at time Bankruptcy Code was

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enacted was rate fixed by statute. Bankr.Code, [11 U.S.C.A. § 726\(a\)\(5\)](#).

[25 Cases that cite this headnote](#)

[7] [Federal Courts](#) ➡ [Interest](#)

In diversity actions brought in federal court, prevailing plaintiff is entitled to prejudgment interest at state law rates, while postjudgment interest is determined by federal law.

[38 Cases that cite this headnote](#)

[8] [Bankruptcy](#) ➡ [Interest](#)

Overriding policy consideration in an award of interest to creditor in bankruptcy case is the balancing of equities among creditors.

[9] [Constitutional Law](#) ➡ [Bankruptcy Interest](#) ➡ [Constitutional and statutory provisions](#)

Award of postpetition interest on unsecured claims, in Chapter 11 case of solvent debtor, not at contractual or at state statutory rates, but only at lower federal judgment rate, did not violate unsecured creditor's substantive due process rights; utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. [U.S.C.A. Const.Amends. 5, 14](#); Bankr.Code, [11 U.S.C.A. § 726\(a\)\(5\)](#).

[38 Cases that cite this headnote](#)

Attorneys and Law Firms

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*1233 [William M. Burd](#), [Karen Sue Naylor](#), Burd & Naylor, Santa Ana, CA, for the defendant-appellee.

Appeal from the United States District Court for the Central District of California; [Dean D. Pregerson](#), District Judge, Presiding. D.C. No. CV-00-01990DDP.

Before: [SCHROEDER](#), Chief Judge, [McKEOWN](#), Circuit Judge, and ZILLY, District Judge. *

OPINION

ZILLY, District Judge.

Appellants Willem and Marsha Onink appeal the district court's application of the federal interest rate as defined by [28 U.S.C. § 1961\(a\)](#) to an award of post-petition interest pursuant to [11 U.S.C. § 726\(a\)\(5\)](#). This appeal presents the narrow but important issue of whether such post-petition interest is to be calculated using the federal judgment interest rate or is determined by the parties' contract or state law. We conclude that [11 U.S.C. § 726\(a\)\(5\)](#) mandates application of the federal interest rate. Accordingly, we AFFIRM.

Appellee Samuel Duke Cardelucci owns and operates several rubbish companies in Southern California. On January 15, 1993, a California state court jury found that Cardelucci had engaged in predatory pricing and was jointly and severally liable to the Oninks for unfair trade practices. The state court subsequently entered judgment in the amount of \$5,423,825.50 plus interest calculated at the rate of 10% per annum in favor of the Oninks. The state court judgment was ultimately affirmed on appeal with the amount of damages modified to \$5,273,147.50 plus interest at the applicable legal rate.

After judgment was entered in the state court action, Cardelucci filed a voluntary petition for relief under Chapter 11 in the United States Bankruptcy Court for the Central District of California. Cardelucci's Modification of Fourth Amended Plan of Reorganization provided for payment in full of the Oninks' claim with post-confirmation interest at the rate of 5% and post-petition interest at a rate to be determined under the provisions of the Bankruptcy Code. During subsequent proceedings before the bankruptcy court regarding the Plan, the parties agreed that the Oninks were entitled to post-petition interest but disputed whether the applicable interest rate was California's state statutory interest rate of 10% or the federal interest rate. The bankruptcy court held that the federal interest rate of approximately 3.5%, calculated pursuant to [28 U.S.C. § 1961\(a\)](#), rather than the judgment rate provided for by state law, applied. Thereafter, the Oninks withdrew their objections to the Plan without prejudice to their right to appeal the interest rate determination and the bankruptcy court ordered the Plan confirmed. The

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Oninks appealed the bankruptcy court's determination to the district court which affirmed the bankruptcy court's ruling. This appeal followed.

[1] [2] This Court reviews de novo the district court's decision on an appeal from a bankruptcy court. *In re Gruntz*, 202 F.3d 1074, 1084 n. 9 (9th Cir.2000) (en banc). This Court applies the same standard of review applied by the district court. *In re Chang*, 163 F.3d 1138, 1140 (9th Cir.1998). Statutory interpretation is a question of law subject to de novo review. *In re Celebrity Home Entertainment, Inc.*, 210 F.3d 995, 997 (9th Cir.2000).

*1234 [3] Where a debtor in bankruptcy is solvent, an unsecured creditor is entitled to "payment of interest at the legal rate from the date of the filing of the petition" prior to any distribution of remaining assets to the debtor. 11 U.S.C. § 726(a)(5). The question presented by this appeal is whether "interest at the legal rate" means a rate fixed by federal statute or a rate determined either by the parties' contract or state law. The Bankruptcy Code does not define the term "interest at the legal rate" and there is a paucity of legislative history regarding this statutory provision.

Although no Court of Appeals has addressed this issue, bankruptcy courts have split over the correct interpretation of this phrase, finding that it either means one single rate as determined by 28 U.S.C. § 1961(a) (the "federal judgment rate approach") or is based on a contract rate or applicable state law (the "state law approach"). Compare *In re Dow Corning Corp.*, 237 B.R. 380, 394 (Bankr.E.D.Mich.1999) (applying the federal judgment rate), with *In re Carter* 220 B.R. 411, 416–17 (Bankr.D.N.M.1998) (using the state law approach to determine the appropriate interest rate).

In *In re Beguelin*, 220 B.R. 94, 99(9th Cir.BAP1998), the Bankruptcy Appellate Panel of the Ninth Circuit squarely addressed the issue presented in this appeal. The BAP held that the federal judgment rate applied to post-petition interest. *Beguelin*, 220 B.R. at 100. Contrasting the state law and federal judgment rate approaches, the BAP concluded that the interests of "fairness, equality, and predictability in the distribution of interest on creditors' claims" as well as the interest in applying federal law to federal bankruptcy cases, required application of the federal judgment rate approach. *Id.* at 100–101 (citing *In re Melenzyer*, 143 B.R. 829

(Bankr.W.D.Tex.1992), and *In re Godsey*, 134 B.R. 865 (Bankr.M.D.Tenn.1991)). While this Court is not bound by a B.A.P. decision, we find the reasoning of *Beguelin* to

be persuasive and adopt it. See *Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 471 (9th Cir.1990).

[4] The principles of statutory interpretation lend strong support to the conclusion that Congress intended "interest at the legal rate" in 11 U.S.C. § 726(a)(5) to mean interest at the federal statutory rate pursuant to 28 U.S.C. § 1961(a). Congress specifically chose the language "interest at the legal rate," replacing the originally proposed language "interest on claims allowed." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93–137, § 4–405(a) (8), (1st Sess.1973), reprinted in Collier App. Pt. 4(c), at 4–679. This Court "assume[s] that Congress carefully select[s] and intentionally adopt[s] the language" used in a statute. *Ebben v. Comm'r*, 783 F.2d 906, 916 (9th Cir.1986) (Beezer, J., concurring in part and dissenting in part). Thus, instead of a general statement allowing for awards of interest, Congress modified what type and amount of interest could be awarded with the specific phrasing "at the legal rate."

[5] [6] The definite article "the" instead of the indefinite "a" or "an" indicates that Congress meant for a single source to be used to calculate post-petition interest. See, e.g., *American Bus Ass'n v. Slater*, 231 F.3d 1, 4–5 (D.C.Cir.2000); *United States v. Kanasco, Ltd.*, 123 F.3d 209, 211 (4th Cir.1997); *In re Dow Corning Corp.*, 237 B.R. at 404; *Black's Law Dictionary* 1477 (6th ed. 1990) ("In construing statute, definite article 'the' particularizes the subject which it precedes and is word of limitation as opposed to indefinite or generalizing force 'a' or 'an' "). The use of "legal rate" indicates that Congress intended the single source to be statutory because the commonly understood meaning *1235 of "at the legal rate" at the time the Bankruptcy Code was enacted was a rate fixed by statute.

See, e.g., *Inv. Serv. Co. v. Allied Equities Corp.*, 519 F.2d 508, 511 (9th Cir.1975) (distinguishing "interest at the legal rate" as a rate defined by statute from a rate determined pursuant to the parties' contract); *In re Dow Corning Corp.*, 237 B.R. at 402 (citing cases). Congress' choice of the phrase "interest at the legal rate" suggests that it intended for bankruptcy courts to apply one uniform rate defined by federal statute. See 3 *Norton Bankruptcy Law & Practice* 2d § 73:7 n. 55 (1997 & Supp.2000) (stating "[i]nterest is

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set at the federal judgment rate as of the petition date”); 6 *Collier on Bankruptcy* ¶ 726.02(5) (15th ed. rev.1997) (“The reference in the statute to the ‘legal rate’ suggests that Congress envisioned a single rate, probably the federal statutory rate for interest on judgments.”).

Additionally, using the federal rate promotes uniformity within federal law. Upon the filing of the bankruptcy petition, creditors with a claim against the estate must pursue their rights to the claim in federal court and entitlement to a claim

is a matter of federal law. See *Bursch v. Beardsley & Piper*, 971 F.2d 108, 114 (8th Cir.1992) (“[O]nce a bankruptcy petition is filed, federal law, not state law, determines a creditor’s rights.”). Absent a timely objection, all claims filed against the bankrupt estate are “deemed allowed” as of the date of filing. 11 U.S.C. § 502(a). This allowed claim, like a judgment, gives the creditor a legal “right to payment” of

a specific sum of money against the debtor. 11 U.S.C. § 501(5); 11 U.S.C. § 502(b). As of the date of the filing of the petition, creditors hold a claim, similar to a federal judgment, against the estate, the payment of which is only dependent upon completion of the bankruptcy process. In this respect, the purpose of post-petition interest makes the award analogous to an award of post-judgment interest. See *Kaiser Aluminum and Chem. Corp. v. Bonjorno*, 494 U.S. 827, 835–36, 110 S.Ct. 1570, 108 L.Ed.2d 842 (1990) (stating that the purpose of post-judgment interest is “to compensate the successful plaintiff for being deprived of compensation for the loss from the time between the ascertainment of the damages and the payment by the defendant”) (citation omitted).

[7] It has long been the rule that an award of post-judgment interest is procedural in nature and thereby dictated by federal law. *Hanna v. Plumer*, 380 U.S. 460, 473–74, 85 S.Ct. 1136, 14 L.Ed.2d 8 (1965) (stating that procedural matters arising in federal court are decided by federal law). This rule is best illustrated by the difference in treatment of pre-judgment and post-judgment interest in diversity actions. In diversity actions brought in federal court a prevailing plaintiff is entitled to pre-judgment interest at state law rates while post-judgment interest is determined by federal law. See *Northrop Corp. v. Triad Int’l Mktg., S.A.*, 842 F.2d 1154, 1155 (9th Cir.1988). In bankruptcy, an allowed claim becomes a federal judgment and therefore entitles the holder of the judgment to an award of interest pursuant to

federal statute. See *In re Chiapetta*, 159 B.R. 152, 160–61 (Bankr.E.D.Penn.1993); *In re Melenzyer*, 143 B.R. at 833.

[8] Lastly, applying a single, easily determined interest rate to all claims for post-petition interest ensures equitable treatment of creditors. An overriding policy consideration in an award of interest to a creditor is the balancing of equities among the creditors. See *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 165, 67 S.Ct. 237, 91 L.Ed. 162 (1946) (“It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities *1236 between creditor and creditor or between creditors and the debtor.”). By using a uniform interest rate, no single creditor will be eligible for a disproportionate share of any remaining assets to the detriment of other unsecured creditors. See *Beguelin*, 220 B.R. at 100 (citing *In re Melenzyer*, 143 B.R. at 832).

In addition to promoting fairness among creditors, application of the federal rate is the most judicially efficient and practical manner of allocating remaining assets. Calculating the appropriate rate and amount of interest to be paid to a myriad of investors has the potential to overwhelm what could otherwise be a relatively simple process pursuant to 11 U.S.C. § 726(a)(5). See *Beguelin*, 220 B.R. at 101 (“It is not hard to imagine the administrative nightmare that bankruptcy trustees would otherwise face if they were required to calculate a different interest rate, based on a different source of interest rate, for each creditor.”); see also, *Katchen v. Landy*, 382 U.S. 323, 328, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (stating “a chief purpose of the bankruptcy laws is to secure a prompt and effectual administration ... of the [bankruptcy] estate ...”) (citation omitted).

The Court recognizes that these two interests, fairness among creditors and administrative efficiency, may be of limited relevance in certain bankruptcy proceedings. Where there are only a few unsecured creditors seeking post-petition interest and there are sufficient assets to pay all claims for all interest, there will be no concerns regarding equity among creditors or practicality. In those instances, a debtor may receive a windfall from the application of a lower federal interest rate to an award of post-petition interest. Nonetheless “interest at the legal rate” is a statutory term with a definitive meaning that cannot shift depending on the interests invoked by the

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specific factual circumstances before the court. See  [In re Thompson](#), 16 F.3d 576, 581 (4th Cir.1994).

[9] Appellants make a final argument that under the circumstances of this case, an award of interest pursuant to a federal statute violates substantive due process. Assuming, *arguendo*, that there is a substantive right to post-petition interest, Appellants' substantive due process claim fails because the application of the federal interest rate to all claims is rationally related to the legitimate interests in efficiency, fairness, predictability, and uniformity within the bankruptcy system. While the instant case might lend itself to easy application of an alternate interest rate, "a classification does not fail rational-basis review because it 'is not made with

mathematical nicety or because in practice it results in some inequality.' ”  [Heller v. Doe](#), 509 U.S. 312, 321, 113 S.Ct. 2637, 125 L.Ed.2d 257 (1993) (quoting  [Dandridge v. Williams](#), 397 U.S. 471, 485, 90 S.Ct. 1153, 25 L.Ed.2d 491 (1970)).

AFFIRMED.

All Citations

285 F.3d 1231, 39 Bankr.Ct.Dec. 110, Bankr. L. Rep. P 78,658, 02 Cal. Daily Op. Serv. 3146, 2002 Daily Journal D.A.R. 3877

Footnotes

- *  Honorable [Thomas S. Zilly](#), United States District Judge for the Western District of Washington, sitting by designation.

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE PG&E CORPORATION; PACIFIC
GAS & ELECTRIC COMPANY,
Debtors,

AD HOC COMMITTEE OF HOLDERS OF
TRADE CLAIMS,
Appellant,

v.

PACIFIC GAS AND ELECTRIC
COMPANY,
Appellee.

No. 21-16043

D.C. No.
4:20-cv-04570-
HSG

OPINION

Appeal from the United States District Court
for the Northern District of California
Haywood S. Gilliam, Jr., District Judge, Presiding

Argued and Submitted December 6, 2021
San Francisco, California

Filed August 29, 2022

Before: Carlos F. Lucero,* Sandra S. Ikuta, and
Lawrence VanDyke, Circuit Judges.

Opinion by Judge Lucero;
Dissent by Judge Ikuta

SUMMARY**

Bankruptcy

The panel reversed the district court's order, which affirmed the bankruptcy court's ruling that in the chapter 11 proceeding of solvent debtor Pacific Gas and Electric Co., unsecured creditors whose claims were designated as unimpaired were limited to recovery of postpetition interest at the federal judgment rate, rather than the higher rates required by their contracts with PG&E and by California law governing contractual obligations not paid.

The chapter 11 plan classified the claims of these creditors, known as the Ad Hoc Committee of Holders of Trade Claims, as general unsecured claims and provided that the creditors would be paid the full principal amount of their claims plus postpetition interest at the federal judgment rate of 2.59 percent under 28 U.S.C. § 1961(a). The plan classified the creditors' claims as unimpaired, meaning that they were deemed to automatically accept the plan and had

* The Honorable Carlos F. Lucero, United States Circuit Judge for the U.S. Court of Appeals for the Tenth Circuit, sitting by designation.

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

no power to vote against it or argue that their treatment was not “fair and equitable” under 11 U.S.C. § 1129(b)(1) (providing that when a class of impaired creditors votes against a plan, the bankruptcy court may confirm the plan only if it is fair and equitable with respect to that class). Because the claims were designated as unimpaired, under 11 U.S.C. § 1124, the creditors’ “legal, equitable, and contractual rights” were required to be “unaltered” by the reorganization plan.

Joining other circuits, the panel held that under the “solvent-debtor exception,” the creditors possessed an equitable right to receive postpetition interest at the contractual or default state rate, subject to any other equitable considerations, before PG&E collected surplus value from the bankruptcy estate. The solvent-debtor exception is a common-law exception to the Bankruptcy Act’s prohibition on the collection of postpetition interest as part of a creditor’s claim.

The panel disagreed with the bankruptcy court’s conclusion that *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), was controlling because it established a broad rule that all unsecured claims in a solvent-debtor bankruptcy are entitled only to postpetition interest at the federal judgment rate, regardless of impairment status. The panel concluded that *Cardelucci* merely interpreted 11 U.S.C. § 726(a)(5), which requires that creditors of a solvent debtor receive postpetition interest at “the legal rate.” Section 726(a)(5), however, applies only to impaired chapter 11 claims, and the panel concluded that *Cardelucci* therefore did not address what rate of postpetition interest must be paid on the Ad Hoc Committee’s unimpaired claims.

The panel also disagreed with the bankruptcy court's alternative holding that the Bankruptcy Code limited the Ad Hoc Committee to postpetition interest at the federal judgment rate. The panel held that passage of the Bankruptcy Code did not abrogate the solvent-debtor exception. Rather, the Code's text, history, and structure compelled the conclusion that creditors like the Ad Hoc Committee continue to possess an equitable right to bargained-for postpetition interest when a debtor is solvent. 11 U.S.C. § 502(b)(2) prohibits the inclusion of "unmatured interest" as part of an allowed claim, codifying the longstanding rule that interest as part of a claim stops accruing once a bankruptcy petition is filed. That bar is subject to a statutory exception under § 726(a)(5). The panel held, however, that § 726(a)(5) applies only to impaired creditors and therefore did not unambiguously abrogate the equitable solvent-debtor exception. The panel concluded that the statutory history of § 1124 and the Bankruptcy Code's structure also supported its conclusion that the solvent-debtor exception survived.

The panel concluded that under the solvent-debtor exception, the creditors had an equitable right to receive postpetition interest pursuant to their contracts. However, PG&E's plan did not compensate the creditors accordingly, but rather provided for interest at the lower federal judgment rate. The panel reversed and remanded to the bankruptcy court to weigh the equities and determine what rate of interest the creditors were entitled to.

Dissenting, Judge Ikuta wrote that the text of the Bankruptcy Code is clear that unsecured creditors holding unimpaired claims in bankruptcy under 11 U.S.C. § 1124(b) are not entitled to postpetition interest on their claims when the debtor is solvent. Judge Ikuta wrote that the majority

erroneously held that pre-Code practice is binding unless the Code clearly abrogates it. Rather, the Supreme Court has directed the courts to take the exact opposite approach: so long as the Code is clear, the courts do not refer to pre-Code practice. Judge Ikuta wrote that Congress chose not to make an exception entitling unimpaired creditors to postpetition interest at the contract or state default rates, and the statutory language provided no basis for the majority's theory that a creditor's "claim," which may not include postpetition interest, is nevertheless deemed "impaired" if the debtor turns out to be solvent and the creditor does not obtain postpetition interest at the end of the bankruptcy case.

COUNSEL

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OPINION

LUCERO, Circuit Judge:

This case involves an oddity in bankruptcy law: a solvent bankrupt. Specifically, it involves Pacific Gas & Electric Company (“PG&E”), which sought chapter 11 protection in a bid to proactively address massive potential liabilities related to a series of wildfires in Northern California. But PG&E was, and has remained, solvent. Its assets at the time of the bankruptcy filing exceeded its known liabilities by nearly \$20 billion. As a result, several creditors—including plaintiffs, the Ad Hoc Committee of Holders of Trade Claims—claimed PG&E must pay postpetition interest at the rates required by their contracts in order for their claims to be “unimpaired” by the reorganization plan. *See* 11 U.S.C. § 1124(1). In other words, plaintiffs argued PG&E had to honor its contractual obligations before its shareholders reaped a surplus from the bankruptcy estate. The bankruptcy court and the district court disagreed. They concluded that *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), and the text of the Bankruptcy Code limited plaintiffs to recovery of postpetition interest at the much lower federal judgment rate. We have jurisdiction under 28 U.S.C. § 158(d)(1) and **REVERSE**.

I

PG&E filed for chapter 11 bankruptcy in January 2019. The company initiated the proceedings in response to catastrophic wildfires that occurred in Northern California during the preceding years. Following the fires, PG&E faced tens of billions of dollars in potential liabilities to fire victims, in addition to the tens of billions of dollars the company owed pursuant to its outstanding contractual

commitments.¹ However, the company was solvent at the time of filing: it reported \$71.4 billion in assets compared to \$51.7 billion in known liabilities. PG&E nonetheless insisted bankruptcy was necessary to resolve its wildfire liabilities and ensure the liquidity needed to sustain operations. The company has never contested its ability to pay non-wildfire creditors in full.

After PG&E filed for bankruptcy, California enacted Assembly Bill 1054 (“A.B. 1054”). *See* Act of July 12, 2019, ch. 79, 2019 Cal. Stat. 1888 (codified in scattered sections of Cal. Pub. Util. Code). The act created a multi-billion-dollar safety net to compensate future victims of utility fires. Cal. Pub. Util. Code §§ 3284, 3288. For PG&E to participate in the fund, A.B. 1054 required that the bankruptcy court confirm its reorganization plan by June 30, 2020. *Id.* § 3292(b).

PG&E’s proposed chapter 11 plan (“the plan”) classified plaintiffs’ non-wildfire-related claims as general unsecured claims. The plan provided that plaintiffs would be paid the full principal amount of these claims. It further stipulated that plaintiffs would receive postpetition interest at the federal judgment rate of 2.59 percent, *see* 28 U.S.C. § 1961(a), accruing from the date of PG&E’s bankruptcy filing through the date of distribution. However, this interest rate was significantly lower than plaintiffs were entitled to under state law for contractual obligations not paid. Some of plaintiffs’ contracts with PG&E contained bargained-for interest rates on unpaid obligations, while California law sets

¹ In a declaration accompanying the bankruptcy filing, a PG&E executive estimated that the company’s wildfire-related liabilities “could exceed \$30 billion, without taking into account potential punitive damages, fines and penalties or damages with respect to ‘future claims.’”

a default interest rate of ten percent. *See* Cal. Civ. Code § 3289(b). Plaintiffs claim that, by paying them the lower federal judgment rate, PG&E’s plan denied them roughly \$200 million they would have received pursuant to interest rates in their contracts or, in the absence of such terms, the California default rate.

Notwithstanding the difference in interest payments, PG&E’s plan classified plaintiffs’ claims as “unimpaired,” a statutory term used to denote which bankruptcy creditors are entitled to vote on a reorganization plan. *See* 11 U.S.C. § 1124. As supposedly unimpaired creditors, plaintiffs were deemed to automatically accept the plan and therefore had no power to vote. *See* 11 U.S.C. § 1126(f). Conversely, all classes of impaired claims were entitled to vote and could assert other statutory protections under the Bankruptcy Code if they voted against the plan. *See* 11 U.S.C. §§ 1129(a)(7), 1129(b)(1).

Plaintiffs and other unsecured creditors objected to the amount of postpetition interest provided under the plan. They argued that, because PG&E was solvent, they must receive interest at the contractual or default state law rates to be considered unimpaired. In a ruling prior to plan confirmation, the bankruptcy court disagreed. That court concluded it was bound by *Cardelucci*, which it read as establishing a broad rule that all unsecured creditors of a solvent-debtor, regardless of impairment status, are entitled only to postpetition interest at the federal judgment rate. The bankruptcy court alternatively ruled that, even if *Cardelucci* did not control, PG&E would prevail because the Bankruptcy Code limits unsecured creditors of a solvent debtor to interest at the federal judgment rate, and therefore plaintiffs’ claims were not actually impaired. The

bankruptcy court confirmed PG&E's plan on June 20, 2020, thus satisfying the deadline set by A.B. 1054.

Plaintiffs appealed the bankruptcy court's confirmation order, which incorporated the postpetition interest order, to the district court. That court affirmed, adopting the bankruptcy court's reasoning that *Cardelucci* controlled the postpetition interest dispute. Plaintiffs appeal that ruling to us.

II

We review de novo a district court's decision on appeal from a bankruptcy court, applying the same standard of review to the bankruptcy court's decision as did the district court. *Northbay Wellness Grp., Inc. v. Beyries*, 789 F.3d 956, 959 (9th Cir. 2015). The bankruptcy court's conclusions of law, including its interpretation of the Bankruptcy Code, are reviewed de novo. *In re Smith*, 828 F.3d 1094, 1096 (9th Cir. 2016).

III

The question we must answer is this: what rate of postpetition interest must a solvent debtor pay creditors whose claims are designated as unimpaired pursuant to § 1124(1) of the Bankruptcy Code?² No circuit court has addressed this issue, and bankruptcy courts have reached different conclusions. *Compare In re Ultra Petroleum Corp.*, 624 B.R. 178, 203–04 (Bankr. S.D. Texas 2020) (unimpaired creditors must receive postpetition interest at

² PG&E has said at previous stages of this litigation that, should plaintiffs prevail in the postpetition interest dispute, it would amend the plan to pay plaintiffs the amount of postpetition interest they are entitled to under the Code as unimpaired creditors.

the contract rate), *with In re Energy Future Holdings Corp.*, 540 B.R. 109, 124 (Bankr. D. Del. 2015) (unimpaired creditors are entitled to interest “under equitable principles” at a rate “the Court deems appropriate”), *and In re The Hertz Corp.*, 637 B.R. 781, 800–01 (Bankr. D. Del. 2021) (unimpaired creditors need only receive interest at the federal judgment rate).

Plaintiffs contend that the bankruptcy and district courts in this case erred in holding that, as unimpaired creditors, they were only entitled to postpetition interest at the federal judgment rate of 2.59 percent. We agree that these rulings were in error. Under the long-standing “solvent-debtor exception,” plaintiffs possess an equitable right to receive postpetition interest at the contractual or default state law rate, subject to any other equitable considerations, before PG&E collects surplus value from the bankruptcy estate. *Cardelucci*, which interpreted a statutory provision inapplicable to unimpaired creditors, does not hold otherwise. Moreover, we disagree with PG&E’s assertion that this solvent-debtor exception was abrogated by passage of the Bankruptcy Code. To the contrary, the Code required PG&E’s plan to leave “unaltered” all of plaintiffs’ “legal, equitable, and contractual rights,” § 1124(1)—including their equitable right to receive the bargained-for postpetition interest under the solvent-debtor exception. PG&E’s plan failed to compensate plaintiffs accordingly.

A

Statutory analysis of the Bankruptcy Code is a “holistic endeavor.” *United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). Our analysis in this case requires reference to various statutory and historic sources. We begin by summarizing (1) the common-

law solvent-debtor exception, and (2) key provisions of the Bankruptcy Code.

1

Although the concept of a solvent bankrupt may seem contradictory, the scenario occurred frequently enough for the common law to develop a special rule for such cases. That rule, in short, is that a solvent debtor must generally pay postpetition interest accruing during bankruptcy at the contractual or state law rates before collecting surplus value from the bankruptcy estate.

The default rule in bankruptcy law is that interest ceases to accrue on a claim once a debtor has filed for bankruptcy. *See Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911); 11 U.S.C. § 502(b)(2). This rule is one of necessity: in most chapter 11 cases, the debtor cannot pay all its creditors, and therefore payment of interest accruing after filing would diminish the value of the estate and result in disparate treatment of creditors. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163–64 (1946). But such concerns do not exist when a bankrupt has sufficient funds to pay all outstanding debts. *See Johnson v. Norris*, 190 F. 459, 462 (5th Cir. 1911) (emphasizing that the default rule halting accrual of interest during bankruptcy “was not intended to be applied to a solvent estate”).

Accordingly, eighteenth century English courts developed the solvent-debtor exception, which required bankrupts to pay interest that accrued during bankruptcy before retaining value from an estate. *See, e.g., Bromley v. Goodere* (1743) 26 Eng. Rep. 49, 51–52; 1 Atkyns 75, 79–81. American courts imported this doctrine and applied it under the Bankruptcy Act of 1898—the predecessor of the current Bankruptcy Code. *See, e.g., City of New York v.*

Saper, 336 U.S. 328, 330 n.7 (1949) (recognizing the solvent-debtor exception); *In re Beverly Hills Bancorp*, 752 F.2d 1334, 1339 (9th Cir. 1984) (same). The Supreme Court emphasized that “in the rare instances where the assets ultimately prove[] sufficient for the purpose, . . . creditors [are] entitled to interest accruing after adjudication.” *Am. Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261, 266–67 (1914) (“*American Iron*”).

The solvent-debtor exception was not codified, instead existing as a common-law exception to the Bankruptcy Act’s prohibition on the collection of postpetition interest as part of a creditor’s claim. See Bankruptcy Act of 1898, ch. 541, § 63, 30 Stat. 544, 562–63 (repealed) (stating that an allowed claim excludes “costs incurred and interests accrued after the filing of the petition”). Courts interpreted the exception as flowing from the purpose of bankruptcy law to ensure an equitable distribution of assets. See *Johnson*, 190 F. at 466; *Debentureholders Protective Comm. of Cont’l Inv. Corp. v. Cont’l Inv. Corp.*, 679 F.2d 264, 269 (1st Cir. 1982) (“*Debentureholders*”) (calling the exception “fair and equitable”). The common-law absolute priority rule requires that a creditor be “made whole” before junior interests—including equity holders—take from the bankruptcy estate. *Consol. Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 520–21 (1941); see also *Bank of Am. Nat’l Tr. & Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 444 (1999). Without a solvent-debtor exception, a solvent bankrupt could reap a windfall at their creditors’ expense, pocketing “money which the debtor had promised to pay promptly to the creditor.” *Debentureholders*, 679 F.2d at 269.

In *American Iron*, for example, the Supreme Court awarded interest that accrued during a period of receiver administration at the Virginia statutory rate. 233 U.S. at 264,

267. The Court explained that the general bar on payment of interest on debts in a receivership did not mean the claims “had lost their interest-bearing quality.” *Id.* at 266. Rather, it was “a necessary and enforced rule” to retain equitable distribution between creditors. *Id.* But the need for such a rule disappeared when “the estate proved sufficient to discharge the claims in full.” *Id.* Similarly, multiple circuit courts hearing cases under the Bankruptcy Act concluded that, in a solvent-debtor bankruptcy, “the task for the bankruptcy court is simply to enforce creditors’ rights according to the tenor of the contracts that created those rights.” *In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 791 F.2d 524, 528 (7th Cir. 1986); *see also Debentureholders*, 679 F.2d at 270 (reversing plan confirmation where a solvent debtor did not pay creditors their “contractual right” to interest); *Ruskin v. Griffiths*, 269 F.2d 827, 832 (2d Cir. 1959) (concluding that equity required the debtor to pay interest on creditors’ claims at the “expressly-bargained-for” rate).³

In short, the solvent-debtor exception was well-established under the Bankruptcy Act. Under this exception, creditors of a solvent debtor were entitled to be made whole, including receiving postpetition interest pursuant to their

³ PG&E contends that early American cases recognizing the solvent-debtor exception, including *Johnson*, did not specify that postpetition interest should be paid at contractual or default state law rates. But it is unclear what other rates those courts could have contemplated. The statute setting a uniform federal judgment rate of interest, 28 U.S.C. § 1961, was not established until 1948. *See* Pub. L. 80-773, 62 Stat. 869, 957–58 (1948). Accordingly, a creditor’s entitlement to postpetition interest accruing on debt would have naturally been understood to arise from state law, either pursuant to the parties’ contracts or the applicable default state law rate. *See American Iron*, 233 U.S. at 266–67 (awarding the state law default rate in a solvent-debtor receivership case).

contractual or state law default rates, before surplus value was returned to the bankrupt. *See Chicago, Milwaukee*, 791 F.2d at 529; *Debentureholders*, 679 F.2d at 270; *Ruskin*, 269 F.2d at 832; Chaim J. Fortgang & Lawrence P. King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions*, 56 N.Y.U. L. Rev. 1148, 1164 (1981) (describing the “well-established” pre-Bankruptcy Code principle that, when a debtor is solvent, “all claims are to be paid the full amount of their principal plus interest, both prepetition and postpetition at the contractual rate”).

2

With this history in mind, we turn to the modern Bankruptcy Code (“the Code”). Congress passed the Code in 1978, replacing the prior statutory regime under the Bankruptcy Act. *See Bankruptcy Reform Act of 1978*, Pub. L. No. 95-598, 92 Stat. 2549. “[W]hile pre-Code practice informs our understanding of the language of the Code, it cannot overcome that language.” *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 10 (2000) (cleaned up).

This case revolves around the Code’s concept of impairment. Section 1124(1) of the Code provides that a claim is impaired unless the bankruptcy plan “leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.” We have said that Congress “defined impairment in the broadest possible terms” and “any alteration” of a creditor’s legal, equitable, and contractual rights by a debtor’s plan constitutes impairment. *In re L&J Anaheim Assocs.*, 995 F.2d 940, 942 (9th Cir. 1993) (cleaned up). A debtor, as part of a proposed plan, must specify which classes of claims are unimpaired. § 1123(a)(2).

Impaired creditors receive several protections during plan confirmation that are not afforded to unimpaired creditors. First, only impaired claim holders may vote on whether to confirm a plan. *See* § 1126(a). Conversely, unimpaired claimants are presumed to accept a plan. § 1126(f). Each class of impaired claims must vote to accept a plan for a consensual confirmation to occur. § 1129(a)(8).

Moreover, an impaired creditor who votes against a plan must receive value “not less than . . . such holder would so receive or retain if the debtor were liquidated under chapter 7” of the Code. § 1129(a)(7)(A)(ii). This provision, known as the best-interests-of-creditors test (“best-interests test”), incorporates by reference 11 U.S.C. § 726, which establishes the priority of distributions in chapter 7 liquidations. Section 726(a)(5) requires that creditors of a solvent debtor receive postpetition interest at “the legal rate”—a term we have said refers to the federal judgment rate established by 28 U.S.C. § 1961(a). *See Cardelucci*, 285 F.3d at 1234. Thus, pursuant to the best-interests test, a dissenting, *impaired* creditor of a solvent, chapter 11 debtor must receive postpetition interest on their claim at the federal judgment rate.

Conversely, no Code provision applies § 726(a)(5) to *unimpaired* chapter 11 claims. To the contrary, the Code expressly limits the application of § 726(a)(5) to chapter 7 liquidations. *See* 11 U.S.C. § 103(b) (stating that subchapter II of chapter 7, which includes § 726, applies only to chapter 7 cases). Section 726(a)(5) applies to chapter 11 cases solely through the best-interests test, § 1129(a)(7), which is inapplicable to unimpaired creditors. *See Energy Future Holdings*, 540 B.R. at 123; 7 Collier on Bankruptcy ¶ 1129.02[7][a] (16th ed. 2021) (noting the best-interests test applies “only to creditors . . . who are members of impaired

classes”). No provision of the Code specifies the rate of postpetition interest a creditor must receive from a solvent debtor to be unimpaired. *See Ultra Petroleum*, 624 B.R. at 202. In fact, the Code is silent as to whether such creditors are entitled to any postpetition interest at all. *Id.*

Finally, when a class of impaired creditors votes against a plan, the bankruptcy court may only confirm the plan if it is “fair and equitable” with respect to that class. § 1129(b)(1). Some courts have held a solvent debtor may be required to pay contractual or default interest, over and above the required federal judgment rate, to objecting, impaired creditors in order to satisfy this “fair and equitable” requirement and secure court approval of a reorganization plan. *See, e.g., In re Dow Corning Corp.*, 456 F.3d 668, 680 (6th Cir. 2006); *In re Mullins*, 633 B.R. 1, 20 (Bankr. D. Mass 2021).

In this case, PG&E’s confirmed plan provided for postpetition interest on plaintiffs’ claims at the federal judgment rate—the same rate plaintiffs would be entitled to as impaired creditors. However, because plaintiffs were designated as unimpaired, they could not (1) vote on the reorganization plan or (2) argue that their treatment was not “fair and equitable” under § 1129(b)(1).

B

Turning to the decisions below, we first address whether *Cardelucci* controls this case. PG&E argues—and the bankruptcy and district courts held—that *Cardelucci* established a broad rule that all unsecured claims in a solvent-debtor bankruptcy are entitled only to postpetition interest at the federal judgment rate, regardless of impairment status. But *Cardelucci* merely held that the phrase “interest at the legal rate” in § 726(a)(5) refers to the

federal judgment rate as defined by 28 U.S.C. § 1961(a). *Cardelucci*, 285 F.3d at 1234. As explained above, § 726(a)(5) only applies to *impaired* chapter 11 claims via the best-interests test. See 11 U.S.C. § 103(b); *Ultra Petroleum*, 624 B.R. at 202; *Energy Future Holdings*, 540 B.R. at 123–24. *Cardelucci* therefore does not tell us what rate of postpetition interest must be paid on plaintiffs’ *unimpaired* claims.

Cardelucci involved a debtor who filed for bankruptcy after a state court entered a civil judgment in favor of the creditors. 285 F.3d at 1233. The parties agreed that the creditors were owed postpetition interest under § 726(a)(5), but they disagreed as to whether that provision required that interest be paid at the federal judgment or state law default rate. *Id.* This court opened its inquiry by explaining that the case involved “an award of postpetition interest *pursuant to 11 U.S.C. § 726(a)(5)*,” and presented “the narrow but important issue of whether *such* post-petition interest is to be calculated using the federal judgment interest rate.” *Id.* (emphasis added). We held that principles of statutory interpretation, among other reasons, compelled the conclusion that Congress intended “interest at the legal rate” in § 726(a)(5) to refer to the federal judgment rate. *Id.* at 1234–35 (“Congress’ choice of the phrase ‘interest at the legal rate’ suggests that it intended for bankruptcy courts to apply one uniform rate defined by federal statute.”).

The bankruptcy and district courts in this case held that *Cardelucci* established a broad rule that all unsecured creditors of a solvent debtor are entitled to postpetition interest at the federal judgment rate. Indeed, *Cardelucci* did not expressly limit its holding to impaired claims; it did not refer to impairment status at all. See *id.* at 1234 (“Where a debtor in bankruptcy is solvent, *an unsecured creditor* is

entitled to ‘payment of interest at the legal rate from the date of the filing of the petition’ prior to any distribution of remaining assets to the debtor.” (quoting § 726(a)(5)) (emphasis added). PG&E thus contends *Cardelucci*’s holding extends to cases involving unimpaired claims.

This argument fails for a simple reason: *Cardelucci* interpreted language from a specific statutory provision—§ 726(a)(5)—that does not apply to unimpaired claims. Rather, as discussed above, § 726(a)(5) only applies to chapter 11 cases through the best-interests test, § 1129(a)(7), which itself only applies to impaired creditors. *See* § 103(b); *Ultra Petroleum*, 624 B.R. at 202; *Energy Future Holdings*, 540 B.R. at 123–24; 7 Collier on Bankruptcy ¶ 1129.02[7][a]. Though our opinion in *Cardelucci* did not say so, the creditors in that case were impaired. Indeed, the creditors in *Cardelucci* had to be impaired for § 726(a)(5) to apply in the first place. Moreover, the parties in *Cardelucci* agreed that the amount of interest owed hinged solely on the interpretation of § 726(a)(5). *See Cardelucci*, 285 F.3d at 1233. Thus, the fact that *Cardelucci* did not reference the creditors’ impaired status—or limit the scope of its holding to impaired claims—is not surprising. But *Cardelucci* provides no textual basis for applying § 726(a)(5) to unimpaired claims, nor could it for the reasons explained above.

We therefore decline to read *Cardelucci* as establishing the broad rule that PG&E advocates. *Cardelucci* merely held that the phrase “interest at the legal rate” in § 726(a)(5) refers to the federal judgment rate. *See, e.g., Mullins*, 633 B.R. at 22 (citing *Cardelucci* for this proposition); *Ultra Petroleum*, 624 B.R. at 203 (same). But this holding does not answer what rate of interest is required where § 726(a)(5) does not apply—including for unimpaired claims. The

bankruptcy and district courts erred in concluding that *Cardelucci* settles the issue before us.

C

The bankruptcy court alternatively held that even if *Cardelucci* does not limit plaintiffs to postpetition interest at the federal judgment rate, the Bankruptcy Code does. In essence, that court read several Code provisions as establishing a uniform postpetition interest rate for all unsecured claims in a solvent-debtor case. Because plaintiffs, in the bankruptcy court's view, received everything the Code entitled them to—that is, the full amount of their claims plus interest at the federal judgment rate—their “legal, equitable, and contractual rights” were not impaired under § 1124(1). *See In re Ultra Petroleum Corp.*, 943 F.3d 758, 763 (5th Cir. 2019) (holding impairment does not occur when the Code limits a creditor's rights); *In re PPI Enters. (U.S.), Inc.*, 324 F.3d 197, 204 (3d Cir. 2003) (same).

Analyzing this aspect of the bankruptcy court's holding requires us to first address an antecedent question: did the Bankruptcy Code displace the historic solvent-debtor exception? As discussed above, this equitable rule—widely recognized and applied under the Bankruptcy Act, even though it was not explicitly codified therein—entitled creditors to postpetition interest at the contract or default state law rate before a solvent debtor received surplus value from an estate. *See supra*, section III.A.1. We conclude passage of the Code did not abrogate the solvent-debtor exception, any more than passage of the Bankruptcy Act did so. The bankruptcy court thus erred in holding that the Code limits plaintiffs to recovery of postpetition interest at the federal judgment rate.

1

The Supreme Court has made clear that it “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998) (quotation omitted); *see also Midlantic Nat’l Bank v. N.J. Dep’t of Env’t Prot.*, 474 U.S. 494, 501 (1986) (“The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.”). Thus, while “[t]he Bankruptcy Code can of course override by implication,” any such implication must be “unambiguous.” *BFP v. Resol. Tr. Corp.*, 511 U.S. 531, 546 (1994).⁴

In this case, the parties agree that courts recognized a common-law, solvent-debtor exception under the Bankruptcy Act. And contrary to arguments made by PG&E and in the Dissent, we discern from the contemporary Code no “clear indication” that Congress meant to severely limit the scope of the solvent-debtor exception. *Cohen*, 523 U.S. at 221. Rather, the Code’s text, history, and structure compel the opposite conclusion: that creditors like plaintiffs

⁴ The Dissent correctly recognizes the Supreme Court’s admonition that pre-Code practice cannot abrogate the Code’s plain text. *See* Dissent at 36–37. But for the reasons discussed below, we cannot say the Code’s text is clear that the equitable solvent-debtor exception does not apply to creditors who are designated as unimpaired. *See infra* at 21–23. And pre-Code practice remains relevant to the construction of provisions that are “subject to interpretation” or contain ambiguities. *Hartford Underwriters*, 530 U.S. at 10 (quotations omitted). Moreover, as we explain, the Dissent’s reading of the Code cannot be squared with Congress’ subsequent action to amend the Code after its passage. *See infra* at 24–25, 28.

continue to possess an “equitable right” to bargained-for postpetition interest when a debtor is solvent. § 1124(1).

PG&E argues—and the bankruptcy court agreed—that the combination of §§ 502(b)(2) and 726(a)(5) reflects Congressional intent to establish a uniform rate of postpetition interest for all unsecured claims when a debtor is solvent. Section 502(b)(2) prohibits the inclusion of “unmatured interest” as part of an allowed claim, codifying the long-standing rule that interest as part of a claim stops accruing once a bankruptcy petition is filed. *See Sexton*, 219 U.S. at 344. PG&E notes that § 502(b)(2)’s bar on postpetition interest is subject to only two statutory exceptions, including § 726(a)’s liquidation waterfall, which applies to impaired chapter 11 creditors through the best-interests test, § 1129(a)(7).⁵ To the extent that courts allowed for recovery of contractual postpetition interest under the Bankruptcy Act, PG&E asserts these Code provisions indicate Congress’ intent to depart from this practice and ensure all unsecured creditors of a solvent debtor receive the same rate of interest. The Dissent goes even farther, concluding that § 502(b)(2), alongside other Code provisions, mandates that creditors who are paid their allowed claims in full are not entitled to any postpetition interest, even when a debtor is solvent.

We are not persuaded. No Code provisions—alone or together—unambiguously displace the long-established solvent-debtor exception or preclude supposedly unimpaired creditors from asserting an equitable right to contractual postpetition interest. Notably, § 502(b)(2)’s prohibition on the collection of “unmatured interest” as part of a claim

⁵ The second exception, which applies to oversecured creditors and is located at 11 U.S.C. § 506(b), is not relevant to this dispute.

effectively restates its predecessor provision, § 63 of the Bankruptcy Act. Bankruptcy Act of 1898, ch. 541, § 63, 30 Stat. 544, 562–63 (repealed) (excluding from recovery “costs incurred and interest accrued after the filing of the petition”). The Senate Report accompanying the passage of the Bankruptcy Code emphasized that § 502(b) simply restated “principles of [then] present law.” S. Rep. No. 95-989, at 63 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5849. The mere recodification of § 63—under which the equitable solvent-debtor exception was widely applied, *see, e.g., Saper*, 336 U.S. at 330 n.7—fails to reflect any Congressional instruction to limit a solvent debtor’s obligation to pay interest on claims against it.

Moreover, § 502(b)(2) simply excludes postpetition interest from “the amount of” a creditor’s allowed claim. But “there is a significant distinction between whether postpetition interest can be *part of* an allowed claim and whether there are circumstances under which the debtor may be required to pay postpetition interest *on* an allowed claim.” *Mullins*, 633 B.R. at 15 (emphasis added); *see also Ultra Petroleum*, 624 B.R. at 195 (explaining that while “interest as part of a claim ceases to accrue upon the filing of a bankruptcy petition . . . in some circumstances, creditors may demand post-petition interest on their claims”); *Energy Future Holdings*, 540 B.R. at 111 (same). The text of § 502(b)(2) is entirely consistent with the conclusion that, in some instances, a creditor must receive postpetition interest *on* their allowed claim to be considered unimpaired.⁶

⁶ The Dissent claims there is “no basis” for distinguishing between interest payments made *on* as opposed to *part of* an allowed claim. Dissent at 39. Yet it is the Dissent that ignores both the text of § 502(b)(2) and the weight of authority acknowledging this difference.

Indeed, PG&E concedes that plaintiffs are entitled to some interest on their allowed claims in this case. Thus, PG&E's own argument forecloses the notion that § 502(b)(2) alone limits unimpaired creditors' ability to collect postpetition interest.

PG&E also points to § 726(a)(5). But that provision does not unambiguously abrogate the equitable solvent-debtor exception because, as explained above, it only applies to *impaired* chapter 11 creditors via the best-interests test, § 1129(a)(7). *See Ultra Petroleum*, 624 B.R. at 202; *Energy Future Holdings*, 540 B.R. at 123; 7 Collier on Bankruptcy ¶ 1129.02[7][a]. If Congress meant to limit all unsecured, chapter 11 creditors to interest at the federal judgment rate, it could have done so directly. Instead, the Code only applies § 726(a)(5)'s limited grant of interest "at the legal rate" to impaired creditors, who (unlike unimpaired creditors) also receive other protections under the Code, including the right to vote on a plan, § 1126(a), and the right to invoke § 1129(b)(1)'s "fair and equitable" requirement. This scheme does not reflect a "clear" requirement to fully depart from the solvent-debtor exception's equitable rule that creditors are entitled to postpetition interest pursuant to their contracts. *Cohen*, 523 U.S. at 221.⁷

See Ultra Petroleum, 624 B.R. at 195; *Mullins*, 633 B.R. at 15; *Energy Future Holdings*, 540 B.R. at 111.

⁷ Seeking to overcome the lack of any statute applying § 726(a)(5) to unimpaired creditors, PG&E next argues that payment of postpetition interest in bankruptcy is analogous to payment of interest on a judgment in federal court. It is true that *Cardelucci* made such a comparison, albeit in dicta. *See Cardelucci*, 285 F.3d at 1235. PG&E reasons that Congress, by applying § 726(a)(5) to unsecured creditors via the best-interests test, confirmed that all awards of postpetition interest to such

The statutory history of § 1124 also supports our conclusion that the equitable solvent-debtor exception survives today. As noted above, no Code provision explicitly entitles a supposedly unimpaired creditor to *any* postpetition interest. See *Ultra Petroleum*, 624 B.R. at 202. However, Congress has foreclosed the possibility that creditors designated as unimpaired need not receive postpetition interest, despite this statutory vacuum. In 1994, Congress repealed a Code provision that stated that a creditor was unimpaired if it was paid the “the allowed amount of [its] claim.” See § 1124(3) (repealed); Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 213, 108 Stat. 4106, 4126. At least one court strictly interpreted § 1124(3), holding that a creditor may be classified as

creditors, regardless of impairment status, are akin to awards of post-judgment interest given at the federal judgment rate.

We are not convinced. Once again, PG&E cannot overcome the fatal flaw in its argument: no statute applies § 726(a)(5) and its limited award of postpetition interest “at the legal rate” to unimpaired claims. Thus, there is no “clear indication” that Congress meant to modify the solvent-debtor exception to limit unimpaired creditors to interest at this amount. *Cohen*, 523 U.S. at 221.

Moreover, we disagree with PG&E that the historic cases discussing the solvent-debtor exception treated awards of postpetition interest as akin to post-judgment interest. PG&E points to passing language from *Johnson*, a Fifth Circuit case, noting that another court had compared allowed bankruptcy claims to judgments. See *Johnson*, 190 F. at 465 (citing *In re John Osborn’s Sons & Co.*, 177 F. 184 (2d Cir. 1910)). But PG&E directs us to no other historic case that made such a comparison. To the contrary, cases applying the solvent-debtor exception under the Bankruptcy Act repeatedly emphasized that the equitable purpose of the exception was to require debtors to honor their “expressly-bargained-for” contracts, lest they realize a windfall. *Ruskin*, 269 F.2d at 832; see also, e.g., *Chicago, Milwaukee*, 791 F.2d at 528; *Debentureholders*, 679 F.2d. at 270.

unimpaired if it was paid the full principal of its claim without any postpetition interest. *See In re New Valley Corp.*, 168 B.R. 73, 79–80 (Bankr. D.N.J. 1994). The House Reporter explained that the repeal of § 1124(3) was meant to preclude *New Valley*’s “unfair result” from occurring again. H.R. Rep. No. 103-835, § 214 at 48 (1994). These actions by Congress confirm that creditors of a solvent debtor who are designated as unimpaired *must* receive postpetition interest on their claim—notwithstanding § 502(b)(2), or the fact that no Code provision expressly entitles such creditors to unaccrued interest.

In addition to Congressional action, the solvent-debtor exception fits comfortably within the text of the Code—specifically, its requirement that a debtor’s plan leave unaltered a creditor’s “legal, *equitable*, and contractual rights.” § 1124(1) (emphasis added); *see Law v. Siegel*, 571 U.S. 415, 421 (2014) (“[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.” (quotation omitted)). While, as discussed, no Code provision legally entitles supposedly unimpaired creditors to postpetition interest, pre-Code practice conclusively establishes creditors’ equitable entitlement to contractual postpetition interest when a debtor is solvent, subject to any other countervailing equities. *See supra*, section III.A.1. Absent this equitable right, creditors whose claims were paid in full and designated as unimpaired would not be entitled to any postpetition interest—the exact result Congress sought to preclude by repealing § 1124(3). *See Energy Future Holdings*, 540 B.R. at 123 (explaining that unimpaired creditors’ equitable right to interest “resolves a conflict between” § 502(b)(2) and the repeal of § 1124(3)).

Finally, our conclusion that the equitable solvent-debtor exception survives is supported by the Code's structure. The Code offers procedural and substantive protections for creditors who are impaired by a plan: including the right to vote on a plan, § 1126(a), and the ability for a dissenting, impaired class to invoke § 1129(b)(1)'s requirement that a plan be "fair and equitable" to be confirmed. By "defin[ing] impairment in the broadest possible terms," *L&J Anaheim*, 995 F.2d at 942 (quotation omitted), Congress ensured that creditors whose rights were altered in any way by a plan could avail themselves of these protections. *See PPI Enters.*, 324 F.3d at 203 ("The Bankruptcy Code creates a presumption of impairment so as to enable a creditor to vote on acceptance of the plan." (quotation omitted)).

But PG&E wants to have its cake and eat it too: it seeks to pay plaintiffs the same, reduced interest rate as impaired creditors, while depriving them of the statutory protections that impaired creditors enjoy. *See Energy Future Holdings*, 540 B.R. at 123 (equitable principles require that unimpaired creditors not be treated inferior to impaired creditors); *Ultra Petroleum*, 624 B.R. at 203 (same).⁸ We decline to adopt a reading of the Code that permits PG&E to end-run these statutory rights while reaping a windfall of hundreds of millions of dollars. Such an outcome is contrary to both a plain text reading of the Code and equitable principles that persist under the modern bankruptcy regime. *See Dow*

⁸ Plaintiffs note that some courts (including one circuit court) have held that, in a solvent-debtor scenario, a "fair and equitable" plan under § 1129(b)(1) may require paying unsecured creditors interest at the contractual rate before the debtor can receive surplus value. *See Dow Corning*, 456 F.3d at 677–78; *Mullins*, 633 B.R. at 20. We express no opinion on this issue, but merely point out that PG&E's designation of plaintiffs as unimpaired precluded them from potentially making this argument to the bankruptcy court.

Corning, 456 F.3d at 671 (“[S]olvent-debtor cases present a situation where all parties ought to be granted the benefit of their bargains, unless the equities compel a contrary result.”). Rather, a more sensible reading of the Code gives solvent debtors a choice: compensate creditors in full pursuant to the solvent-debtor exception or designate them as impaired claimants entitled to the full scope of the Code’s substantive and procedural protections.

In sum, we agree with plaintiffs that the Code lacks any “clear indication,” *Cohen*, 523 U.S. at 221, that Congress meant to displace the historic solvent-debtor exception. See *Ultra Petroleum*, 624 B.R. at 198–200 (holding the same). In so holding, we join multiple sibling circuits in recognizing that the equitable solvent-debtor exception—and its core principle that creditors should be made whole when the bankruptcy estate is sufficient—persists under the Code. See *Dow Corning*, 456 F.3d at 680 (“We conclude, like the other courts to have considered this issue, that there is a presumption that [contract or state law] default interest should be paid to unsecured claim holders in a solvent debtor case.”); *Ultra Petroleum*, 943 F.3d at 765 (“As other circuits have recognized, absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors’ contractual rights.” (quotation omitted)); *Gencarelli v. UPS Cap. Bus. Credit*, 501 F.3d 1, 7 (1st Cir. 2007) (“This is a solvent debtor case and, as such, the equities strongly favor holding the debtor to his contractual obligations . . .”). Accordingly, under the Code, unsecured creditors of a solvent debtor retain an equitable right to postpetition interest pursuant to their contracts, subject to any other equities in a given case. A failure to compensate creditors according to this equitable right as part of a bankruptcy plan results in impairment. See § 1124(1).

2

The Dissent adopts a radically different approach. It concludes that the Code's text clearly establishes that unsecured creditors are not entitled to *any* postpetition interest from a solvent debtor if they are paid their allowed claims in full. It is telling that not even PG&E advocates this position, instead conceding that the Code entitles plaintiffs, at minimum, to postpetition interest on their claims at the federal judgment rate. Likewise, post-*New Valley* courts all agree that a solvent debtor must pay creditors *some* postpetition interest to classify their claims as unimpaired. See *Ultra Petroleum*, 624 B.R. at 203–04; *Energy Future Holdings*, 540 B.R. at 124; *The Hertz Corp.*, 637 B.R. at 800–01.

This unanimity is not surprising. The Dissent's reading of the Code cannot be squared with Congress' repeal of § 1124(3) following the *New Valley* decision. As explained, Congress eliminated this provision expressly to prevent *New Valley*'s "unfair result," which allowed solvent debtors to designate creditors as unimpaired simply because their allowed claims were paid in full. H.R. Rep. No. 103-835, § 214 at 48. To adopt the Dissent's reasoning would effectively nullify the 1994 amendment and allow solvent debtors to replicate "exactly the same result that led Congress to delete section 1124(3)" in the first place. *Energy Future Holdings*, 540 B.R. at 123; see also *PPI Enters.*, 324 F.3d at 203 (adopting bankruptcy court's holding that, after the repeal of § 1124(3), unimpaired creditors must receive interest from a solvent debtor). We have no grounds for ignoring Congress' clear instruction on this matter.

The Dissent nonetheless insists that Congress' repeal of § 1124(3) does not support our holding. In essence, it

concludes that because Congress left various other provisions of the Code intact—and because these provisions, in the Dissent’s view, clearly dictate that unsecured creditors paid their claims in full are unimpaired—the plaintiffs’ claims remain governed by the “general rule disallowing postpetition interest.” *See* Dissent at 43, 50 (quotation omitted). But that “general rule disallowing postpetition interest” derives from a provision—§ 502(b)(2)—that cannot carry the weight the Dissent ascribes to it. *See supra* at 21–23. We find it implausible that Congress meant to abrogate the equitable solvent-debtor exception by recodifying § 63 of the Bankruptcy Act, under which that exception was widely applied. Moreover, the fact that the best-interests test created by § 1129(a)(7) only applies to impaired creditors is hardly grounds for concluding that creditors designated as unimpaired need not receive any interest at all when a debtor is solvent, for the reasons explained above. *See supra* at 23–27.

More broadly, the Dissent’s framing of the issue—that is, “whether unsecured creditors holding unimpaired claims . . . are entitled to postpetition interest,” Dissent at 34—elides the antecedent question of what constitutes unimpairment in the first place. As discussed, the Code “creates a presumption of impairment,” *PPI Enters.*, 324 F.3d at 203, by requiring that a debtor’s plan “leave[] unaltered” an unimpaired creditor’s “legal, *equitable*, and contractual rights,” § 1124(1) (emphasis added). *See also L&J Anaheim*, 995 F.2d at 942 (emphasizing that Congress “define[d] impairment in the broadest possible terms” (citation omitted)). We clarify today that, pursuant to the solvent-debtor exception, unsecured creditors possess an “equitable right” to postpetition interest when a debtor is

solvent. § 1124(1).⁹ A failure to provide for postpetition interest according to this equitable right as part of a bankruptcy plan results in impairment. No Code provision

⁹ The Dissent would hold that the “equitable rights” referred to by § 1124(1) encompass only a single right: the “right to an equitable remedy for breach of performance,” which is part of a claim pursuant to 11 U.S.C. § 101(5). Dissent at 40, 51–52. But this novel reading relies on the faulty premise that the “equitable rights” contemplated by § 1124(1) encompass only those rights that are part of an allowed claim. Numerous courts have rejected this logic, holding that a claim may entitle its holder to postpetition interest as an equitable right when a debtor is solvent, even though such a right is not part of the claim itself. *See, e.g., Ultra Petroleum*, 624 B.R. at 203–04, *Energy Future Holdings*, 540 B.R. at 124, *supra* at 51–52. That § 101(5) indisputably confers a statutory right to an equitable remedy *as part of a claim* is hardly grounds for construing § 1124(1)’s reference to equitable rights in the narrow fashion advocated by the Dissent. This is especially true, given that the Dissent’s construction would conflict with the ample textual, historical, and structural evidence we survey above supporting the solvent-debtor exception’s survival under the Code. *See supra* at 20–27.

Moreover, we do not hold (as the Dissent asserts) that claims “retroactively” become impaired when a creditor of a solvent debtor is denied postpetition interest. Dissent at 53. Impairment is a concept rooted in § 1124, “the plain language of [which] says that a creditor’s claim is ‘impaired’ unless its rights are left ‘unaltered’ *by the Plan*.” *L&J Anaheim*, 995 F.2d at 943 (emphasis added); *see also PPI Enters.*, 324 F.3d at 204 (“Impairment results from what the *plan* does” (quotation omitted) (emphasis in original)). Our holding “recognizes that the equitable prong of § 1124 applies differently when the debtor is solvent”—as PG&E undisputedly is in this case—by entitling claim holders to postpetition interest as an equitable right. *Ultra Petroleum*, 624 B.R. at 203. A failure by a bankruptcy plan to leave this equitable right unaltered results in impairment from the outset, unless and until a plan is amended accordingly.

dictates otherwise, and no other result coheres the Code with Congress' repeal of § 1124(3).¹⁰

3

Having concluded that the equitable solvent-debtor exception survives under the Code, we now address whether the bankruptcy court erred in holding that PG&E's plan provided plaintiffs with all the Code entitled them to as unimpaired creditors. We have little trouble concluding it did.

Once again, because PG&E designated the plaintiffs' claims as unimpaired, plaintiffs' "legal, equitable, and contractual rights" must be "unaltered" by the reorganization plan. § 1124(1). Prior to PG&E's bankruptcy filing, plaintiffs possessed a contractual right to interest on debts not paid—either at rates stipulated by their contracts or the California default rate of ten percent. *See* Cal. Civ. Code § 3289(b). But this contractual right, as applied to postpetition debts, was superseded by the Code—specifically, by § 502(b)(2)'s prohibition on the inclusion of "unmatured interest" as part of a claim. *See Ultra Petroleum*, 943 F.3d at 763.¹¹ As a result, plaintiffs' claims

¹⁰ Although we rely on the text, history, and structure of the Code to reach today's result, even the Dissent's authorities acknowledge that pre-Code practice is relevant in interpreting sections of the Code that are otherwise incoherent or inconsistent. *See, e.g., United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240–41 (1989).

¹¹ As our sibling circuits have held, an alteration of pre-bankruptcy rights that occurs by operation of the Code does not result in impairment. *Ultra Petroleum*, 943 F.3d at 763 ("The plain text of § 1124(1) requires that 'the plan' do the altering."); *PPI Enters.*, 324 F.3d at 204 ("[W]e must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights."); *see also In re Sylmar*

do not include any contractual right to postpetition interest. Moreover, plaintiffs did not have a legal right to interest on their claims, as no provision of the Code expressly provides for postpetition interest for unimpaired creditors. *Energy Future Holdings*, 540 B.R. at 123–24.

Because PG&E was solvent, however, plaintiffs’ claims *did* entail an equitable right to receive postpetition interest under the solvent-debtor exception. *See Ultra Petroleum*, 624 B.R. at 203–04; *Dow Corning*, 456 F.3d at 678 (emphasizing that “equitable considerations operate differently when the debtor is solvent”). This equitable right entitled plaintiffs to recovery of interest pursuant to their contracts, subject to any countervailing equities, before PG&E’s shareholders received surplus value. However, PG&E’s plan did not compensate plaintiffs accordingly. Rather, the plan provided for postpetition interest at the much lower federal judgment rate of 2.59 percent. Thus, PG&E’s plan—and not the Code—altered plaintiffs’ equitable right to postpetition interest under the solvent-debtor exception. *Ultra Petroleum*, 624 B.R. at 203–04; *Energy Future Holdings*, 540 B.R. at 123–24. The bankruptcy court erred in holding that plaintiffs received all that the Code entitled them to.

D

All that remains is to determine how much postpetition interest plaintiffs, as unimpaired creditors, are entitled to in this case. We reiterate that creditors of a solvent debtor—

Plaza, L.P., 314 F.3d 1070, 1075 (9th Cir. 2002) (“In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely alter creditors’ contractual and nonbankruptcy rights.” (quotation omitted)).

including plaintiffs in this case—enjoy an equitable right to contractual or state law default postpetition interest before allocation of surplus value from a bankruptcy estate. *See, e.g., Dow Corning*, 456 F.3d at 679–80 (noting that the solvent-debtor exception entails “a presumption that [contractual or state law] default interest should be paid to unsecured claim holders”). However, we are cognizant of the Supreme Court’s admonition that “exceptions to the denial of postpetition interest are not rigid,” and that “the touchstone of each decision on allowance of interest in bankruptcy has been a balance of equities between creditor and creditor or between creditors and the debtor.” *Ron Pair*, 489 U.S. at 248 (cleaned up). Accordingly, we remand to the bankruptcy court to weigh the equities and determine what rate of interest plaintiffs are entitled to in this instance.

We join our sibling circuits, however, in emphasizing that the solvent-debtor exception, though equitable in nature, does not give bankruptcy judges “free-floating discretion to redistribute rights in accordance with [their] personal views of justice and fairness.” *Dow Corning*, 456 F.3d at 679 (quoting *Chicago, Milwaukee*, 791 F.2d at 528). Rather, “absent compelling equitable considerations, when a debtor is solvent, it is the role of the bankruptcy court to enforce the creditors’ contractual rights.” *Ultra Petroleum*, 943 F.3d at 765 (quotation omitted). We are confident that in most solvent-debtor cases involving unimpaired creditors, the equitable role of the bankruptcy court will be “simply to enforce creditors’ rights according to the tenor of the contracts that created those rights.” *Chicago, Milwaukee*, 791 F.2d at 528. However, we acknowledge the possibility that cases could arise where payment of contractual or default interest could impair the ability of other similarly situated creditors to be paid in full, or where other “compelling equitable considerations” could counsel in

favor of payment of postpetition interest at a different rate. *Dow Corning*, 456 F.3d at 679; *Ultra Petroleum*, 943 F.3d at 765.

We see no sign of any “compelling equitable considerations” in this case that would defeat the presumption that plaintiffs are entitled to contractual or default postpetition interest. However, we acknowledge that the record before us is limited.¹² We therefore remand to the bankruptcy court, which is most familiar with the facts of the case and the financial conditions of the parties.

IV

For the reasons stated, we **REVERSE** the district court’s opinion affirming the bankruptcy court’s postpetition interest ruling. We **REMAND** to the district court with instructions to remand to the bankruptcy court for further proceedings consistent with this opinion.

IKUTA, Circuit Judge, dissenting:

This case raises the question whether unsecured creditors holding unimpaired claims in bankruptcy under 11 U.S.C. § 1124(b) are entitled to post-petition interest on their claims when the debtor is solvent. The text of the Code provides a clear answer: No. In order to reach the opposite result, the majority erroneously holds that pre-Code practice is binding unless the text of the Code clearly abrogates it. Maj. at 20–

¹² The record fails to disclose, for example, the extent of PG&E’s solvency post-bankruptcy, or the precise amount of postpetition interest that would be owed to plaintiffs were the contract or default state law rates enforced.

20, 27. But the Supreme Court has directed us to take the exact opposite approach: so long as the Code is clear, we do not refer to pre-Code practice. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989). Here, the text of the Code is clear and does not authorize an award of post-petition interest to unimpaired creditors. I therefore dissent.

I

The debtor in this case is Pacific Gas & Electric Company (PG&E), a California-based utility company. Between 2015 and 2018, California suffered a series of catastrophic wildfires. PG&E faced over \$30 billion in potential liability related to those wildfires, excluding punitive damages and civil penalties. Unrelated to the wildfires, PG&E also owed billions of dollars to traditional creditors. Although PG&E was solvent at the time it filed its petition in bankruptcy (its assets exceeded known liabilities by approximately \$20 billion), PG&E concluded that it lacked the resources to resolve wildfire claims that had been asserted against it (as well as future wildfire claims related to the fires between 2015 and 2018) while also continuing to provide electric and gas services, invest in wildfire-related safety practices, and service the billions of dollars in traditional debt obligations. Accordingly, on January 29, 2019, PG&E filed for Chapter 11 bankruptcy, which would allow PG&E to continue its operations while also resolving all wildfire claims. In September 2019, PG&E filed its proposed bankruptcy plan.

The appellants here are unsecured trade creditors in PG&E's bankruptcy proceedings who formed the Ad Hoc Committee of Holders of Trade Claims ("Trade Committee"). In the Chapter 11 proceedings, PG&E proposed a plan that would give the members of the Trade Committee the full cash value of their allowed claims as of

the date the petition was filed. Under 11 U.S.C. § 1124, these claims were not “impaired.” The plan also provided that the members of the Trade Committee would receive interest on their claims at the federal judgment rate accruing from the petition date through the date of distribution.

Rather than argue that the plan should designate their claims as “impaired,” the members of the Trade Committee argued that because PG&E was a solvent debtor, and the proposed plan treated their claims as unimpaired, they were entitled to post-petition interest on their claims at the rate provided for by contract or applicable state law. The bankruptcy court rejected this argument, concluding that, under *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002), unimpaired creditors in a solvent-debtor case are entitled to post-petition interest only at the federal judgment rate. The district court affirmed.

On appeal, the Trade Committee members assert that they are entitled to post-petition interest at the contract or state default rates. According to the Trade Committee, this result is compelled by the solvent-debtor exception which had been adopted and applied by bankruptcy courts before the Code was enacted. The Trade Committee asserts that we must interpret the Code in light of this pre-Code practice, and the majority adopts this reasoning.

II

A

In order to address the Trade Committee’s argument, it is crucial to understand the Supreme Court’s framework for interpreting the Code. According to the Supreme Court, in interpreting the Code, as with any other congressional enactment, “we begin with the understanding that Congress

‘says in a statute what it means and means in a statute what it says there.’” *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (quoting *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254 (1992)). Therefore, “when the statute’s language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.” *Id.* (cleaned up). “[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute.” *Ron Pair*, 489 U.S. at 240–41.

Because the statutory text takes precedence, practices adopted by bankruptcy courts before the Code was enacted play a limited role. Indeed, the Court has recognized that Congress’s intent in enacting the Code was to “codify creditors’ rights *more clearly than the case law*.” *Id.* at 248 (emphasis original) (cleaned up). Therefore, “[w]here the meaning of the Bankruptcy Code’s text is itself clear . . . its operation is unimpeded by contrary . . . prior practice.” *Hartford*, 530 U.S. at 10 (citation omitted); *see also Ron Pair*, 489 U.S. at 241 (holding that where Congress expresses its intent “with sufficient precision,” then “reference to legislative history and to pre-Code practice is hardly necessary”). The Supreme Court has relied on pre-Code practice merely to clarify ambiguities in the text of the Code, or to “fill in the details of a pre-Code concept that the Code had adopted without elaboration.” *Hartford*, 530 U.S. at 11. In other words, pre-Code practice is “a tool of construction, not an extratextual supplement,” *id.* at 10, and “there are limits to what may constitute an appropriate case” for employing that tool of construction, *Ron Pair*, 489 U.S. at 245.

B

It is important to understand how this interpretative framework works with the Code's statutory scheme. "A business may file for bankruptcy under either Chapter 7 or Chapter 11" of the Code. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 978 (2017). "In Chapter 7, a trustee liquidates the debtor's assets and distributes them to creditors." *Id.* (citing 11 U.S.C. § 701 *et seq.*). "In Chapter 11, debtor and creditors try to negotiate a plan that will govern the distribution of valuable assets from the debtor's estate and often keep the business operating as a going concern." *Id.*

In a case filed under chapter 11 of the Code, the debtor-in-possession or trustee proposes a plan of reorganization, which designates "classes of claims" and interests. The Code defines the term "claim" as a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(5). A claim is allowed in bankruptcy proceedings if the creditor files a proof of claim, and there is no objection. *Id.* § 502(a). If an objection is made, the bankruptcy court (after notice and a hearing) will allow the claim in the amount determined by the court subject to several exceptions. *Id.* § 502(b).

A key exception here is for "unmatured interest." *Id.* Section 502(b)(2) establishes that "creditors are not entitled to include un-matured or post-petition interest as part of their claims in the bankruptcy proceeding and cannot collect such interest from the bankruptcy estate." *In re Pardee*, 193 F.3d 1083, 1085 n.3 (9th Cir. 1999). In light of § 502(b)(2), there is no dispute that an allowed claim stops accruing interest as of the date the debtor files a petition in bankruptcy. *See In re Weiss*, 251 B.R. 453, 463 (Bankr. E.D. Pa. 2000). All

other circuits are in accord.¹ Because § 502(b)(2) establishes “the general rule disallowing postpetition interest,” *United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 373 (1988), it “does not simply prohibit certain creditors from filing a proof of claim for post-petition interest; it prohibits those creditors from collecting the interest from the bankruptcy estate.” *Victor*, 121 F.3d at 1387. There is no basis for the majority’s interpretation of § 502(b)(2) as prohibiting interest *as part of* an allowed claim but not prohibiting interest *on* a claim once it is allowed. Maj. at 22–23.

Once the allowed claims have been identified, the trustee must specify which classes of claims are impaired and which are unimpaired. See 11 U.S.C. § 1123(a)(2), (3). An allowed claim is unimpaired if it “leaves unaltered the legal,

¹ See *Gencarelli v. UPS Cap. Bus. Credit*, 501 F.3d 1, 6 n.2 (1st Cir. 2007) (noting that § 502(b)(2) is an “explicit statutory provision” that bars post-petition interest); *SummitBridge Nat’l Invs. III, LLC v. Faison*, 915 F.3d 288, 295 (4th Cir. 2019) (describing § 502(b)(2) as a “general rule against allowance” of post-petition interest); *Matter of Johnson*, 146 F.3d 252, 260 (5th Cir. 1998) (“Post-petition interest is disallowed against the bankruptcy estate under section 502.” (citation omitted)); *In re Kentucky Lumber Co.*, 860 F.2d 674, 676 (6th Cir. 1988) (citing § 502(b)(2) to explain the “general rule of actions in bankruptcy [] that unsecured creditors are not entitled to postpetition interest upon their allowable claims”); *Matter of Fesco Plastics Corp., Inc.*, 996 F.2d 152, 155 (7th Cir. 1993) (“[C]reditors cannot recover post-petition interest on their claims. This rule has been written into the Bankruptcy Code at 11 U.S.C. § 502(b)(2).”); *Bursch v. Beardsley & Piper, a Div. of Pettibone Corp.*, 971 F.2d 108, 114 (8th Cir. 1992) (“In general, under section 502(b), a creditor is not entitled to postpetition prejudgment interest because such interest is unmaturing at the time of filing.”); *United States v. Victor*, 121 F.3d 1383, 1387 (10th Cir. 1997) (“Section 502(b) does not simply prohibit certain creditors from filing a proof of claim for post-petition interest; it prohibits those creditors from collecting the interest from the bankruptcy estate.”).

equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.”² *Id.* § 1124(1). Reading this definition together with § 502(b)(2) and § 101(5) (defining a “claim” as a “right to payment” or a “right to an equitable remedy for breach of performance,” *id.* § 101(5)), a claim is unimpaired so long as the proposed plan gives the creditor the same legal or contractual right to payment, or right to an equitable remedy, that the creditor had as of the date the petition was filed. Such a claim would include any interest that had matured by the time the petition was filed. *See id.* § 1124(1). The statutory language provides no basis for the majority’s theory that a creditor’s “claim,” which may not include post-petition interest, *see* § 502(b), is nevertheless deemed “impaired” if the debtor turns out to be solvent and the creditor does not obtain post-petition interest at the end of the bankruptcy case. Maj. at 29–30 & n.9.

Because creditors with unimpaired claims are set to receive full payment of those claims under the plan, they are conclusively presumed to have accepted the plan. *See id.* § 1126(f). By contrast, creditors with impaired claims are entitled to vote on whether to accept or reject a plan, *see id.* § 1126(a), and the plan cannot be confirmed by consent unless each class of claims has accepted the plan, *see id.* § 1129(a)(8). If all classes of impaired claims do not accept the plan, the bankruptcy court can still approve the plan “provided the plan is fair and equitable and does not unfairly discriminate against any impaired claims, and the plan meets all the statutory requirements of § 1129(a).” *In re Barakat*,

² A claim may be unimpaired even if the holder of the claim is deprived of a contractual or legal right to demand accelerated payment under certain circumstances. 11 U.S.C. § 1124(2).

99 F.3d 1520, 1524 (9th Cir. 1996) (internal citation omitted).

Although a claim stops accruing interest at the time the petition in bankruptcy is filed, § 502(b)(2), the members of the Trade Committee argue that they are nevertheless entitled to post-petition interest under the solvent debtor exception applied in pre-Code practice. Before the Code was enacted, bankruptcy proceedings were governed by the Bankruptcy Act of 1898 (“the Bankruptcy Act”). Like § 502(b)(2) of the modern Code, § 63 of the Bankruptcy Act prohibited an award of post-petition interest to creditors. *See* Bankruptcy Act of 1898, ch. 541, § 63, 30 Stat. 544, 562–63 (repealed) (excluding “costs incurred and interests accrued after the filing of the petition” from allowed claims). However, courts recognized equitable exceptions to § 63 of the Bankruptcy Act. *See Ron Pair*, 489 U.S. at 246. One of those equitable exceptions, known as the solvent-debtor exception, “allowed postpetition interest when the debtor ultimately proved to be solvent.” *Id.*

In enacting the Code, Congress implicitly incorporated this solvent debtor exception in certain circumstances, and therefore identified exceptions to § 502(b)(2)’s “general rule disallowing postpetition interest.” *Timbers of Inwood Forest*, 484 U.S. at 373. For example, although an allowed claim in a Chapter 7 case does not include post-petition interest, *see* 11 U.S.C. § 502(b), the holder of such a claim may nevertheless receive post-petition interest as part of the distribution of property of the estate after higher priority distributions have been made, *see id.* § 726(a)(5) (providing that the fifth priority of property distribution is “in payment of interest at the legal rate from the date of the filing of the petition” on an allowed claim.). The Code also implicitly incorporated the solvent debtor exception in the “best

interest of creditors” tests set forth in § 1129(a)(7)(a)(ii).³ This section provides that, to confirm a proposed plan, creditors with unsecured *impaired* claims must accept the plan or receive property of a value “as of the effective date of the plan, that is not less than . . . such holder would so receive or retain if the debtor were liquidated under chapter 7” of the Code. *Id.* 1129(a)(7). This means that a Chapter 11 plan cannot be confirmed unless each objecting, unsecured creditor holding impaired claims receives the same post-petition interest as that creditor would have received under § 726(a)(5) if the debtor’s estate had been liquidated. *See In re Cardelucci*, 285 F.3d 1231, 1234 (9th Cir. 2002) (citing 11 U.S.C. § 726(a)(5)). This section applies only to unsecured creditors holding impaired claims.⁴ 11 U.S.C. § 1129(a)(7).

As these provisions demonstrate, “Congress knew how to draft the kind of statutory language that petitioner seeks to read into [the Code].” *State Farm Fire & Cas. Co. v. U.S. ex rel. Rigsby*, 137 S. Ct. 436, 444 (2016); *see* 11 U.S.C.

³ The best interest of creditors test is also available in a Chapter 12 or Chapter 13 bankruptcy, *see* 11 U.S.C. § 1225(a)(4) and § 1325(a)(4).

⁴ Congress specified other circumstances where post-petition interest was allowed. Congress permitted an award of contract-rate interest for creditors holding secured claims, up to the amount of the creditor’s collateral. *See* 11 U.S.C. § 506(b). Undersecured creditors are not entitled to post-petition interest. *Timbers of Inwood Forest*, 484 U.S. at 373. In a Chapter 13 bankruptcy, Congress also allowed for post-petition interest on nondischargeable debts “to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims,” 11 U.S.C. § 1322(b)(10). Nondischargeable debts are specified in 11 U.S.C. § 523 and include tax debts, *id.* § 523(a)(1), debts for money procured through fraud, *id.* § 523(a)(2), and restitution payments under Title 18, *id.* § 523(a)(13).

§§ 506(b), 726(a)(5), 1127(a)(7), 1322(b)(10). But despite incorporating exceptions to the general rule disallowing post-petition interest into these specific sections, Congress chose not to make a similar exception authorizing an award of post-petition interest to unsecured creditors holding unimpaired claims, regardless of whether the debtor ends up solvent. As a general rule, “[w]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.” *Hillman v. Maretta*, 569 U.S. 483, 496 (2013) (citation omitted). This canon of construction has even greater weight in the bankruptcy context, where the Supreme Court has warned us not “to inquire beyond the plain language of the statute,” *Ron Pair*, 489 U.S. at 241, where Congress’s “statutory scheme is coherent and consistent,” *id.* at 240. Accordingly, we should conclude that unsecured creditors holding unimpaired claims are governed by “the general rule disallowing postpetition interest,” even in a solvent debtor case. *Timbers of Inwood Forest*, 484 U.S. at 373.

Therefore, because the members of the Trade Committee hold unsecured claims classified as unimpaired, I would hold that they are not entitled to post-petition interest, despite PG&E’s solvency.

III

Notwithstanding the absence of any provision entitling an unimpaired creditor to post-petition interest, as the majority itself recognizes, *see* Maj. at 24, the majority nevertheless decides that unimpaired creditors are entitled to post-petition interest—even though Congress chose not to make an exception for such creditors. All of the majority’s justifications for this addition are flawed.

A

The majority's central rationale is that unimpaired creditors are entitled to the post-petition interest they would have received under pre-Code practice because Congress did not expressly abrogate such practice. Maj. at 21–22. The majority's argument proceeds in several steps. First, it claims (contrary to the Supreme Court's direction) that there is a presumption that the Code incorporates pre-Code practice unless the Code contains a clear indication that Congress intended to abrogate that practice. *See* Maj. at 20–23 (citing *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998)). Under pre-Code practice, courts awarded post-petition interest to unimpaired creditors, even though § 63 of the Bankruptcy Act precluded the accrual of interest on a claim once the petition in bankruptcy has been filed. Because Congress did not expressly state that bankruptcy courts must stop awarding post-petition interest to unimpaired creditors, and § 502(b)(2) is just a recodification of § 63, the majority infers that courts can continue to award post-petition interest to unimpaired creditors notwithstanding § 502(b)(2). Maj. at 20–27.

This reasoning fails because the majority's underlying principle—that pre-Code practice applies unless Congress clearly abrogated it—is wrong. As explained above, courts must start with the language of the Code and rely on pre-Code practice only as “a tool of construction, not an extratextual supplement,” *Hartford*, 530 U.S. at 10. “[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute,” including by looking to pre-Code practice. *Ron Pair*, 489 U.S. at 240–41. Moreover, because “the [pre-Code] exceptions to the denial of postpetition interest are not rigid doctrinal categories” but are instead

“flexible guidelines” that were “developed by the courts in the exercise of their equitable powers,” there is “no reason to think that Congress, in enacting a contrary standard, would have felt the need expressly to repudiate it.” *Id.* at 248 (cleaned up).

The majority bases its erroneous rule of interpretation on statements taken out of context from Supreme Court decisions. In its central statement of this “rule,” the majority cites *Cohen v de la Cruz* for the proposition that the Supreme Court “will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.” Maj. at 20 (citing 523 U.S. at 221). But in context, *Cohen* faithfully followed the Supreme Court’s textualist approach to the Code. *Cohen* construed 11 U.S.C. § 523(a)(2)(A), which makes nondischargeable “any debt . . . for money . . . to the extent obtained by . . . actual fraud.” 523 U.S. at 214–15. *Cohen* held that the statutory language encompassed an award against the debtor of treble damages, attorneys’ fees, and costs due to the debtor’s fraudulent conduct. *Id.* at 219. In so holding, *Cohen* first performed a thorough textual analysis, *see id.* at 217–21, and concluded that, “[w]hen construed in the context of the statute as a whole . . . § 523(a)(2)(A) is best read to prohibit the discharge of any liability arising from a debtor’s fraudulent acquisition of money, property, etc., including an award of treble damages for the fraud,” *id.* at 220–21. Only after an in-depth analysis of the statutory text did the Court turn to pre-Code practice for confirmation of its interpretation, stating that “[t]he history of the fraud exception *reinforces* our reading of § 523(a)(2)(A).” *Id.* at 221 (emphasis added). Because the statutory language in § 523(a)(2)(A) was substantially the same as the language in the Bankruptcy Act, the Court stated that it would not “read the Bankruptcy Code to erode past

bankruptcy practice absent a clear indication that Congress intended such a departure, and the change to the language of § 523(a)(2)(A) in 1984 in no way signals an intention to narrow the established scope of the fraud exception along the lines suggested by petitioner.” *Id.* at 220–21 (cleaned up). In other words, the Court confirmed its interpretation of statutory language by reference to pre-Code interpretation of substantially the same statutory language. This by no means gives courts carte blanche to give creditors rights unsupported by (and inconsistent with) the Code.⁵

Once the majority’s erroneous approach is eliminated, there is no support for the majority’s conclusion. The majority’s boon to unimpaired creditors neither interprets an ambiguous phrase nor “fill[s] in the details of a pre-Code concept that the Code had adopted without elaboration,” *Hartford*, 530 U.S. at 11. Instead, the majority overrides the scheme set forth in the Code, which does *not* allow for an award of post-petition interest to unimpaired creditors but rather adopted a different scheme that incorporated the solvent debtor exception in limited circumstances, *see* 11 U.S.C. §§ 506(b), 726(a), 1129(a)(7)(A)(ii), 1322(b)(10). In short, the majority is using pre-Code practice as an “extratextual supplement” in violation of Supreme Court directions, *Hartford*, 530 U.S. at 10, and therefore exceeds

⁵ The majority’s reliance on *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494 (1986), and *BFP v. Resolution Trust Corporation*, 511 U.S. 531 (1994), is equally flawed. *BFP* relied on pre-Code practice merely to clarify the meaning of an ambiguous phrase, *see* 511 U.S. at 543, 546–47, and *Midlantic* relied on pre-Code practice to “fill in the details” of the “codification of trustee’s abandonment power” that “the Code had adopted without elaboration,” *Hartford*, 530 U.S. at 11.

the “limits to what may constitute an appropriate case” for relying on pre-Code practice, *Ron Pair*, 489 U.S. at 245.

Contrary to the majority, its ruling is not supported by our sister circuits. Maj. at 27. None of the cases the majority cites awarded post-petition interest to *unimpaired* creditors pursuant to the solvent-debtor exception. For example, the Sixth Circuit held that *impaired* creditors in a solvent debtor case are generally entitled to post-petition interest at the contract rate pursuant to 11 U.S.C. § 1129(b). *See In re Dow Corning Corp.*, 456 F.3d 668, 677–80 (6th Cir. 2006). The Sixth Circuit did not address unimpaired claims. The First Circuit held that a creditor could be entitled to bargained-for prepayment penalties because the debtor was solvent, *see Gencarelli v. UPS Cap. Bus. Credit*, 501 F.3d 1, 6 (1st Cir. 2007), but did not address post-petition interest, let alone whether such interest applies to unimpaired claims in a solvent debtor case. To the contrary, the First Circuit noted that cases addressing post-petition interest were “inapposite” because, unlike the prepayment penalties at issue in the case, post-petition interest is barred by “an explicit statutory provision.” *Id.* at 6 n.2 (citing 11 U.S.C. § 502(b)(2)). Finally, although the Fifth Circuit stated in dicta that it discerned “no reason why the solvent-debtor exception could not apply” to unimpaired claims, *In re Ultra Petroleum Corp.*, 943 F.3d 758, 765 (5th Cir. 2019), this dicta lacks persuasive force, since the Fifth Circuit relied on *In re Dow*, which did not address unimpaired claims, *see* 456 F.3d at 677–80, and *In re Chicago, Milwaukee, St. Paul and Pac. R.R. Co.*, 791 F.2d 524, 528 (7th Cir. 1986), which

was decided pursuant to the Bankruptcy Act, not the Code, *see id.* at 525–26.⁶

B

The majority also attempts to justify its decision that unimpaired creditors are entitled to post-petition interest based on legislative history. Even though “no Code provision legally entitles unimpaired creditors to postpetition interest,” Maj. at 25, the majority claims that “Congress has foreclosed the possibility that unimpaired creditors need not receive postpetition interest.” Maj. at 24.

This bold statement is based on a 1994 amendment to the Code, deleting § 1124(3), which had stated that a claim was unimpaired if the proposed plan in a Chapter 11 bankruptcy provided the holder of such a claim “cash equal to . . . the allowed amount of such claim.” 11 U.S.C. § 1124(3) (1993). A report of the House Judiciary Committee indicated that this amendment was intended to overrule a bankruptcy court decision, *In re New Valley Corp.*, 168 B.R. 73, 79 (1994), which ruled that unimpaired creditors were not entitled to post-petition interest when the debtor was solvent. In reaching this conclusion, *In re New Valley Corp.* relied on several sections of the Code, including § 1129(a)(7)(A) (applying the “best interest of creditors” test to impaired claims), § 502(b)(2) (providing that an allowed claim does not include unmatured interest); and § 1124(3) (providing that a claim that is paid in full is not impaired). *Id.* The report of the House Judiciary Committee explained that its

⁶ Another case relied on by the majority, *Debentureholders Protective Comm. of Cont'l Inv. Corp. v. Cont'l Inv. Corp.*, 679 F.2d 264, 265 (1st Cir. 1982), was also decided pursuant to the Bankruptcy Act, not the Code, *see id.*

deletion of § 1124(3) would establish that creditors who are paid in full could still be “impaired,” and therefore entitled to post-petition interest under § 1129(a)(7) in a solvent debtor case. H.R. Rep. No. 103-835, § 214 at 48 (1994).⁷ But according to the report, the deletion of § 1124(3) would not affect § 1129(a)(7) of the Code, “which excluded from application of the best interests of creditors test classes that are unimpaired under section 1124.” *Id.* The 1994 amendments did not delete or amend § 1129(a)(7)(a) or § 502(b)(2) in any relevant way, nor amend the Code to establish that an unimpaired creditor was entitled to post-petition interest.

The deletion of § 1124(3) and the House Judiciary Committee report provide no support for the majority’s attempt to benefit unimpaired creditors. First, any reliance on legislative history is unwarranted where, as here, the Code’s language is unambiguous.⁸ *See Toibb v. Radloff*,

⁷ Specifically, according to the report, with this deletion “if a plan proposed to pay a class of claims in cash in the full allowed amount of the claims, the class would be impaired, entitling creditors to vote for or against the plan of reorganization,” which would protect dissenting creditors by requiring compliance with the “best interests of creditors” test under § 1129(a)(7) of the Bankruptcy Code. H.R. Rep. No. 103-835, § 214 at 48.

⁸ The majority confuses legislative history with legislation by referring to statements in this House Judiciary Committee report as “Congress’ clear instruction on this matter,” Maj. at 28, and as Congress’s “express[]” statement that it intended to prevent the “unfair result” in *New Valley*. Maj. at 28. But “the best evidence” of Congress’s instruction on a matter “is the statutory text adopted by both Houses of Congress and submitted to the President.” *W. Virginia Univ. Hosps., Inc. v. Casey*, 499 U.S. 83, 98–99 (1991). “[W]here, as here, the statute’s language is plain, the sole function of the courts is to enforce it according to its terms,” and “reference to legislative history and to pre-Code

501 U.S. 157, 162 (1991). Second, even if the report merited consideration, it provides no support for the majority's rule that unimpaired creditors are entitled to post-petition interest. As indicated above, the report stated that the deletion of § 1124(3) was intended to expand the definition of impaired claims, so more creditors would be deemed to be holding impaired claims, and thus be entitled to post-petition interest under one of the established "best interests of creditors" tests. *See* H.R. Rep. No. 103-835, § 214 at 48. But the report also makes clear that unimpaired creditors would still be deprived of post-petition interest. *See id.* Therefore, the report would not help creditors with unimpaired claims, because such claims (which cannot include postpetition interest, *see* § 502(b)) are not automatically transformed into impaired claims merely because a court determines that the creditor is entitled to post-petition interest in addition to the claim. *See infra* at Section III.C. Finally, the report fails on its own terms, because it does not accurately describe the effect of the deletion of § 1124(3). Although Congress eliminated the section defining a claim as unimpaired if the creditor obtains the full amount of the claim, this deletion did not provide any guidance for differentiating impaired from unimpaired claims, expressly state that claims such as the ones held by members of the Trade Committee should be classified as impaired, or alter the Code's "general rule disallowing postpetition interest." *Timbers of Inwood Forest*, 484 U.S. at 373.

practice is hardly necessary." *Ron Pair Enterprises, Inc.*, 489 U.S. at 241.

C

The majority makes the related contention that § 1124(1), which states that a claim is impaired unless the plan “leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest,” requires holding that an unsecured claim must be classified as impaired in a solvent debtor case unless the creditor obtains post-petition interest. The majority reasons that the term “equitable . . . rights” in § 1124(1) includes the right to post-petition interest under the solvent debtor exception, and “[a] failure to provide for postpetition interest according to this equitable right as part of a bankruptcy plan results in impairment.” Maj. at 30.

This argument fails for multiple reasons.⁹ First, § 1124(1) explains when a “class of claims or interests” is impaired. Because a claim cannot include post-petition interest, *see* § 502(b)(2), the failure of a plan to provide for payment of post-petition interest cannot impair the claim itself. The majority argues that even if a claim does not include post-petition interest, a claim can *entitle* its holder to such interest. Maj. at 29–30 n.9. But this ignores the language of § 1124(1), which explains only when a *claim* is impaired. The statute does not describe when a *holder’s* equitable rights are impaired, nor is there any basis for concluding that a holder’s loss of some equitable right under pre-Code practice would impair the holder’s *claim*. Moreover, because the Code establishes that an allowed claim does *not* include post-petition interest, *see* § 502(b)(2), it is not plausible to read § 1124(1), as the majority does, as

⁹ As a threshold matter, the argument fails because the members of the Trade Committee did not distinctly argue to the bankruptcy court that their claims were impaired, and such an argument is therefore forfeited.

contemplating that a claim *must* include post-petition interest (when the debtor is solvent), or it would be impaired.

Second, the majority misinterprets the term “equitable . . . rights” in § 1124(1). By its terms, § 1124(1) focuses on the creditor’s claim, and the scope of the rights included in that claim. Congress defined “claim” broadly to include any “right to payment” and any “right to an equitable remedy for breach of performance if such breach gives rise to a right to payment.” § 101(5).¹⁰ Therefore, a creditor’s claim includes equitable rights such as restitution, quantum meruit, or other equitable remedy to which the creditor has a right at the time of filing.¹¹ If the plan fails to provide for payment of any of these rights, then under § 1124(1), that claim is impaired. This is the only plausible reading of the term “equitable rights” in § 1124(1), because it gives effect to the statute’s purpose of explaining when a claim is impaired due to the failure to pay the full amount of the allowed claim as of the date of the petition in bankruptcy. By contrast, interpreting the term “equitable rights” in § 1124(1) as authorizing a bankruptcy court to provide creditors with an equitable benefit beyond the amount of the allowed claim makes no sense, because a court’s failure to provide such a

¹⁰ Indeed, in enacting § 101(5), Congress intended to “adopt the broadest available definition of ‘claim,’” including any “enforceable obligation,” be it legal or equitable. *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991); *see also In re Davis*, 778 F.3d 809, 813 (9th Cir. 2015) (explaining that the language of § 101(5) “permits the broadest possible relief in the bankruptcy court”) (quoting H.R. Rep. 95-595, 309 (1978)).

¹¹ The majority argues that reading § 1124(1) as referring only to equitable rights that are part of the allowed claim is “novel” and based on a “faulty premise.” Maj. at 29–30 n.9. To the contrary, it is based on the plain language of § 1124(1), and the definition of “claim” in § 101(5).

benefit could not “impair” the allowed claim itself. Moreover, interpreting § 1124(1) as authorizing courts to provide creditors with extra-textual equitable benefits would be contrary to the Supreme Court’s rulings that bankruptcy courts may not use equitable powers to provide benefits not permitted by the Code. *See Law v. Siegel*, 571 U.S. 415, 421–22 (2014) (holding that a bankruptcy court cannot make additional funds available to defray administrative expenses by imposing an “equitable surcharge” on a debtor’s homestead exemption). “[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.” *Id.* at 421 (citations omitted).

Finally, the majority’s holding that a “failure to provide for postpetition interest according to this equitable right as part of a bankruptcy plan results in impairment,” Maj. at 30, means that an unimpaired claim automatically and retroactively becomes an impaired claim if the creditor is not awarded postpetition interest in a solvent debtor case. But such an unprecedented backwards-looking impact has no basis in the Code. “[T]he amount and priority of an unsecured creditor’s claim is fixed on the date of the filing of the petition.” *In re LCO Enterprises*, 12 F.3d 938, 941 (9th Cir. 1993). Obligations accruing *after* the petition is filed are not part of a claim, and so a debtor’s failure to fulfill those obligations does not result in impairment. Even where post-petition interest is available, it is inherently an obligation that accrues *after* the petition for bankruptcy is filed. *See In re Pardee*, 193 F.3d at 1085 n.3; *see also Bursch v. Beardsley & Piper, a Div. of Pettibone Corp.*, 971 F.2d 108, 114 (8th Cir. 1992) (explaining that post-petition interest “is unmaturing at the time of filing”). Indeed, as § 726(a)(5) indicates, the solvency of the debtor may be unknown until the property of the estate is being

distributed.¹² Therefore, regardless whether a creditor is entitled to post-petition interest *in addition to* the amount of its claim under a solvent debtor exception, a creditor's failure to obtain post-petition interest does not affect a claim's designation as impaired or unimpaired, nor does it retroactively make an unimpaired claim "impaired."

D

Finally, the majority makes the policy argument that prohibiting unimpaired claimants from receiving post-petition interest (or limiting their post-petition interest to the same rate as impaired creditors) is inconsistent with "the Code's structure," Maj. at 26, because unimpaired creditors should not be treated worse than impaired creditors. But "the pros and cons of [treating different classes of creditors differently] are for the consideration of Congress, not the courts." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 649 (2012). "[I]t is not for the courts to alter the balance struck by the statute," *Siegel*, 571 U.S. at 427, especially after Congress "worked on the formulation of the Code for nearly a decade," *Ron Pair*, 489 U.S. at 240,

¹² The solvency of a debtor may not be known at the time the petition is filed. *See, e.g., In re Kentucky Lumber Co.*, 860 F.2d 674, 675 (6th Cir. 1988) (describing a debtor that was "clearly perceived as insolvent on the date of confirmation of the plan" but "subsequently achieved a large and unexpected structured settlement" rendering the debtor solvent). Accordingly, the majority's statement that "[a] failure by a bankruptcy plan to leave this equitable right unaltered results in impairment *from the outset*, unless and until a plan is amended accordingly," Maj. at 29–30 n.9 (emphasis added), indicates that either *every* plan must include the statement that all unimpaired creditors are entitled to post-petition interest if the debtor turns out solvent, or that by force of law, the failure to distribute post-petition interest at the end of the bankruptcy case causes a nunc pro tunc transformation of a claim to the status of impairment "from the outset."

and “standardize[d] an expansive (and sometimes unruly) area of law,” *RadLAX*, 566 U.S. at 649. Rather, “the sole function of the courts is to enforce [the Code’s plain language] according to its terms,” *Ron Pair*, 489 U.S. at 241 (citation omitted), even if that “may produce inequitable results for trustees and creditors,” *Siegel*, 571 U.S. at 426. Moreover, even if policy considerations were relevant, Congress could have chosen to give impaired creditors greater protections than unimpaired creditors, because impaired creditors (such as classes of wildfire victims here) may not receive payment of their claims in full. Thus, “depriving [unimpaired creditors] of the statutory protections that impaired creditors enjoy” does not “end-run th[e] statutory rights” of unimpaired creditors. Maj. at 26. To the contrary, it enforces the Code’s express terms, and it is the majority that allows unimpaired creditors to end-run Congress’s prohibition on post-petition interest.

* * *

Because I would follow the Supreme Court’s direction, and leave it to Congress to decide whether creditors holding claims that are fully paid under a plan of reorganization are entitled to post-petition interest when the debtor is solvent, I respectfully dissent.

In re AMR Corp., 730 F.3d 88 (2013)

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730 F.3d 88

United States Court of Appeals,
Second Circuit.

In re AMR CORPORATION et al., Debtors,
U.S. Bank Trust National Association, as Trustee and
Security Agent under the Indenture and Aircraft Security
Agreement for American Airlines 2009–2 Senior Secured
Notes Due 2016, as Loan Trustee and Pass Through
Trustee under those certain Indenture and Security
Agreements with respect to the AMR 2009–1 EETC
and AMR 2011–2 EETC Transactions, Appellant,
v.

AMR Corporation, American Airlines, Inc., Appellees.

Docket Nos. 13–1204–cv, 13–1207–cv, 13–1208–cv.

Argued: June 20, 2013.

Decided: Sept. 12, 2013.

Synopsis

Background: Chapter 11 debtors moved for leave to obtain postpetition financing and utilize proceeds to pay indentures, and lender objected that any such payment had to include the “make whole” payment to which lender was contractually entitled upon prepayment of debtors' obligations. The United States Bankruptcy Court for the Southern District of New York, [Lane, J., 485 B.R. 279](#), granted debtor's motion and denied lender's motion to lift the automatic stay. The Bankruptcy Court granted lender's motion for certification for direct appeal. Lender petitioned Court of Appeals to allow direct appeal and the Court granted that motion. Lender appealed.

Holdings: The Court of Appeals, [Debra Ann Livingston](#), Circuit Judge, held that:

[1] voluntary petition for bankruptcy was event of default under provision of indentures;

[2] voluntary filing of bankruptcy petition triggered automatic acceleration of debt under indentures;

[3] “make whole” payment to which lender was entitled under indentures if debtors prepaid their obligations was inapplicable to debtors' proposed use of proceeds of postpetition financing to pay obligations that had been automatically accelerated by their bankruptcy filing;

[4] refusal to enforce automatic acceleration provision in indenture agreement with make-whole payment was not warranted in equity or under New York law;

[5] lender's rescission of acceleration under indentures, or waiver of events of default, was barred by automatic stay;

[6] debtors' payoff of indentures did not trigger their obligation for “make whole” payment to lender;

[7] clause in indentures providing that borrowers' bankruptcy filing would be event of default, that would serve to automatically accelerate borrowers' obligations, was not invalid ipso facto clause; and

[8] debtors were not required to cure their default or pay off automatically accelerated debt triggered by bankruptcy filing to obtain protection of automatic stay.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (21)

[1] **Bankruptcy** ➡ [Conclusions of law; de novo review](#)

The Court of Appeals reviews the legal conclusions of the bankruptcy court de novo.

[1 Cases that cite this headnote](#)

[2] **Bankruptcy** ➡ [Discretion](#)

Review of a bankruptcy court's denial of relief from the automatic stay is for abuse of discretion.

[11 U.S.C.A. § 362](#).

[8 Cases that cite this headnote](#)

[3] **Contracts** ➡ [Construction as a whole](#)

A court applying New York law construes a contract so as to give full meaning and effect to all of its provisions.

[17 Cases that cite this headnote](#)

[4] **Contracts** ➡ [Ambiguity in general](#)

Under New York law, whether a contract is ambiguous is a question of law for a court to resolve.

[12 Cases that cite this headnote](#)

[5] **Corporations and Business Organizations** ➡ [Construction, operation, and effect in general](#)

Voluntary petition for bankruptcy was event of default under New York law under provision of indentures, where provision expressly defined filing of “voluntary petition in bankruptcy or a voluntary petition or an answer seeking reorganization, liquidation or other relief as a debtor in a case under any bankruptcy laws or insolvency laws” as event of default.

[1 Cases that cite this headnote](#)

[6] **Corporations and Business Organizations** ➡ [Construction, operation, and effect in general](#)

Voluntary filing of bankruptcy petition triggered automatic acceleration of debt under indenture agreement, where agreement provided that such filing was event of default and provided that if event of default ... “shall have occurred and be continuing, then and in every such case the unpaid principal amount of the equipment notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (but for the avoidance of doubt, without make-whole amount), shall immediately and without further act become due and payable without presentment, demand, protest or notice, all of which are hereby waived.”

[2 Cases that cite this headnote](#)

[7] **Contracts** ➡ [General and specific words and clauses](#)

Under New York law, a specific contractual provision governs the circumstance to which it is directed, even in the face of a more general provision.

[9 Cases that cite this headnote](#)

[8] **Corporations and Business Organizations** ➡ [Construction, operation, and effect in general](#)

“Make whole” payment to which lender was entitled under indenture agreement if Chapter 11 debtor-borrowers prepaid their obligations was inapplicable to debtors' proposed use of proceeds of postpetition financing to pay obligations that had been automatically accelerated by their bankruptcy filing, where agreement provided that voluntary filing of bankruptcy petition was event of default and also explicitly provided that “[n]o Make-Whole Amount shall be payable as a consequence of or in connection with an Event of Default or the acceleration of the Equipment Notes.”

[3 Cases that cite this headnote](#)

[9] **Bankruptcy** ➡ [Equitable powers and principles](#)
Bankruptcy ➡ [Debtor's Contracts and Leases](#)
Corporations and Business Organizations ➡ [Rights and Remedies of Holders](#)

Refusal to enforce automatic acceleration provision in indenture agreement with make-whole payment was not warranted in equity or under New York law, where provision was not solely for benefit of one party, but simultaneously afforded potential benefits to both by accelerating outstanding principal and any applicable interest payments presently due for purpose of noteholders' claims against debtor in bankruptcy and it excluded any make-whole

amount from debtor's obligations, to debtor's benefit.

[4 Cases that cite this headnote](#)

[10] [Commercial Paper](#) ➡ [Acceleration](#)

Under New York law, acceleration is a remedy that affirmatively must be chosen by lenders and cannot be invoked by borrowers.

[11] [Commercial Paper](#) ➡ [Provisions as to Payment or Default](#)

Under New York law, the parties to a loan agreement are free to include provisions directing what will happen in the event of default of the debt, supplying specific terms that supersede other provisions in the contract if those events occur.

[1 Cases that cite this headnote](#)

[12] [Bankruptcy](#) ➡ [Notice to creditors; commencement](#)

[Bankruptcy](#) ➡ [Proceedings, Acts, or Persons Affected](#)

[Bankruptcy](#) ➡ [Rights under contracts](#)

[Bankruptcy](#) ➡ [Aircraft equipment and vessels](#)

Lender's rescission of acceleration under indenture agreement, or waiver of events of default, to prevent debtor from repaying its accelerated debt without make-whole amount as provided by agreement, was attempt to modify contract rights that were property of bankruptcy estate, and therefore was barred by automatic stay that went into effect when debtor made its elections to perform its obligations.  [11 U.S.C.A. §§ 541\(a\)\(1\), 1110](#).

[5 Cases that cite this headnote](#)

[13] [Bankruptcy](#) ➡ [Debtor's Contracts and Leases Corporations and Business Organizations](#) ➡ [Construction, operation, and effect in general](#)

Chapter 11 debtors' payoff of indentures, after their obligations thereunder had been accelerated automatically as result of their bankruptcy filing, was in nature of post-maturity-date repayment, rather than of prepayment, and did not, by express terms of indentures, trigger their obligation for "make whole" payment to lender, notwithstanding voluntary nature of repayment; indentures did not distinguish between "voluntary" or "involuntary" payments, but between amounts due in connection with redemption of debtors' notes and amounts due in connection with acceleration.

[1 Cases that cite this headnote](#)

[14] [Commercial Paper](#) ➡ [Acceleration](#)

Under New York law, acceleration of a debt changes the date of maturity from some point in the future to an earlier date based on the debtor's default under the contract.

[3 Cases that cite this headnote](#)

[15] [Bankruptcy](#) ➡ ["Ipso facto" clauses](#)

Clause in indentures providing that borrowers' bankruptcy filing would be event of default, that would serve to automatically accelerate borrowers' obligations, was not invalid ipso facto clause, which was clause in contract or lease that modified relationship of contracting parties due to filing of bankruptcy petition, where parties acknowledged that indentures were not executory contracts.  [11 U.S.C.A. § 365\(e\)\(1\)](#).

[3 Cases that cite this headnote](#)

[16] [Bankruptcy](#) ➡ [Property and claims subject to stay](#)

[Bankruptcy](#) ➡ [Aircraft equipment and vessels](#)

[Corporations and Business Organizations](#) ➡ [Rights and Remedies of Holders](#)

Chapter 11 debtors' elections, in order to enjoy protections of automatic stay as to aircraft that secured their obligations to lender for more

than 60 days after petition date, to cure their monetary defaults and maintain their payments to lender, was not prepayment, but post-maturity-date repayment, and thus did not trigger lender's right to "make whole" payment. [11 U.S.C.A. § 1110\(a\)\(2\)](#).

[17] [Bankruptcy](#) ➡ [Property and claims subject to stay](#)

[Bankruptcy](#) ➡ [Aircraft equipment and vessels](#)

The provision regarding protections of the automatic stay as to equipment that secures an obligation to a lender for more than 60 days after petition date does not modify the parties' contractual relationship or commit the debtor to an assumption of any such modified relationship, but simply provides a mechanism by which a debtor can gain the protection of the automatic stay notwithstanding the provision governing the rights of secured parties with security interests in equipment; a debtor's elections, for the period it complies with them, merely establish an interim arrangement in bankruptcy pursuant to which it is entitled to the benefit of the automatic stay.

🚩 [11 U.S.C.A. §§ 362, 1110\(a\)\(1, 2\)](#).

[1 Cases that cite this headnote](#)

[18] [Bankruptcy](#) ➡ [Property and claims subject to stay](#)

[Bankruptcy](#) ➡ [Aircraft equipment and vessels](#)

Chapter 11 debtors were not required to cure their default or pay off automatically accelerated debt triggered by bankruptcy filing to obtain protection of automatic stay as to aircraft that secured their obligations to lender for more than 60 days after petition date. 🚩 [11 U.S.C.A. §§ 365\(b\)\(2\), 1110\(a\)\(2\)](#).

[2 Cases that cite this headnote](#)

[19] [Bankruptcy](#) ➡ [Curing defaults; adequate assurance](#)

Statute creating exception to requirement of curing defaults prior to assumption and assignment of executory contract if default is breach of provision relating to satisfaction of penalty rate or provision relating to default arising from debtor's failure to perform nonmonetary obligations concerns itself, broadly, with contract provisions that force debtors into default merely for becoming insolvent or seeking bankruptcy protection or that impose penalties for defaults which are often a product of the debtor's very financial distress.

🚩 [11 U.S.C.A. § 365\(b\)\(2\)](#).

[20] [Bankruptcy](#) ➡ [Particular Cases](#)

Bankruptcy court did not abuse its discretion by not lifting automatic stay, where lifting stay would have served only to increase size of one creditor's claim to amount greater than that to which it was entitled to harm of estate and debtor's other creditors. 🚩 [11 U.S.C.A. § 362](#).

[4 Cases that cite this headnote](#)

[21] [Bankruptcy](#) ➡ [Automatic Stay](#)

One of the principal purposes of the automatic stay is to preserve the property of the debtor's estate for the benefit of all the creditors. 🚩 [11 U.S.C.A. § 362](#).

[3 Cases that cite this headnote](#)

Attorneys and Law Firms

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In re AMR Corp., 730 F.3d 88 (2013)

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New York, NY; [Ira H. Goldman](#), [Kathleen M. LaManna](#), Shipman & Goodwin LLP, Hartford CT, on the brief) for Appellant U.S. Bank Trust National Association, as Loan Trustee and Pass Through Trustee under those certain Indenture and Security Agreements with respect to the AMR 2009–1 EETC and AMR 2011–2 EETC Transactions.

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Before: [LIVINGSTON](#), [LYNCH](#), and [LOHIER](#), Circuit Judges.

Opinion

[DEBRA ANN LIVINGSTON](#), Circuit Judge:

This case requires us to address two questions of law important to the workings of the Bankruptcy Code: (1) whether indenture clauses declaring a debtor's default upon the filing of a voluntary bankruptcy petition and providing for automatic debt acceleration are unenforceable *ipso facto* provisions¹ under  *92 § 365(e)(1) of the Bankruptcy Code,  11 U.S.C. § 365(e)(1), or other Code provisions cited by U.S. Bank; and (2) the requirements and consequences of an [11 U.S.C. § 1110\(a\)](#) election when the only outstanding default is an *ipso facto* default that triggered automatic acceleration of the debt.

Appellant U.S. Bank National Trust Association (“U.S. Bank”) appeals from an order entered February 1, 2013 and two judgments entered February 11, 2013 by the United States Bankruptcy Court for the Southern District of New York (“USBC–SDNY”) (Lane, *B.J.*), which: (1) authorized AMR Corporation and American Airlines, Inc. (collectively “American” or “Debtors”) to obtain postpetition financing; (2) authorized American to repay certain prepetition notes held by U.S. Bank and secured by aircraft; and (3) denied U.S. Bank's request to lift the automatic stay. On February 28, 2013, the bankruptcy court granted U.S. Bank's motion for direct appeal to our Court in light of the public importance of the matter and the lack of controlling Second Circuit law in relation to questions it presents; we granted U.S. Bank's petition for direct appeal on April 2, 2013.

We determine that: (1) per the language of the notes' Indenture Agreements (the “Indentures”), American's voluntary petition for bankruptcy triggered a default that accelerated the debt

but required no Make–Whole Amount payment in connection with debt repayment; (2) the pertinent clauses, contained in nonexecutory contracts, are not within the scope of  11 U.S.C. § 365(e)(1) and are not rendered unenforceable by any other Bankruptcy Code provision identified by U.S. Bank; (3) American complied with its [§ 1110\(a\)](#) elections to perform its obligations under the Indentures and cure any non-exempt defaults by making regularly scheduled principal and interest payments, and it was not required to cure its bankruptcy default; and (4) the bankruptcy court did not err in denying U.S. Bank's motion to lift the automatic stay. Accordingly, we affirm the relevant order and judgments of the bankruptcy court.

BACKGROUND

AMR Corporation, parent company to American Airlines, Inc., is an airline company with nearly 900 aircraft in operation serving customers in the United States and throughout the world. American commenced a voluntary bankruptcy on November 29, 2011, which is ongoing. This case concerns the impact of American's bankruptcy filing on certain notes held by U.S. Bank and secured by aircraft that American continues to operate as debtor-in-possession.

I.

In order to finance a number of its aircraft, American entered into three separate transactions with U.S. Bank in 2009 and 2011. These transactions include the 2009–2 Secured Notes Financing (“2009–2 Note”) issued by American in July 2009 and secured by a certain group of aircraft,² and two enhanced equipment trust certificate (“EETC”) financings, issued by American in July 2009 (“2009–1 EETC”) and October 2011 (“2011–2 EETC”), respectively, and secured by certain other *93 groups of aircraft.³ The 2009–2 Note has a maturity date of August 1, 2016; the 2009–1 EETC has a maturity date of July 2, 2019; and the 2011–2 EETC has a maturity date of October 15, 2021.

Each financing transaction includes an Indenture and Security Agreement made between American Airlines, Inc. and U.S. Bank in its capacity as Loan Trustee.⁴ The Indentures authorize the issuance of the Notes and assign rights to the aircraft as collateral for American's obligations. The Indentures provide for regularly scheduled principal

and interest payments until maturity; such payments are distributed according to a schedule in Section 3.01, “Basic Distributions.” However, the Indentures also provide for alternate payment distributions to the extent that certain delineated contingencies occur. Accordingly, the Indentures indicate in Section 3.01, “[e]xcept as otherwise provided in Section 3.02, Section 3.03 and Section 3.04, each periodic payment by the Company of regularly scheduled installments of principal or interest on the Equipment Notes received by the Loan Trustee shall be promptly distributed in the following order of priority.” J.A. 132.

Section 3.02 outlines the payment distribution when an Event of Loss (which triggers a mandatory redemption)⁵ or a voluntary redemption occurs, “[e]xcept as otherwise provided in Sections 3.03 and 3.04.”⁶ J.A. 133. Section 3.02 specifically references Sections 2.10 and 2.11, which respectively define mandatory⁷ and voluntary⁸ redemption. In the event of a voluntary redemption *but not* in the event of a mandatory redemption, a Make-Whole Amount may be required. The “Make-Whole Amount,” due if the airline voluntarily redeems the notes prior to the maturity date, is the present value of the remaining scheduled payments of principal and interest to maturity using a discount rate linked to the Treasury Yield.

Section 3.03 outlines payments to be made “after both an Event of Default shall have occurred and be continuing *and* the Equipment Notes shall have become due and payable pursuant to Section 4.02(a).”⁹ J.A. 135 (emphasis added). While the Indentures distinguish between voluntary and mandatory redemptions as to the debtor's obligation to pay a Make-Whole Amount, Section 3.03 expressly provides, regarding continuing Events of Default in the context of accelerated debt, that “[n]o Make-Whole Amount shall be payable on the Equipment Notes as a consequence of or in connection with an Event of Default or the acceleration of the Equipment Notes.” J.A. 140.

Article IV of the Indentures defines the Events of Default referred to in Section 3.03. There are ten Events of Default listed in Section 4.01, including, *inter alia*, failure to make payment, failure to maintain insurance, failure to abide by various covenants or conditions, and material misrepresentations in operative documents. Section 4.01(g) identifies filing a voluntary petition in bankruptcy or a voluntary petition “seeking reorganization, liquidation or other relief as a debtor” as an Event of Default.

After delineating Events of Default in Section 4.01, Section 4.02 of the Indentures outlines remedies that the Loan Trustee “*may*, and upon the written instruction of a Majority in Interest of Noteholders ... *shall*” pursue after an Event of Default occurs and continues. J.A. 144 (emphases added). Section 4.02(a)(i) provides that upon an Event of Default, the Loan Trustee *may* declare the Equipment Notes due and payable (accelerating the maturity date); however, Section 4.02(a)(i) then specifies:

*provided that if an Event of Default referred to in Section 4.01(f), Section 4.01(g), Section 4.01(h) or Section 4.01(i) shall have occurred and be continuing, then and in every such case the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (but for the avoidance of doubt, without Make-Whole Amount), shall immediately and without further act become due *95 and payable without presentment, demand, protest or notice, all of which are hereby waived.*

J.A. 145 (emphases added). Section 4.02(a)(ii) elaborates the three remedies the Loan Trustee may pursue after the Loan Trustee declares the notes due and payable or after the debt is automatically accelerated by operation of Section 4.02(a)(i): (1) delivery of the equipment; (2) sale of the equipment; or (3) “any other remedy of a secured party under the Uniform Commercial Code of the State of New York.” If American defaults, the default continues, *and* the debt is accelerated, “all payments received and amounts held or realized by the Loan Trustee” are to be distributed according to the order of priority specified in Section 3.03. *See* Section 3.03.

II.

On November 29, 2011, American filed a voluntary petition for bankruptcy. On December 23, 2011, the bankruptcy court entered an order authorizing Debtors to (1) enter into agreements under [11 U.S.C. § 1110\(a\)](#) of the Bankruptcy Code (hereinafter “[§ 1110\(a\)](#) elections” or “[§ 1110\(a\)](#) agreement”); (2) enter into stipulations to extend the time to comply with [§ 1110](#); and (3) file redacted [§ 1110](#) stipulations.¹⁰ American thereafter committed in December 2011 and January 2012 [§ 1110\(a\)](#) elections “to perform all obligations of the Debtors under the [Indentures] with respect to the Aircraft Equipment” and to cure any default “other than a default of a kind specified in  [section 365\(b\)\(2\) of the](#)

[Bankruptcy Code](#).” J.A. 68. Each election also confirmed that it did not constitute an assumption of the underlying financing agreements, and that it was freely revocable.

American thereafter made regularly scheduled payments of principal and interest on February 1, 2012 and August 1, 2012. U.S. Bank did not object in February or August 2012 that the amount paid by American was insufficient. As of September 30, 2012, American was indebted in the principal amounts of \$445,618,425 for the 2009–1 EETC, \$174,163,156 for the 2009–2 Note, and \$703,645,330 for the 2011–2 EETC.

On October 9, 2012, Debtors filed a motion for authorization under [11 U.S.C. § 364\(c\)](#) to obtain postpetition financing in the amount of \$1.5 billion, citing low interest rates available in the market. Debtors also requested authorization to use the new financing to “repay certain existing prepetition obligations secured by the Aircraft, including obligations under the Prepetition Notes ... without the payment of any Make–Whole Amount” pursuant to  [11 U.S.C. § 363\(b\)](#). See J.A. 79. U.S. Bank filed objections on October 23, 2012 as both Loan Trustee for the EETC Transactions and as Trustee and Security Agent *96 for the 2009–2 Note, ¹¹ arguing that: (1) American could only “voluntarily” redeem the notes by paying all secured obligations, including the Make–Whole Amount; (2) the Make–Whole provisions are enforceable under applicable law; (3) filing for bankruptcy did not automatically accelerate the debt and any clauses that so dictated were unenforceable *ipso facto* clauses; (4) if the debt was accelerated under a bankruptcy event of default, U.S. Bank should be allowed to waive the default and decelerate the debt; and (5) the [§ 1110\(a\)](#) election and regular principal and interest payments made in February and August 2012 prevent Debtors from now attempting to repay a “default” without any Make–Whole Amount. U.S. Bank filed complaints for declaratory relief on November 7 and November 16, 2012, and argued, in addition, that assuming the debt was accelerated, American had not complied with its [§ 1110\(a\)](#) elections by not paying the full accelerated amount. In its complaints for declaratory relief, U.S. Bank requested that the court declare that American must pay the Make–Whole Amount in accordance with the Indentures’ voluntary redemption provisions to the extent American obtains new financing and attempts to repay the notes. U.S. Bank also requested that the bankruptcy court lift the automatic stay to the extent necessary for U.S. Bank to waive the alleged default and annul any acceleration. ¹²

The bankruptcy court issued a decision on January 17, 2013, an order on February 1, 2013, and judgments on February 11, 2013, granting American’s motion to secure financing and to repay its obligations, and denying U.S. Bank’s request to lift the automatic stay. In its decision, the court principally addressed U.S. Bank’s request that the court declare the legal rights of the parties under the Indentures pursuant to the Declaratory Judgment Act. See *In re AMR Corp.*, 485 B.R. 279 (Bankr.S.D.N.Y.2013). The court concluded that the Indentures clearly state that American’s bankruptcy filing was an Event of Default that automatically accelerated the debt and that in such circumstances American does not owe any Make–Whole Amount in connection with repayment of the accelerated debt still owed.

Addressing U.S. Bank’s arguments, the court first disagreed with the contention that acceleration is a remedy to be invoked by the Loan Trustee and that, because the Loan Trustee here never elected such a remedy, the debt was not accelerated. The court concluded that the Indentures clearly and specifically provide for automatic acceleration upon a bankruptcy-related default and that this contractual provision is not in conflict with case law cited by U.S. Bank. *Id.* at [290–93](#). The court also concluded that the automatic stay bars U.S. Bank from waiving the Event of Default and decelerating the debt, and that lifting the stay in order to permit U.S. Bank to do so was not appropriate. *Id.* at [293–96](#). As to U.S. Bank’s argument that Section 4.02(a)(i) is an *ipso facto* clause unenforceable under  [11 U.S.C. § 365\(e\)\(1\)](#), the bankruptcy court disagreed, concluding *97 that  [§ 365\(e\)\(1\)](#) pertains only to *ipso facto* clauses in executory contracts and unexpired leases. *Id.* at [296–98](#).

The bankruptcy court next addressed U.S. Bank’s argument that American is attempting voluntarily to redeem the notes under Section 2.11(a) of the Indentures and that, in this circumstance, a Make–Whole Amount is due. In light of its conclusion that filing for bankruptcy automatically accelerated the debt and that the Indentures distinguish between voluntary prepayment and payments due upon automatic acceleration, the court rejected U.S. Bank’s argument. *Id.* at [298–99](#). The court noted that case law from the Southern District of New York and USBC–SDNY supports the conclusion that a payment of debt due upon acceleration is different from voluntary redemption, and the isolated parts of the Indentures cited by U.S. Bank—such as the “Make–Whole Amount” definition and phrases concerning voluntary redemption—neither undercut the

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relevance of these cases nor point to a contrary interpretation of these Indentures. *Id.* at 299–304 (citing *HSBC Bank USA, Nat'l Ass'n v. Calpine Corp.*, No. 07–cv–3088, 2010 WL 3835200 (S.D.N.Y. Sep. 15, 2010); *In re Solutia Inc.*, 379 B.R. 473 (Bankr.S.D.N.Y.2007)).

Finally, the bankruptcy court examined 11 U.S.C. § 1110 and American's § 1110(a) elections and concluded that the default at issue is a bankruptcy default that American was not required to cure under § 1110(a)(2)(B). American therefore complied with the conditions of its § 1110(a) elections by performing its contractual obligations to make regularly scheduled principal and interest payments. *Id.* at 304–06. The court also concluded that American's performance in making regularly scheduled payments did not estop American from subsequently paying the accelerated debt due (but protected from collection by the automatic stay), and it observed that § 1110(a) elections do not constitute permanent commitments to bind the debtor to their terms. *Id.* at 306–07. As the court explained, the source of U.S. Bank's unhappiness lies in the language of 11 U.S.C. § 1110 and the terms of the Indentures, both of which permit American, in the circumstances here, to make principal and interest payments during bankruptcy proceedings and then subsequently to repay the accelerated debt without the Make-Whole Amount. *Id.* at 307–09.

Accordingly, the court approved American's motion for new financing under 11 U.S.C. § 364(c), concluding that the relief sought by American was an appropriate exercise of the Debtors' business judgment, and that the Debtors had sound business reasons for moving to repay obligations under 11 U.S.C. § 363(b). It authorized the postpetition financing and repayment of financing transactions in its February 1, 2013 orders. On February 28, 2013, the bankruptcy court granted U.S. Bank's motion for certification for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2), stating that the appeals present questions of law for which there is no controlling decision of the Second Circuit and involve matters of public importance. U.S. Bank then petitioned this Court to allow direct appeal of the bankruptcy court's order and judgments, and a different Panel of this Court granted that motion on April 2, 2013. This appeal followed.

DISCUSSION

[1] [2] We have jurisdiction over this appeal certified from the bankruptcy court and accepted by this Court pursuant

to 28 U.S.C. § 158(d)(2), and we “review the legal conclusions of the bankruptcy court ... *de novo*.” *In re Bernard L. Madoff *98 Inv. Secs. LLC*, 654 F.3d 229, 234 (2d Cir.2011). Our review of a bankruptcy court's denial of relief from the automatic stay is for abuse of discretion. See *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 91 (2d Cir.2003).

On appeal, U.S. Bank reiterates the arguments advanced in the bankruptcy court. Principally, it asserts that American's proposed debt payment is properly construed as a voluntary prepayment under the Indentures and thus requires payment of the Make-Whole Amount. U.S. Bank contends that although an Event of Default occurred when American filed for bankruptcy in November 2011, U.S. Bank did not elect to accelerate the debt as a remedy, and therefore—in accordance with the Debtors' § 1110(a) elections and regularly scheduled payments of principal and interest—American is now trying to prepay without satisfying the contractual obligation of the Make-Whole Amount. U.S. Bank also maintains that to the extent acceleration occurred automatically under Indenture provisions by virtue of American's bankruptcy filing, such provisions are unenforceable *ipso facto* clauses. Alternatively, U.S. Bank proposes that to the extent the Notes were accelerated, the § 1110(a) election decelerated them, as confirmed by American's payment of regularly scheduled principal and interest. Finally, U.S. Bank contends that it should be permitted to rescind any such acceleration or waive the Event of Default because such a rescission does not violate the automatic stay but merely enforces contractual rights and rights under § 1110.

I. Indentures

[3] [4] We begin with the text of the Indentures, which we interpret applying basic contract law. *Jamie Secs. Co. v. The Ltd. Inc.*, 880 F.2d 1572, 1576 (2d Cir.1989) (“It is a well-established rule in this Circuit that the ‘[i]nterpretation of [I]ndenture provisions is a matter of basic contract law.’” (quoting *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1049 (2d Cir.1982)) (alterations in *Jamie*)). New York law governs the interpretation of these Indentures, and courts applying New York law construe a contract “so as to give full meaning and effect to all of its provisions.” *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1199 (2d Cir.1996) (quoting *Am. Express Bank Ltd.*

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v. Uniroyal, Inc., 164 A.D.2d 275, 562 N.Y.S.2d 613, 614 (1st Dep't 1990)); see also *Consedine v. Portville Cent. Sch. Dist.*, 12 N.Y.3d 286, 879 N.Y.S.2d 806, 907 N.E.2d 684, 689 (2009) (instructing courts to read contracts as a whole and not place “undue emphasis” upon particular words or phrases). “[W]hen parties set down their agreement in a clear, complete document,” the New York Court of Appeals has said, “their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing.” *W.W.W. Assocs., Inc. v. Giancontieri*, 77 N.Y.2d 157, 565 N.Y.S.2d 440, 566 N.E.2d 639, 642 (1990). Whether a contract is ambiguous is a question of law for the courts to resolve. *Id.*; see also *S. Rd. Assocs., LLC v. Int'l Bus. Machs. Corp.*, 4 N.Y.3d 272, 793 N.Y.S.2d 835, 826 N.E.2d 806, 809 (2005) (“Whether a contract is ambiguous is a question of law and extrinsic evidence may not be considered unless the document itself is ambiguous.”).

A. American's Voluntary Petition Triggered a Default Under the Indentures that Accelerated the Debt but Excluded Make-Whole Amount

[5] [6] [7] Reading the Indentures *de novo*, we agree with the bankruptcy court that American's voluntary petition for bankruptcy *99 was an Event of Default under Section 4.01(g) of the Indentures. Section 4.01(g) expressly defines filing a “voluntary petition in bankruptcy or a voluntary petition or an answer seeking reorganization, liquidation or other relief as a debtor in a case under any bankruptcy laws or insolvency laws” as an Event of Default. J.A. 143. We also agree that American's bankruptcy filing triggered the automatic acceleration of its debt. For non-bankruptcy Events of Default under the Indentures, Section 4.02(a) states that the Trustee “may, and upon the written instructions of a Majority in Interest of Noteholders, ... shall ” “declare by written notice to [American] all the Equipment Notes to be due and payable....” J.A. 144–45 (emphases added).¹³ Thus, as to non-bankruptcy Events of Default, the Trustee has the *option* to invoke acceleration as a remedy. This is not the case, however, with regard to the voluntary filing of a bankruptcy petition, defined as an Event of Default in Section 4.01(g). For after setting forth the general rule, Section 4.02(a)(i) expressly states:

provided that if an Event of Default referred to in ... Section 4.01(g) ... shall have occurred and be continuing, then

and in every such case the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due thereunder (but for the avoidance of doubt, without Make-Whole Amount), shall immediately and without further act become due and payable without presentment, demand, protest or notice, all of which are hereby waived.

J.A. 145 (emphases added). Under New York law, “a specific provision ... governs the circumstance to which it is directed, even in the face of a more general provision.”

 *Capital Ventures Int'l v. Republic of Argentina*, 652 F.3d 266, 271 (2d Cir.2011) (citing *Muzak Corp. v. Hotel Taft Corp.* [1 N.Y.2d 42, 150 N.Y.S.2d 171], 133 N.E.2d 688, 690 (N.Y.1956)). Generally, when Events of Default occur, the Loan Trustee, acting for noteholders, can elect to declare debts due, pursue other remedies, or let a default go unremedied. But, as made plain in Section 4.02(a) (i), the debt was automatically accelerated by American's bankruptcy filing.¹⁴

[8] We also agree with the bankruptcy court that in this circumstance—where a Section 4.01(g) Event of Default has occurred resulting in the automatic acceleration of the debt—the Indentures provide that no Make-Whole Amount is due. American's November 29, 2011 bankruptcy filing triggered an Event of Default (Section 4.01(g)), which automatically accelerated the debt under Section 4.02(a)(i). And Section 4.02(a)(i) expressly provides *100 that this accelerated debt —“the unpaid principal amount of the Equipment Notes then outstanding, together with accrued but unpaid interest thereon and all other amounts due”—is “*without Make-Whole Amount* ” (emphasis added). Section 3.03, governing payments to be made by American after an Event of Default “shall have occurred and be continuing and the Equipment Notes shall have become due and payable pursuant to Section 4.02(a),” confirms this, explicitly providing that “[n]o Make-Whole Amount shall be payable ... as a consequence of or in connection with an Event of Default or the acceleration of the Equipment Notes.” J.A. 140. Prior to October 2012 (and consistent with American's position that it properly made and abided by § 1110(a) elections, entitling it to the benefit of the automatic stay) American made no attempt to pay the outstanding accelerated debt. But this delay in no way changes the status of the parties vis-à-vis the Indentures as of November 29, 2011: American owed and continues to owe the outstanding principal and any unpaid interest on the accelerated debt, but no Make-Whole Amount.

B. U.S. Bank's Arguments Fail to Refute this Plain Language Interpretation of the Indentures

U.S. Bank makes three arguments in an effort to refute the plain language of the Indentures. First, U.S. Bank argues that the Trustee never elected to accelerate the debt, and that such action by the Trustee is required under New York law. Second, U.S. Bank asserts that even if acceleration took place, U.S. Bank can rescind this acceleration, obliging American to pay a Make-Whole Amount in connection with its refinancing, and that the bankruptcy court erred in concluding that such rescission is barred by the automatic stay. Finally, U.S. Bank argues that regardless whether American's debt was accelerated at the time it filed for bankruptcy, American's attempt to capitalize on favorable market conditions by paying off the debt nearly one year later, properly understood, is a voluntary redemption pursuant to Section 2.11, requiring payment of a Make-Whole Amount. We discuss each argument in turn.

1. Automatic Acceleration Versus Trustee Election

[9] [10] U.S. Bank first argues that despite the plain language of the Indentures, “[u]nder New York law, acceleration is a remedy that affirmatively must be chosen by lenders and cannot be invoked by borrowers.” U.S. Bank relies principally on two cases:  [*Wurzler v. Clifford*, 36 N.Y.S.2d 516 \(N.Y.Sup.Ct.1942\)](#), and  [*Tymon v. Wolitzer*, 39 Misc.2d 504, 240 N.Y.S.2d 888 \(N.Y.Sup.Ct.1963\)](#). Like the bankruptcy court, we are unpersuaded.

As the bankruptcy court noted, both *Wurzler* and *Tymon* deal with “bare bones acceleration clauses,” which provide that any default operates so as to make obligations due and payable without specification as to whether any action or notice on the part of the non-defaulting creditor is required. [*In re AMR Corp.*, 485 B.R. at 291](#). The *Wurzler* and *Tymon* courts interpreted the clauses at issue in those cases as “not self-operative,” intended simply to give the creditor “the right to treat the entire debt as matured.”

 [*Wurzler*, 36 N.Y.S.2d at 517](#). But as subsequent courts have recognized, these cases “did not foreclose the ability of parties to draft acceleration provisions that would be self-operative.” See  [*In re Premier Entm't Biloxi LLC*, 445 B.R. 582, 627 \(Bankr.S.D.Miss.2010\)](#) (distinguishing *Tymon* as establishing a rule for similar acceleration clauses but not foreclosing the availability of self-executing acceleration clauses). Indeed, no court applying New York law since

Tymon *101 has cited the holdings of *Wurzler* or *Tymon* as a basis for declining to enforce an automatic acceleration provision, and certainly not one of the sort here: contained in an agreement that specifically differentiates between those Events of Default pursuant to which the Loan Trustee may declare the Equipment Notes due and payable and those Events of Default pursuant to which the Notes “shall immediately and without further act become due and payable without presentment, demand, protest or notice.” J.A. 145.

[11] To the contrary, as we recognized in  [*Analytical Surveys, Inc. v. Tonga Partners, L.P.*, 684 F.3d 36, 44 \(2d Cir.2012\)](#), “under New York law, ‘[t]he parties to a loan agreement are free to include provisions directing what will happen in the event of default ... of the debt, supplying specific terms that super[s]ede other provisions in the contract if those events occur.’” (quoting  [*NML Capital v. Republic of Argentina*, 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 491 \(2011\)](#) (alterations in *Analytical Surveys*)). And numerous courts applying New York law have enforced automatic acceleration provisions. See [*Calpine Corp.*, 2010 WL 3835200, at *3](#) (enforcing a clause automatically accelerating debt upon a voluntary bankruptcy filing);  [*In re Solutia Inc.*, 379 B.R. at 484](#) (noting that “[i]t was entirely appropriate to provide for automatic acceleration in the Original Indenture since the giving of a notice of acceleration post-petition would violate the automatic stay”). As the New York Court of Appeals has stated, “[i]n rare cases, agreements providing for the acceleration of the entire debt upon the default of the obligor may be circumscribed or denied enforcement by utilization of equitable principles. In the vast majority of instances, however, these clauses have been enforced at law in accordance with their terms.”  [*Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc.*, 46 N.Y.2d 573, 415 N.Y.S.2d 800, 389 N.E.2d 113, 116 \(1979\)](#); see also  [*Key Int'l Mfg. Inc. v. Stillman*, 103 A.D.2d 475, 480 N.Y.S.2d 528, 530 \(2d Dep't 1984\)](#) (“Acceleration clauses are quite common and are generally enforced according to their terms. It is only in rare cases that clauses will be denied enforcement under equitable principles.” (internal quotation marks and citations omitted)).

U.S. Bank suggests that automatic acceleration provisions of the sort here benefit lenders and that permitting American “to use Section 4.02 as a sword” is inequitable, presenting the sort of “rare circumstance” in which New York courts hold enforcement is properly refused. We disagree. Even

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were we (unwisely) to disregard the “sensible proposition of law” that contracts are to be enforced pursuant to their clear and unambiguous terms, *see Wallace v. 600 Partners Co.*, 86 N.Y.2d 543, 634 N.Y.S.2d 669, 658 N.E.2d 715, 717 (1995) (internal quotation marks omitted), the automatic acceleration provision here is not solely for the benefit of one party, but simultaneously affords potential benefits to both: it accelerates the amount presently due for the purpose of the noteholders' claims against American in bankruptcy and it excludes any Make-Whole Amount from American's obligations, to American's benefit. U.S. Bank is due the outstanding principal and any applicable interest payments when American repays its debts, but “there is no warrant, either in law or equity, for a court to refuse enforcement of the agreement of the parties” in the circumstances here.  *Fifty States Mgmt. Corp.*, 415 N.Y.S.2d 800, 389 N.E.2d at 116; *see also*  *In re Solutia Inc.*, 379 B.R. at 484 (noting that the automatic acceleration provision in a note indenture was “the result that [noteholders] bargained for”).

***102** 2. *Rescinding the Event of Default*

[12] U.S. Bank next argues that even assuming an automatic acceleration occurred, it is entitled to rescind this acceleration and decelerate the debt under Section 4.02(d) of the Indentures.¹⁵ U.S. Bank urges, as it did before the bankruptcy court, that Section 4.02(d) permits it to rescind the automatic acceleration so long as American is current on the principal and interest payments under the Notes (as well as other amounts owed otherwise than by virtue of the acceleration) and all other Events of Default have been waived. Because American has remained current on its payments pursuant to its § 1110(a) elections, U.S. Bank argues that this option is contractually available and that by exercising it, U.S. Bank can require American to proceed in its refinancing pursuant to Section 2.11, which provides for the payment of a Make-Whole Amount.

To the extent this argument concerns U.S. Bank's contention that the bankruptcy court abused its discretion by declining to lift the automatic stay so that U.S. Bank may rescind acceleration or waive it, we more fully address that argument *infra*. As relevant here, suffice it to say that regardless whether U.S. Bank may theoretically rescind the acceleration pursuant to Section 4.02(d) of the Indentures (or waive Events of Default pursuant to Section 4.05) the bankruptcy court did not err in concluding that any attempt to do so would be an attempt to modify contract rights and

would therefore be subject to the automatic stay that went into effect when American made its § 1110(a) elections. *In re AMR Corp.*, 485 B.R. at 294; *see In re Enron Corp.*, 300 B.R. 201, 212 (Bankr.S.D.N.Y.2003) (noting that “contract rights are property of the estate ... protected by the automatic stay” (internal quotation marks omitted)); *accord*  *In re 48th St. Steakhouse, Inc.*, 835 F.2d 427, 431 (2d Cir.1987) (holding that landlord's effort to terminate a prime tenant's lease violated automatic stay with respect to debtor's sublease).

As of the filing of its bankruptcy petition on November 29, 2011, American had the contractual right, pursuant to the Indentures, to repay its accelerated debt without Make-Whole Amount. We therefore agree with the bankruptcy court that any attempt by U.S. Bank to rescind acceleration now—after the automatic stay has taken effect—is an effort to affect American's contract rights, and thus the property ***103**

of the estate. *See*  11 U.S.C. § 541(a)(1) (the bankruptcy estate is comprised of “all legal or equitable interests of the debtor in property as of the commencement of the case”); *see also*  *In re Albion Disposal, Inc.*, 217 B.R. 394, 407–08 (W.D.N.Y.1997) (“[I]t is well-established ... that a debtor's contractual rights—including rights arising under post-petition contracts—are included in the property of his estate.”). As in *In re Solutia*, in which the bankruptcy court voided a notice from noteholders attempting to waive another automatic acceleration provision triggered by a bankruptcy filing in order to secure contractual payments not due in

the event of acceleration, *see*  379 B.R. at 476–79, U.S. Bank's efforts here represent “a direct attempt to get more property from the debtor and the estate, either through a simple increase in the amount of a pro-rata plan distribution or through recovery of a greater amount of the collateral which

secures the claim.”  *Id.* at 485; *see also*  *In re Manville Forest Prods. Corp.*, 43 B.R. 293, 298 (Bankr.S.D.N.Y.1984) (“Therefore ... it ... would have violated the stay, for the long-term lenders to take overt steps to accelerate the debt without first seeking a modification of the stay from this Court.”),

rev'd on other grounds by  60 B.R. 403 (S.D.N.Y.1986). In such circumstances, the bankruptcy court did not err in concluding that the automatic stay applies, preventing any such action by U.S. Bank without judicial intervention.

3. *Post-Maturity Payment Not a Voluntary Redemption*

[13] U.S. Bank argues, finally, that regardless whether American's November 2011 bankruptcy petition was an Event of Default triggering debt acceleration, American's effort in October 2012 to pay off its debt constitutes a Section 2.11 voluntary redemption for which Section 3.02 provides for payment of a Make-Whole Amount. The bankruptcy court rejected this argument, holding that the Debtors' proposed payment is a "post-maturity date repayment, not a prepayment," and that in such circumstances, Section 3.03's payment provisions, describing the order of priority for "all payments received ... after both an Event of Default shall have occurred and be continuing and the Equipment Notes shall have become due and payable pursuant to Section 4.02(a)" is applicable. *In re AMR Corp.*, 485 B.R. at 298 (internal quotation marks and citation omitted). We agree.

[14] As is already clear, American's bankruptcy petition triggered a default, and this default automatically accelerated the debt. That acceleration "change[d] the date of maturity from some point in the future ... to an earlier date based on the debtor's default under the contract." *Analytical Surveys*, 684 F.3d at 44 (quoting *NML Capital*, 928 N.Y.S.2d 666, 952 N.E.2d at 491). When the event of default occurred and the debt accelerated, the new maturity date for the debt was November 29, 2011. Consequently, American's attempt to repay the debt in October 2012 was not a voluntary prepayment because "[p]repayment can only occur prior to the maturity date." *In re Solutia*, 379 B.R. at 488. The soundness of this conclusion, moreover, is reinforced by the plain text of Section 3.02, the voluntary redemption payment schedule, which provides for potential payment of a Make-Whole Amount but itself states that it operates "[e]xcept as otherwise provided in Section 3.03" (emphasis added). Section 3.03 is the payment provision dealing specifically with payments in the context of a continuing Event of Default and debt acceleration.¹⁶

*104 The case law dealing with similar automatic-acceleration-upon-bankruptcy clauses in indenture agreements supports this reading.¹⁷ *In re Solutia Inc.* involved notes held by the Bank of New York and governed by an indenture agreement. *379 B.R. at 476*. The agreement provided that filing for bankruptcy was an event of default under which the notes "shall become immediately due and payable without any declaration or other act on the part of the Trustee or any Holder." *Id. at 478* (quoting the Indentures). One of the noteholders' claims was for interest

through the notes' stated maturity date despite the maturity date adjustment that occurred with automatic acceleration. The court rejected the noteholders' claim for interest: "By incorporating a provision for automatic acceleration, the 2009 Noteholders made a decision to give up their future income stream in favor of having an immediate right to collect their entire debt. Because the 2009 Notes were automatically accelerated, any payment at this time would not

be a prepayment." *379 B.R. at 488*. The court also noted the possibility of "post-acceleration 'yield maintenance'" but found the indenture provisions did not provide for it. *Id.* U.S. Bank faces a similar dilemma. *See also Calpine Corp.*, 2010 WL 3835200, at *4 (noting that although parties "could have provided for the payment of premiums in the event of payment pursuant to acceleration ... [w]ithout such a provision ... no damages are recoverable after acceleration").

Notwithstanding the clear language of the Indentures and applicable case law, U.S. Bank attempts to imbue ambiguity into the Indentures by highlighting isolated Indenture provisions, most notably the definition of "Make-Whole Amount" in the Indentures' Annex A. This definition begins by stating:

"Make-Whole Amount" means ... the amount (as determined by an independent investment banker selected by the Company (and, following the occurrence and during the continuance of an Event of Default, reasonably acceptable to the Loan Trustee))....

J.A. 222. U.S. Bank argues that the parenthetical's reference to a Make-Whole Amount to be determined "following the occurrence and during the continuance of an Event of Default" establishes that such an amount may be payable following an Event of Default and that this is inconsistent with American's claim that it owes no Make-Whole Amount pursuant to the plain language of both Sections 3.03 and 4.02(a)(i). We are not persuaded.

Section 3.03, as previously noted, governs payments made by American after an Event of Default "shall have occurred and be continuing and the Equipment Notes shall have become due and payable pursuant *105 to Section 4.02(a)" (providing for debt acceleration either at the option of the Loan Trustee upon the occurrence of some Events of Default or, in the context of a bankruptcy-related default such as the one specified in Section 4.01(g), automatically). J.A. 135. Section 3.03 expressly provides that "[n]o Make-Whole Amount shall be payable on [such] Equipment Notes as a

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consequence of or in connection with an Event of Default or the acceleration of the Equipment Notes.” J.A. 140.

U.S. Bank is correct that there are scenarios pursuant to the plain terms of the Indentures in which an Event of Default could occur and continue and a Make-Whole Amount would be due. Thus, one can postulate an Event of Default under Section 4.01(c) (such as failure to carry insurance), after which the Loan Trustee does not elect to remedy the default, the failure to carry insurance continues, and then six months later, the Debtor attempts to pay off all outstanding—and nonaccelerated—principal. Such an attempt would likely qualify as a voluntary redemption and a Make-Whole Amount would be owed pursuant to Section 3.02. (Section 3.03 would not be triggered, because it applies only when an Event of Default occurs, continues, *and the debt is accelerated*.) Thus, contrary to U.S. Bank's assertions, the Make-Whole Amount definition's parenthetical is not rendered “meaningless” by affording Section 3.03 its plain meaning. For while in some scenarios American might owe a Make-Whole Amount in connection with a voluntary redemption during the persistence of an Event of Default, this is simply not true regarding the scenario here.

U.S. Bank argues, next, that Section 3.03, by its terms, only excludes payment of a Make-Whole Amount “as a consequence of or in connection with an Event of Default or the acceleration of the Equipment Notes,” and that the post-maturity repayment that American now attempts is not, in fact, “a consequence of or in connection with” either its bankruptcy filing or debt acceleration but is, instead, an attempt to take advantage of low interest rates. We need not parse the meanings of “consequence” or “connection” to reject U.S. Bank's interpretation. U.S. Bank again focuses on isolated phrases in the Indentures. Given Section 4.02(a)(i)'s directive that debt acceleration upon a voluntary bankruptcy filing is automatic and that in this circumstance the debt owed is “for the avoidance of doubt, *without Make-Whole Amount*” (emphasis added), Section 3.03 must clearly be read to exclude the payment of any Make-Whole Amount where an Event of Default has occurred, is continuing, and debt acceleration has taken place—precisely the circumstance here.

In conclusion, as of November 29, 2011 and as a matter of contract, American owed the entire accelerated debt of principal and interest but no Make-Whole Amount. Because we find the relevant language of the Indentures to be unambiguous, moreover, we reject U.S. Bank's alternative

argument to the effect that discovery should have been undertaken as to the proper interpretation of the disputed provisions.

II. *Ipsa Facto* Clauses and [11 U.S.C. § 365\(e\)\(1\)](#)

[15] U.S. Bank next argues that even assuming the preceding interpretation of the Indentures is correct (that American's bankruptcy filing was an Event of Default pursuant to Section 4.01(g) that automatically triggered debt acceleration in accord with Section 4.02(a)(i)), default and automatic acceleration provisions of this sort—*ipso facto* provisions “modify[ing] the relationships of contracting parties due to the *106 filing of a bankruptcy petition,”  [In re Chateaugay Corp.](#), 1993 WL 159969, at *5, 1993 U.S. Dist. LEXIS 6130, at *14 (S.D.N.Y. May 10, 1993)—are “broadly unenforceable” under the Bankruptcy Code. U.S. Bank is correct that Sections 4.01(g) and 4.02(a)(i) are indeed *ipso facto* clauses. See  [In re Lehman Bros. Holdings Inc.](#), 422 B.R. 407, 414 (Bankr.S.D.N.Y.2010) (defining *ipso facto* clauses as clauses within a contract that “seek to modify the relationships of contracting parties due to the filing of a bankruptcy petition”). But its argument that the Code categorically prohibits enforcement of such clauses—and that these clauses, in particular, are unenforceable—is without merit.

U.S. Bank relies on three provisions in the Bankruptcy Code that decline enforcement of *ipso facto* clauses in specified circumstances. First is  [§ 365\(e\)\(1\)](#) of the Code, which provides in relevant part as follows:

Notwithstanding a provision in an executory contract or unexpired lease ... an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

- (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
- (B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

11 U.S.C. § 365(e)(1). By its terms, § 365(e)(1) is inapplicable here. Both parties agree that the Indentures are not executory contracts—contracts “on which performance remains due to some extent on both sides,” *In re Penn Traffic Co.*, 524 F.3d 373, 379 (2d Cir.2008) (quoting *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 522 n. 6, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984)); see also Vernon Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L.Rev. 439, 460 (1973) (defining executory contract as one “under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other”), and neither argues that this case involves an unexpired lease. The bankruptcy court therefore did not err in concluding that “Section 4.02(a)(i) is not an invalid *ipso facto* clause” pursuant to this provision. *In re AMR Corp.*, 485 B.R. at 297.

The two remaining provisions, § 541(c)(1)(B) and § 363(l), are similarly inapposite. Section 541(c)(1)(B) provides that once a bankruptcy case is commenced, any property interests of the debtor become property of the bankruptcy estate, notwithstanding any *ipso facto* clause that “effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.” See *id.* (“[A]n interest of the debtor in property becomes property of the estate ... notwithstanding any provision in an agreement” that is “conditioned on the insolvency or financial condition of the debtor” or on the commencement of a bankruptcy case “and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property”). But Sections 4.01(g) and 4.02(a)(i) do not prevent property of American from becoming property of the estate.

Finally, § 363 of the Code gives the bankruptcy trustee general powers to use, sell, or lease property of the estate, see *107 *id.* § 363(b), (c), and § 363(l) makes clear that the trustee has such powers, notwithstanding any *ipso facto* clause, see *id.* § 363(l) (“Subject to the provisions of section 365, the trustee may use, sell, or lease property under subsection (b) or (c) of this section ... notwithstanding any provision in a contract, a lease, or applicable law that is conditioned on the insolvency or financial condition of the

debtor” or the commencement of a bankruptcy case “and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property”). The Indenture clauses at issue here, however, do not prevent the bankruptcy trustee from using, selling, or leasing estate property, and so do not fall within § 363(l)'s terms.

U.S. Bank argues that these statutory provisions “broadly prohibit the enforcement” of *ipso facto* clauses, and apparently regardless whether they by their terms apply. The Appellant cannot identify any provision of the Bankruptcy Code, however, that provides support for such a *per se* prohibition. Moreover, the specificity of the provisions on which U.S. Bank *does* rely—which demonstrate that Congress clearly knows how to limit or negate the effect of *ipso facto* clauses when it wants to—counsels against the position that U.S. Bank urges here. As in *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 452, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007), “[t]he absence of textual support is fatal” to U.S. Bank's position that *ipso facto* provisions are broadly or categorically denied enforcement by the Code. The bankruptcy court did not err in rejecting this argument.

III. 11 U.S.C. § 1110(a) Elections

[16] U.S. Bank's penultimate arguments on appeal concern 11 U.S.C. § 1110(a) and American's December 2011 and January 2012 elections committing the Debtors “to perform all obligations ... under the [Indentures] with respect to the Aircraft Equipment” and to cure any default (other than a default “of a kind specified in section 365(b)(2) of the Bankruptcy Code”). Section 1110(a)(1) provides generally that creditors with a secured interest in aircraft or related equipment may repossess their collateral or enforce other rights under a “security agreement, lease, or conditional sales contract” with the debtor notwithstanding, *inter alia*, § 362's automatic stay.¹⁸ As we have said, Congress in § 1110(a) “intend[ed] to extend extraordinary protection to financiers of aircraft,” providing them heightened ability to protect their collateral in bankruptcy proceedings, “in order to encourage investment in new equipment for air carriers.” *In re Air Vt., Inc.*, 761 F.2d 130, 132 (2d Cir.1985); see also *In re Trans World Airlines*, 145 F.3d 124, 137 (3d Cir.1998) *108 (“Section 1110 was designed in part to increase availability of low-interest capital to the

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transportation industry.”). At the same time, pursuant to [§ 1110\(a\)\(2\)](#), a debtor like American may secure the protection of the automatic stay (preventing, *inter alia*, repossession of its equipment) if within 60 days of a bankruptcy filing it: (1) agrees to perform “all obligations of the debtor” pursuant to its agreement with the secured creditor; and (2) it cures any default not “of a kind specified in [§ 365\(b\)\(2\)](#)” within a defined period.¹⁹ [Section 1110\(a\)](#) elections of the sort American made here “require[] court approval but not the [secured creditor’s] consent.” [In re Trans World Airlines](#), 145 F.3d at 137.

U.S. Bank makes three arguments regarding [§ 1110](#). First, U.S. Bank argues that the Debtors’ election to “perform all obligations” under the Indentures pursuant to [§ 1110\(a\)\(2\)](#) requires the Debtors to abide by *all* the terms of the Indentures, including the requirement to pay the Make-Whole Amount. Second, U.S. Bank argues that assuming the Notes were accelerated pursuant to Section 4.02(a)(i) of the Indentures upon American’s bankruptcy filing (so that no Make-Whole Amount need be paid upon their post-maturity repayment) American’s [§ 1110\(a\)](#) elections and regular payments of principal and interest pursuant to these elections had the effect of decelerating the Notes. Finally, U.S. Bank argues that if the Notes were accelerated and American’s [§ 1110\(a\)](#) elections did *not* decelerate them, then American has not cured its defaults as required by [§ 1110\(a\)\(2\)](#) because since it entered into its elections, American has remitted only principal and interest payments but not the accelerated amount. Accordingly, says U.S. Bank, American is not (and never was) entitled to the protection of the automatic stay. For the following reasons, we are not persuaded.

1. [Section 1110\(a\)\(2\)](#) Does Not Require Assumption of the Indentures

U.S. Bank’s first argument—that American’s commitment in its [§ 1110\(a\)\(2\)](#) elections to “perform all obligations” under the Indentures requires it to pay a Make-Whole Amount—is but a reprise of its arguments pursuant to the Indentures themselves, and it fails for the same reason. U.S. Bank is correct that in order to maintain the protection of the automatic stay, American is required pursuant to [§ 1110\(a\)\(2\)\(A\)](#) to perform its obligations *109 under the Indentures, with the exception that it need not cure defaults “of a kind specified in [§ 365\(b\)\(2\)](#).” 11 U.S.C. [§ 1110\(a\)\(2\)](#). But contrary to U.S. Bank’s claim, American’s commitment “to perform all obligations” under the Indentures while the

automatic stay remains in effect does not obligate it to pay a Make-Whole Amount pursuant to Section 3.02. American’s debt was accelerated pursuant to Section 4.02(a)(i) upon its bankruptcy filing and American is not now voluntarily redeeming the notes, but attempting to effect a post-maturity date repayment. No Make-Whole Amount is now or has ever been due pursuant to the Indentures.

[17] U.S. Bank’s second argument is, in effect, a response to the preceding point: U.S. Bank argues that American *is* attempting a voluntary redemption (and so owes a Make-Whole Amount) because American’s [§ 1110\(a\)](#) elections themselves decelerated its debt, returning it to its pre-bankruptcy filing position. U.S. Bank cites no pertinent authority for this proposition, however, and for a simple reason: there isn’t any. [Section 1110\(a\)\(2\)](#) does not modify the parties’ contractual relationship or commit the debtor to an assumption of any such modified relationship, but simply provides a mechanism by which an airline can gain the protection of the automatic stay notwithstanding [§ 1110\(a\)\(1\)](#).²⁰ Thus, American’s elections, for the period it complies with them, merely establish an interim arrangement in bankruptcy pursuant to which it is entitled to the benefit of the automatic stay. The bankruptcy court therefore correctly determined that American’s [§ 1110\(a\)](#) elections and its payments pursuant to these elections did not alter American’s ability to repay the accelerated debt pursuant to the terms of the Indentures. [In re AMR Corp.](#), 485 B.R. at 307.

2. [Section 1110\(a\)\(2\)](#) Does Not Require Cure of a Bankruptcy Default

[18] That brings us to U.S. Bank’s third and final argument pursuant to [§ 1110\(a\)](#): that if the debt was accelerated under Section 4.02(a)(i) and if American’s [§ 1110\(a\)\(2\)](#) elections did not decelerate this debt, returning the parties to their pre-bankruptcy position, then American has failed to cure its default as to this accelerated debt by paying it off and thus is not (and never was) entitled to the protection of the automatic stay. According to U.S. Bank, when American made its [§ 1110\(a\)](#) elections in December 2011 and January 2012, it promised, as the statute requires, to perform all obligations under the Indentures and to cure any default other than a default of a kind specified in [§ 365\(b\)\(2\)](#). But assuming American’s entire debt was due and payable at that time, U.S. Bank asserts that American did not and has not subsequently cured this default by paying it off. Accordingly, American was never entitled to the protection of the automatic stay. Its secured creditors should therefore be declared free to

exercise *110 whatever rights and remedies the Indentures afford to them (including, presumably, the right to rescind acceleration pursuant to Section 4.02(d) or to waive default as to acceleration and thus to require payment of a Make-Whole Amount in connection with American's refinancing).

We note that U.S. Bank did not object to American's § 1110 notices in December 2011 and January 2012 on the ground that American had not and was not intending to pay the full accelerated debt, even though each such notice makes clear that American proposed to pay only regularly scheduled principal and interest payments in availing itself of § 1110(a)(2). In October 2012, when American moved before the bankruptcy court to effect its post-petition refinancing, moreover, U.S. Bank did not argue that the § 1110(a)(2) elections were invalid from the start by virtue of American's failure to pay back the full accelerated amount, but instead acknowledged that “Section 1110 permitted the Debtors to make the 1110(a) Agreement and to perform under the Aircraft Agreements, *including by making regularly scheduled payments of principal and interest*, as if the bankruptcy Event of Default under Section 4.01(g) of the Indenture had never occurred.” (emphasis added).²¹ The instant argument was eventually made before the bankruptcy court in November 2012. But this was after U.S. Bank had already accepted payments of principal and interest from American in February and August 2012.

At any rate (and however U.S. Bank's position may have shifted below) we conclude that U.S. Bank's argument fails on the merits. Turning again to the text of § 1110(a)(2)(A), a debtor need not cure a default “of a kind specified in 11 U.S.C. § 365(b)(2)” in order to obtain the benefit of the automatic stay. A § 365(b)(2) default in turn is:

[A] default that is a breach of a provision relating to—

- (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
- (B) the commencement of a case under this title;
- (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or
- (D) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

11 U.S.C. § 365(b)(2).²² Thus, American was not required to pay off its accelerated debt to obtain the benefit of the automatic stay pursuant to § 1110(a)(2) if the failure to do so is a default “of a kind specified in” § 365(b)(2). We conclude that it is.

[19] Section 365(b)(2) concerns itself, broadly, with “contract provisions that force debtors into default merely for becoming insolvent or seeking bankruptcy *111 protection” or that impose penalties for defaults which are “often a product of the debtor's very financial distress.” *In re BankVest Capital Corp.*, 360 F.3d 291, 301 (1st Cir.2004); see also *In re Rickel Home Ctrs., Inc.*, 209 F.3d 291, 298 (3d Cir.2000). It explicitly lists among the defaults with which it is concerned “a default that is a breach of a provision relating to ... the commencement of a [bankruptcy] case.”

11 U.S.C. § 365(b)(2)(B). As is by now clear, the default that triggered the acceleration of American's debt was its breach of Section 4.01(g) of the Indentures, which defines an “Event of Default” as occurring when “the Company shall file a voluntary petition in bankruptcy or a voluntary petition ... seeking reorganization, liquidation or other relief as a debtor.” And debt acceleration, pursuant to Section 4.02(a)(i), followed automatically from this bankruptcy default.

We conclude that American was not required to pay off the accelerated debt to gain the protection of the automatic stay. The default of this obligation was “of a kind specified in section 365(b)(2)” —namely, the breach of a provision relating to the commencement of a bankruptcy case. 11 U.S.C. § 1110(a)(2)(B). Section 1110(a)(2)(B) does not negate such defaults, but it does permit the debtor to postpone their consequences—as U.S. Bank noted in one of its October 2012 filings: “to make the 1110(a) Agreement and to perform under the Aircraft Agreements, including by making regularly scheduled payments of principal and interest, as if the bankruptcy Event of Default under Section 4.01(g) of the Indenture *had never occurred*.” For the period in which American sought protection of the automatic stay, it was obligated to make its scheduled principal and interest payments in order to obtain the benefit of the automatic stay, but not to pay off the accelerated debt, due only as a result of its bankruptcy filing. See *In re Trans World Airlines*, 145 F.3d at 138 (noting that under 11 U.S.C. § 1110(a), a debtor must perform “according to pre-bankruptcy terms” (emphasis

omitted));  *In re Airlift Int'l*, 761 F.2d at 1513 (noting that “Congress defined the adequate protection necessary [for creditors] to be the guarantee of installment payments under the note or lease for as long as the debtor retains possession of the aircraft”).

Accordingly, we hold that under the terms of [§ 1110\(a\)\(2\)](#) and American's [§ 1110\(a\)](#) elections, American did not have to cure its Section 4.01(g) default or pay off the automatically accelerated debt triggered by its bankruptcy filing to obtain the protection of the automatic stay. American's payments of principal and interest to U.S. Bank in February and August 2012 were thus in compliance with its [§ 1110\(a\)\(2\)](#) obligations. And because a [§ 1110\(a\)\(2\)](#) election does not modify the parties' contract or constitute the debtor's assumption of the contract, but merely sets forth conditions pursuant to which the debtor may obtain the benefit of the automatic stay, American's subsequent application in October 2012 to repay its still-accelerated debt (and thus end the period in which the automatic stay would apply) did not in any way contravene [§ 1110\(a\)](#). U.S. Bank's arguments to the contrary are without merit.

IV.

[20] Finally, U.S. Bank argues that the bankruptcy court erred in denying its motion to lift the automatic stay. U.S. Bank argues that if American's debt is accelerated and if its [§ 1110\(a\)](#) elections are proper but did not have the effect of themselves decelerating the debt, the automatic stay should be lifted so that U.S. Bank may waive American's Section 4.01(g) default *112 and decelerate the debt. The court's decision denying U.S. Bank's motion is reviewable only for an abuse of discretion.  *In re Mazzeo*, 167 F.3d 139, 142 (2d Cir.1999).

Our Court has referenced twelve factors in considering the propriety of lifting the automatic stay, recognizing that not all of these factors will be relevant in all cases. See  *In re Bogdanovich*, 292 F.3d 104, 110 (2d Cir.2002) (citing  *In re Sonnex Indus.*, 907 F.2d 1280, 1285–86 (2d Cir.1990)). The bankruptcy court generally found relevant factor two, relating to the impact of lifting the stay on the bankruptcy case, and

factor twelve, concerning the impact of the stay on the parties and the balance of harms. *In re AMR Corp.*, 485 B.R. at 295.

[21] We find no abuse of discretion in the bankruptcy court's conclusion that lifting the automatic stay would serve only to increase the size of U.S. Bank's claim (to an amount greater than that to which it is entitled pursuant to the Indentures), harming the estate and American's other creditors.²³ “One of the principal purposes of the automatic stay is to preserve the property of the debtor's estate for the benefit of all the creditors.”  *In re Prudential Lines Inc.*, 928 F.2d 565, 573 (2d Cir.1991). We conclude that the bankruptcy court did not abuse its discretion in denying U.S. Bank's motion to lift the automatic stay.

CONCLUSION

To summarize, we conclude that:

- (1) Under the language of the Indentures, American's voluntary petition for bankruptcy triggered a default and automatically accelerated the debt, the satisfaction of which requires no make-whole payment;
- (2) *ipso facto* clauses in a nonexecutory contract are not unenforceable pursuant to  [11 U.S.C. § 365\(e\)](#) or any other Bankruptcy Code provision identified by U.S. Bank;
- (3) American complied with its [11 U.S.C. § 1110\(a\)](#) elections to perform its obligations under the Indentures and cure any nonexempt defaults by making regularly scheduled principal and interest payments; it was not required to cure its Section 4.01(g) default; and
- (4) the bankruptcy court did not abuse its discretion in denying U.S. Bank's motion to lift the automatic stay.

Accordingly, the judgment of the bankruptcy court is AFFIRMED.

All Citations

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Footnotes

¹ “An *ipso facto* clause is a clause in a contract or lease that modif[ies] the relationship of contracting parties due to the filing of a bankruptcy petition.” *In re AMR Corp.*, 485 B.R. 279, 296 (Bankr.S.D.N.Y.2013) (alteration in original) (internal quotation marks omitted).

² U.S. Bank serves as trustee and security agent for the Indenture and Security Agreement between American Airlines, Inc. and U.S. Bank on the 2009–2 Note, secured by twelve Boeing Aircraft.

³ In equipment trust certificate transactions, “[a] trustee issues equipment trust certificates to investors, and uses the funds raised to buy the aircraft, which is then leased to the airline which ordered it.” PETER S. MORELL, AIRLINE FINANCE 212 (3d ed.2007). An enhanced equipment trust certificate divides the certificates issued to investors into different categories based on risk, *see id.*, though the notes in question only involve one series of equipment notes and related class, *see* J.A. 82 n.1. A single subordination agent holds the equipment notes on behalf of the pass-through trust, and the trustee administers the notes and issues them to the third-party investors. J.A. 81–82.

For the 2009–1 EETC, U.S. Bank acts as successor loan trustee to over 20 separate Indenture and Security Agreements, each of which finances one Boeing airframe and two Rolls Royce or CFM International aircraft engines (collectively, “Aircraft”). For the 2011–2 EETC, U.S. Bank acts as the successor loan trustee pursuant to over 43 separate Indenture and Security Agreements, each of which finances an Aircraft.

⁴ The three separate Indenture Agreements use similar language for the relevant contingencies and terms at issue; unless specified, we will collectively refer to the three separate indentures as the “Indentures” and cite to the 2011–2 EETC.

⁵ “Event of Loss” is defined in Annex A of the Indentures, and principally covers damage to the aircraft, airframe, or engine, as well as possible takings or requisitions by governments for extended periods of time. Section 2.10 provides that Events of Loss trigger mandatory redemption, *see* J.A. 125 (“The Company *shall* redeem the Equipment Notes in whole in connection with an Event of Loss.”) (emphasis added).

⁶ Section 3.03 is discussed *infra*. Section 3.04, “Certain Payments,” concerns payments received by the Trustee outside of the normal principal and interest payments provided for in Section 3.01, or any payment schedule triggered by mandatory redemption, voluntary redemption, or Events of Default. *See* J.A. 140. It is not applicable to the present appeal.

⁷ Section 2.10 provides that mandatory redemption occurs upon an Event of Loss and requires American to redeem the Equipment Notes in whole “at a redemption price equal to 100% of the unpaid principal amount thereof, together with all accrued and unpaid interest thereon to (but excluding) the date of redemption, *but without any Make-Whole Amount.*” J.A. 125 (emphasis added). In the 2009–2 Note, the mandatory redemption provision provides for different redemption scenarios apart from the Event of Loss described in the EETC transactions, but these differences are not at issue in the instant case. *See* J.A. 898–900.

⁸ Section 2.11 provides that American can voluntarily redeem the Equipment Notes

at any time upon at least 15 days' revocable prior written notice to the Loan Trustee and the Noteholders, and such Equipment Notes shall be redeemed in whole at a redemption price equal to 100% of the unpaid principal amount thereof, together with accrued and unpaid interest thereon to (but excluding) the date of redemption and all other Secured Obligations owed or then due and payable to the Noteholders, plus Make-Whole Amount, if any....

- J.A. 126. In the 2009–2 Note, voluntary redemption is listed under Section 2.20. The only notable difference between the two sections relates to their notice provisions, which are not material to the case at hand. See J.A. 900.
- [9](#) Section 4.02(a) is discussed *infra*, but it broadly addresses circumstances in which the debt owed by American is accelerated, either upon action by the Loan Trustee in specified circumstances or automatically, upon the occurrence of certain bankruptcy-related Events of Default.
- [10](#) [Section 1110\(a\)](#), to be further discussed *infra*, is a provision of the Bankruptcy Code granting secured parties with a security interest in aircraft or related equipment the power to possess the collateral “in compliance with a security agreement, lease, or conditional sale contract” and to enforce other rights notwithstanding application of the automatic stay under [11 U.S.C. § 362](#) or other Bankruptcy Code provisions. [11 U.S.C. § 1110\(a\)\(1\)](#). In the event that the debtor satisfies the conditions of [§ 1110\(a\)\(2\)](#)—agreeing to perform obligations under its agreement with the secured creditor and curing any default not specified in [11 U.S.C. § 365\(b\)\(2\)](#)—within a designated timeframe, however, the debtor effectively makes a [§ 1110\(a\)](#) “election” and thereby receives protection under the automatic stay so long as it continues to comply with its election. See, e.g., [In re Trans World Airlines, Inc.](#), 145 F.3d 124, 137 (3d Cir.1998) (“If a [§ 1110](#) agreement is executed, which requires court approval but not the lessor’s consent, the automatic stay remains in effect.”).
- [11](#) U.S. Bank made separate objections for the EETC Transactions and the 2009–2 Note throughout the proceedings below, yet the bankruptcy court consolidated these objections in its Memorandum Opinion and accompanying order and judgments. On appeal, U.S. Bank again filed two appellant briefs and replies. As U.S. Bank’s arguments in these two sets of briefs are virtually the same, the legal issues are equivalent, and the relevant indenture language differs in only immaterial respects, we adopt the bankruptcy court’s approach and refer to the separately briefed arguments as one U.S. Bank argument.
- [12](#) U.S. Bank filed a motion before the Bankruptcy Court seeking limited relief from the automatic stay on December 6, 2012.
- [13](#) Declaring a note due and payable is accelerating the debt. See *Black’s Law Dictionary* 12 (9th ed.2009) (defining acceleration as “the advancing of a loan agreement’s maturity date so that payment of the entire debt is due immediately”). Acceleration “changes the date of maturity from some point in the future ... to an earlier date based on the debtor’s default under the contract.” [Analytical Surveys, Inc. v. Tonga Partners, L.P.](#), 684 F.3d 36, 44 (2d Cir.2012) (quoting [NML Capital v. Republic of Argentina](#), 17 N.Y.3d 250, 928 N.Y.S.2d 666, 952 N.E.2d 482, 491 (2011)).
- [14](#) The bankruptcy court also posited that regardless of the language in the Indentures, the debt is automatically accelerated by operation of law when the debtor files a voluntary bankruptcy petition. See [In re AMR Corp.](#), 485 B.R. at 290 n. 7. We agree with the bankruptcy court’s subsequent statement that we “do[] not need to look beyond the controlling language of the operative contract,” *id.*, and so we do not reach this ground for the bankruptcy court’s conclusion.
- [15](#) Section 4.02(d) of the Indentures provides:
- At any time after the Loan Trustee has declared the unpaid principal amount of all Equipment Notes then outstanding to be due and payable, or all Equipment Notes shall have become due and payable as provided in the proviso to Section 4.02(a)(i), and, in either case, prior to the sale of any part of the Collateral pursuant to this Article IV, a Majority in Interest of Noteholders, by written notice to the Company and the Loan Trustee, may rescind and annul such declaration ... if: (i) there has been paid to or deposited with the

Loan Trustee an amount sufficient to pay all overdue installments of principal amount of, and interest on, the Equipment Notes, and all other amounts owing under the Operative Documents, that have become due otherwise than by such declaration of acceleration and (ii) all other Events of Default, other than nonpayment of principal amount or interest on the Equipment Notes that have become due solely because of such acceleration, have been either cured or waived; *provided* that no such rescission or annulment shall extend to or affect any subsequent default or Event of Default or impair any right consequent thereon.

J.A. 148. U.S. Bank also relies on Section 4.05, which provides that the Loan Trustee may waive past defaults upon written instructions from a majority in interest of the noteholders, after which “such default[s] shall cease to exist and any Event of Default arising therefrom shall be deemed to have been cured for every purpose of this Indenture.” J.A. 149.

[16](#) U.S. Bank accords significance to the text of Section 2.11, which states that Equipment Notes “may be redeemed by the Company at *any time* upon at least 15 days’ revocable prior written notice.” J.A. 126 (emphasis added). But this general language carries less weight than the more specific terms contained in Sections 3.02 and 3.03. See  [County of Suffolk v. Alcorn](#), 266 F.3d 131, 139 (2d Cir.2001). The voluntary redemption schedule in Section 3.02 is subordinate to Section 3.03, which undermines U.S. Bank’s argument that American’s attempt to repay its debt after filing a bankruptcy petition can be deemed a voluntary prepayment under Section 3.02.

[17](#) We are not persuaded by U.S. Bank’s attempts to distinguish these cases as involving “no call” provisions. Both “[m]ake-whole and no-call provisions in bond indentures protect lenders’ right to the yield that was expected at the time that they made their loans.”  [In re Chemtura Corp.](#), 439 B.R. 561, 596 (Bankr.S.D.N.Y.2010). Regardless which provision is employed, when the contract explicitly excludes their applicability upon automatic debt acceleration, the lender has no claim under either the no-call or the make-whole when the debtor attempts to pay off the accelerated debt.

[18](#) [11 U.S.C. § 1110\(a\)\(1\)](#) provides as follows:

Except as provided in paragraph (2) and subject to subsection (b), the right of a secured party with a security interest in equipment described in paragraph (3), or of a lessor or conditional vendor of such equipment, to take possession of such equipment in compliance with a security agreement, lease, or conditional sale contract, and to enforce any of its other rights or remedies, under such security agreement, lease, or conditional sale contract, to sell, lease, or otherwise retain or dispose of such equipment, is not limited or otherwise affected by any other provision of this title or by any power of the court.

As set forth *infra*, [paragraph \(2\) of § 1110\(a\)](#), referenced in [§ 1110\(a\)\(1\)](#), provides a means by which a debtor may secure the protection of the automatic stay notwithstanding [§ 1110\(a\)\(1\)](#). [Section 1110\(b\)](#) specifies circumstances in which the time period in which the debtor must act pursuant to [§ 1110\(a\)\(2\)](#) may be extended, and is not relevant to this appeal.

[19](#) As the bankruptcy court noted, [§ 1110\(a\)\(2\)](#) refers to the trustee, not the debtor, but the trustee in this case, as in most cases under Chapter 11, is the debtor-in-possession. [In re AMR](#), 485 B.R. at 305 n. 26. [Section 1110\(a\)\(2\)](#) provides as follows:

The right to take possession and to enforce the other rights and remedies described in paragraph (1) shall be subject to  [section 362](#) if—

(A) before the date that is 60 days after the date of the order for relief under this chapter, the trustee, subject to the approval of the court, agrees to perform all obligations of the debtor under such security agreement, lease, or conditional sale contract; and

(B) any default, other than a default of a kind specified in  [section 365\(b\)\(2\)](#), under such security agreement, lease, or conditional sale contract—

(i) that occurs before the date of the order is cured before the expiration of such 60-day period;

(ii) that occurs after the date of the order and before the expiration of such 60-day period is cured before the later of—

(I) the date that is 30 days after the date of the default; or

(II) the expiration of such 60-day period; and

(iii) that occurs on or after the expiration of such 60-day period is cured in compliance with the terms of such security agreement, lease, or conditional sale contract, if a cure is permitted under that agreement, lease, or contract.

[20](#) The text of [Section 1110\(a\)](#) makes this clear enough, but it is also confirmed in relevant case law. *See, e.g.*,  [In re Trans World Airlines](#), 145 F.3d at 137 (“A [§ 1110](#) agreement ... operates neither as an assumption nor as a rejection of the entire lease ... [and] after the [§ 1110](#) agreement is made, the debtor remains free to make a formal assumption or rejection of the lease and, until that time or such time as the [§ 1110](#) agreement is breached or terminated, the automatic stay of  [§ 362](#) remains in effect.”);  [In re Airlift Int'l, Inc.](#), 761 F.2d 1503, 1508 (11th Cir.1985) (noting that “the debtor upon entering into a [section 1110](#) stipulation does not assume and is not ultimately liable for performance of the contract”); [In re Enron Corp.](#), 300 B.R. 201, 213 (Bankr.S.D.N.Y.2003) (“A debtor's decision to elect to receive benefits under a contract post-petition does not translate into an obligation to assume the contract, because a debtor cannot assume a contract by implication.”).

[21](#) The objection filed in connection with the EETC Indentures similarly noted that “[t]he only existing default under the Prepetition Notes Indentures is the ‘*ipso facto*’ default arising under Section 4.01(g) thereof as a result of the commencement of these chapter 11 cases, and that default is rendered unenforceable by [section 1110\(a\)\(2\)\(B\)](#).”

[22](#)  [Section 365\(b\)\(2\)](#) is part of a Code provision dealing with executory contracts and unexpired leases.  [Paragraph \(1\) of § 365\(b\)](#) sets forth conditions (such as cure of outstanding defaults) that the bankruptcy trustee must satisfy before assuming an executory contract or unexpired lease pursuant to which there has been a default, while  [§ 365\(b\)\(2\)](#), set forth in relevant part here, describes defaults to which Paragraph (1) is inapplicable.

[23](#) We do not reach the bankruptcy court's brief discussion of U.S. Bank's bringing its motion for the first time over a year after American declared bankruptcy. *See In re AMR Corp.*, 485 B.R. at 295.

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Declined to Follow by [In re Hertz Corp.](#), Bankr.D.Del., December 22, 2021

874 F.3d 787

United States Court of Appeals, Second Circuit.

In the MATTER OF: MPM SILICONES, L.L.C.

Momentive Performance Materials Incorporated,
Apollo Global Management, LLC, Ad Hoc Committee
of Second Lien Holders, Plaintiffs-Appellees,
v.BOKF, NA, as First Lien Trustee, Wilmington Trust,
N.A., as 1.5 Lien Trustee, Defendants-Appellants.U.S. Bank National Association, as
Indenture Trustee, Plaintiff-Appellant,
v.Wilmington Savings Fund Society, FSB, as Successor
Indenture Trustee, Momentive Performance Materials
Incorporated, Ad Hoc Committee of Second Lien
Noteholders, Apollo Management, LLC, and Certain
of its Affiliated Funds, Defendants-Appellees.

Nos. 15-1682 (L), 15-1824 (CON)

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No. 15-1771

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August Term, 2016

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Submitted: November 9, 2016

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Decided: October 20, 2017

Synopsis

Background: Order was entered by the United States Bankruptcy Court for the Southern District of New York, [Robert D. Drain](#), J., [2014 WL 4436335](#), confirming debtor's proposed Chapter 11 plan, and noteholders appealed on theory that the plan violated the "absolute priority" rule, that Chapter 11 "cramdown" interest rate was inadequate, and that the lower court had erroneously denied their request for make-whole premium. The District Court, [Briccetti](#), J., [531 B.R. 321](#), affirmed, and noteholders appealed.

Holdings: The Court of Appeals, [Barrington D. Parker](#), Circuit Judge, held that:

[1] proposed Chapter 11 plan did not violate "absolute priority" rule, by providing a partial distribution to second lien noteholders on their claims but none to holders of subordinated notes;

[2] to determine appropriate Chapter 11 "cramdown" rate of interest, bankruptcy court should have engaged in two-stage process and first determined whether there existed an efficient market for loans of type that secured creditors would be required to make under plan;

[3] senior lien noteholders were not entitled to make-whole premium on notes which had been accelerated automatically upon debtors' Chapter 11 filing; and

[4] appeal from district court's affirmance of bankruptcy court's Chapter 11 plan confirmation order was not equitably moot.

Affirmed in part, reversed in part, and remanded.

Procedural Posture(s): On Appeal.

West Headnotes (16)

[1] [Bankruptcy](#) [Conclusions of law; de novo review](#)

[Bankruptcy](#) [Clear error](#)

Court of Appeals exercises plenary review over district court's affirmance of bankruptcy court's decision, reviewing de novo the bankruptcy court's conclusions of law, and reviewing its findings of facts for clear error. [Fed. R. Bankr. P. 8013](#).

[3 Cases that cite this headnote](#)

[2] [Contracts](#) [Intention of Parties](#)

Under New York law, fundamental objective of contract interpretation is to give effect to the expressed intention of the parties.

[25 Cases that cite this headnote](#)

[3] Contracts [Existence of ambiguity](#)

Under New York law, contract language is “ambiguous” if it is capable of more than one meaning.

[24 Cases that cite this headnote](#)

[4] Bankruptcy [Preservation of priority](#)

Proposed Chapter 11 plan did not violate “absolute priority” rule, by providing a partial distribution to second lien noteholders on their claims but none to holders of subordinated notes; ambiguity in trust indenture as to whether second lien notes were “senior indebtedness,” to which these subordinated notes had been subordinated, had to be resolved in favor of finding such subordination, not only because this was consistent with debtors’ repeated representations to the Securities and Exchange Commission (SEC) and to financial community, but because contrary interpretation led to irrational results.

 [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)\(ii\)](#).

[2 Cases that cite this headnote](#)

[5] Contracts [Application to Contracts in General](#)

Evidence  [Showing Intent of Parties as to Subject Matter](#)

When contract term is ambiguous, New York courts look to extrinsic evidence to determine the intention of the parties, including evidence of parties’ apparent intention, evidence of what would be commercially reasonable, and the parties’ interpretation of the contract in practice, prior to litigation.

[17 Cases that cite this headnote](#)

[6] Bankruptcy [Secured creditors, protection of](#)

To determine appropriate Chapter 11 “cramdown” rate of interest to ensure that objecting secured class receives stream of

payments under proposed plan with present value that is at least equal to amount of class members’ allowed secured claims, bankruptcy court should engage in two-stage process and first determine whether there exists efficient market for loans of type that secured creditors will be required to make under plan; only if there is no efficient market for such loans should courts proceed to second stage of process and use “formula” or prime-plus approach to calculate appropriate “cramdown” rate by starting with largely risk-free interest rate and applying appropriate risk adjustments.  [11 U.S.C.A. § 1129\(b\)\(2\)\(A\)\(i\)\(II\)](#).

[5 Cases that cite this headnote](#)

[7] Bankruptcy [Secured creditors, protection of](#)

To determine appropriate Chapter 11 “cramdown” rate of interest to ensure that objecting secured class received stream of payments under proposed plan with present value that was at least equal to amount of class members’ allowed secured claims, bankruptcy court should not have categorically rejected the probative value of evidence as to market rates of interest, but should have considered such evidence to determine whether an efficient market existed for loans of type that objecting secured creditors would be required to make under proposed plan.  [11 U.S.C.A. § 1129\(b\)\(2\)\(A\)\(i\)\(II\)](#).

[3 Cases that cite this headnote](#)

[8] Commercial Paper [Charges, premiums, and penalties](#)

“Make-whole premium” is a contractual substitute for interest lost on promissory notes redeemed before their expected due date, and is meant to ensure that lender is compensated, if paid earlier than the original maturity of loan, for the interest that it will not receive.

[5 Cases that cite this headnote](#)

[9] **Commercial Paper** ➡ [Charges, premiums, and penalties](#)

Senior lien noteholders were not entitled to make-whole premium on notes which had been accelerated automatically upon debtors' Chapter 11 filing, an event of default under senior notes; while notes required payment of make-whole premium in event that they were redeemed early, repayment of notes that had been accelerated automatically due to debtors' bankruptcy filing was not a voluntary early "redemption" of notes prior to their due date, but a repayment contractually required on notes that had become due, pursuant to their terms, due to commencement of jointly administered bankruptcy cases.

[7 Cases that cite this headnote](#)

[10] **Bankruptcy** ➡ [Proceedings, Acts, or Persons Affected](#)

Any attempt by senior noteholders to rescind the automatic acceleration of their notes that occurred due to debtors' Chapter 11 filing, in attempt to preserve their right to make-whole premium, would be a postpetition attempt to modify their contractual rights, and was barred by automatic stay. [11 U.S.C.A. § 362\(a\)](#).

[3 Cases that cite this headnote](#)

[11] **Bankruptcy** ➡ [Moot questions](#)

Equitable mootness is a prudential doctrine that is invoked to avoid disturbing a reorganization plan once implemented.

[2 Cases that cite this headnote](#)

[12] **Bankruptcy** ➡ [Moot questions](#)

Equitable mootness doctrine allows appellate courts to dismiss bankruptcy appeals when, during pendency of appeal, events occur such that, while appellate court may conceivably be able to fashion effective relief, implementation of that relief would be inequitable.

[13] **Bankruptcy** ➡ [Moot questions](#)

Equitable mootness doctrine requires a bankruptcy appellate court to carefully balance importance of finality in bankruptcy proceedings against appellant's right to review and relief.

[3 Cases that cite this headnote](#)

[14] **Bankruptcy** ➡ [Moot questions](#)

When reorganization plan has been substantially consummated, bankruptcy appellate court presumes that appeal from plan confirmation order is equitably moot; that presumption, however, will give way upon showing of presence of the five *Chateaugay* factors: (1) that effective relief can be ordered; (2) that such relief will not affect debtor's re-emergence from bankruptcy; (3) that such relief will not unravel intricate transactions; (4) that affected third parties were notified and able to participate in appeal; and (5) that appellant diligently sought stay of reorganization plan.

[1 Cases that cite this headnote](#)

[15] **Bankruptcy** ➡ [Moot questions](#)

While each of the five *Chateaugay* factors must be satisfied in order to overcome presumption that substantial consummation of Chapter 11 reorganization plan will equitably moot an appeal from plan confirmation order, bankruptcy appellate courts place significant weight on fifth factor, i.e., on whether appellant diligently sought a stay of reorganization plan; if stay was sought, then courts will provide relief if it is at all feasible, that is, unless relief would knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for bankruptcy court.

[1 Cases that cite this headnote](#)

[16] **Bankruptcy** ➡ [Moot questions](#)

Appeal from district court's affirmance of bankruptcy court's Chapter 11 plan confirmation order, on ground that bankruptcy court had

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improperly relied solely on a “formula,” or prime-plus approach, to calculate appropriate “cramdown” interest rate and had not considered whether there was efficient market for loans of type that objecting secured creditors would be required to make under proposed plan, was not rendered equitably moot by substantial consummation of plan, where creditors had diligently sought stay pending appeal from multiple courts, and where requiring debtors to pay additional interest to objecting secured creditors would not unravel the plan, threaten debtors' re-emergence from bankruptcy, or otherwise materially implicate *Chateaugay* concerns.  [11 U.S.C.A. § 1129\(b\)\(2\)\(A\)\(i\)\(II\)](#).

[7 Cases that cite this headnote](#)

***790** Appeals from the United States District Court for the Southern District of New York. Vincent L. Briccetti, *Judge*.

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Ronald J. Mann, Columbia Law School, New York, NY, for Amici Curiae Loan Syndications and Trading Association, the Managed Funds Association, and the Securities Industry and Financial Markets Association.

Before: [Cabranes](#), [Pooler](#), and Parker, Circuit Judges.

Opinion

[Barrington D. Parker](#), Circuit Judge:

Three groups of creditors separately appeal a judgment of the United States District Court of the Southern District of New York (Briccetti, *J.*) affirming the confirmation of Debtors' Chapter 11 reorganization plan by the U.S. Bankruptcy Court (Drain, *J.*). The creditors argue that the plan improperly eliminated or reduced the value of notes they held. Debtors argue that the plan was properly confirmed and that these appeals should be dismissed as equitably moot. With one exception, we conclude that the plan confirmed by the bankruptcy court and affirmed by the district court comports with the provisions of Chapter 11. We remand so that the bankruptcy court can address the single deficiency we identify with the proceedings below which is the process for determining the proper interest rate under the cramdown provision of Chapter 11. We decline to dismiss these appeals as equitably moot.

These appeals by three groups of creditors challenge various aspects of Appellee Momentive Performance Materials, Inc.'s (“MPM,”) substantially consummated plan of reorganization under Chapter 11 of the U.S. Bankruptcy Code.¹ With one exception, we conclude that the reorganization plan (the “Plan”) confirmed by the bankruptcy court and affirmed by the district court comports with Chapter 11. We remand so that the bankruptcy court can address the single deficiency we identify in the proceedings below, which is the process

for determining the proper interest rate under the cramdown provision of Chapter 11.

I

MPM, a leading producer of silicone, faced serious financial problems after it took on significant new debt obligations beginning in the mid-2000s.² See 15-1771 JA 286-88; 15-1682 JA 1605-06.³ Following these debt issuances, MPM was substantially overleveraged, and ultimately filed a petition under Chapter 11. The four relevant classes of notes issued by MPM are as follows:

Subordinated Notes. In 2006, MPM issued \$500 million in subordinated unsecured notes (the “Subordinated Notes”) pursuant to an indenture (the “2006 Indenture”). 15-1771 JA 303. Appellant U.S. Bank is the indenture trustee for the Subordinated Notes. In 2009 MPM issued secured second-lien notes and offered the Subordinated Notes holders the option of exchanging their notes for the newly-issued second-lien notes. The second-lien notes were offered at a 60% discount but were secured. 15-1771 JA 2241. Holders of \$118 million of the Subordinated Notes accepted the offer, leaving \$382 million in unsecured Subordinated Notes outstanding. 15-1771 JA 2241.

Second-Lien Notes. In 2010, MPM issued approximately \$1 billion in “springing” *792 second-lien notes (the “Second-Lien Notes”). 15-1682 JA 1616; 15-1771 JA 476. The Second-Lien Notes were to be unsecured until the \$118 million of previously exchanged Subordinated Notes were redeemed, at which point the “spring” in the lien would be triggered. 15-1771 JA 517, 580-81. Once triggered, the Second-Lien Notes would then (but only then) obtain a security interest in the Debtor’s collateral. The exchanged Subordinated Notes were redeemed in November 2012, 15-1771 JA 721, at which point the trigger occurred and the Second-Lien Notes became secured with second-priority liens junior to other pre-existing liens on the Debtors’ collateral. A primary issue on this appeal is whether the Second-Lien Notes have priority over the Subordinated Notes.

Senior-Lien Notes. In 2012, MPM again issued more debt, this time in the form of two classes of senior secured notes. Specifically, MPM issued \$1.1 billion in first-lien secured notes (the “First-Lien Notes”), and \$250 million in 1.5-lien secured notes (the “1.5-Lien Notes,” and, with

the First-Lien Notes, the “Senior-Lien Notes”). 15-1682 JA 1615. Appellants BOKF and Wilmington Trust are the indenture trustees for the First-Lien Notes and 1.5-Lien Notes, respectively. Pursuant to the governing indentures (the “2012 Indentures”), the Senior-Lien Notes were to be repaid in full by their maturity date of October 15, 2020. They carried fixed interest rates of 8.875% and 10%, respectively. The 2012 Indentures also called for the recovery of a “make-whole” premium if MPM opted to redeem the notes prior to maturity. Because the Second-Lien Notes and the Senior-Lien Notes are secured by the same collateral, the holders of those notes executed an intercreditor agreement (the “Intercreditor Agreement”), which provided that the Senior-Lien Notes stood in priority to the Second-Lien Notes as to their respective liens, but that each was junior to pre-existing liens on MPM’s collateral. 15-1771 JA 691-718. Other primary issues on this appeal are whether the Senior-Lien Note holders are entitled to the make-whole adjustment and the cramdown interest rate they are entitled to if their Notes are replaced under the Plan.

II

After these notes were issued, MPM experienced significant financial problems. See 15-1771 JA 284-88. In April 2014, MPM filed a petition under Chapter 11 and ultimately submitted a reorganization plan to the bankruptcy court. 15-1682 JA 3841-912. Several elements of that Plan are at issue on these appeals. The Plan provided for (i) a 100% cash recovery of the principal balance and accrued interest on the Senior-Lien Notes; (ii) an estimated 12.8%-28.1% recovery on the Second-Lien Notes in the form of equity in the reorganized Debtors; but (iii) no recovery on the Subordinated Notes. 15-1771 JA 271-74.

The Plan also gave the Senior-Lien Notes holders the option of (i) accepting the Plan and immediately receiving a cash payment of the outstanding principal and interest due on their Notes (without a make-whole premium), or (ii) rejecting the Plan, receiving replacement notes “with a present value equal to the Allowed amount of such holder’s [claim],” and then litigating in the bankruptcy court issues including whether they were entitled to the make-whole premium and the interest rate on the replacement notes. 15-1771 JA 271-72; 15-1682 JA 3873-75. The Senior-Lien Notes holders rejected the Plan, and, thus, elected the latter option.

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The appellants here—the Subordinated Notes holders and the Senior-Lien Notes holders—opposed the Plan. (The Second-Lien Notes holders unanimously accepted *793 it.) The Subordinated Notes holders, who were to receive nothing, contended that, under relevant indenture provisions, their Notes were not subordinate to the Second-Lien Notes holders and, consequently, they were entitled to some recovery. The Senior-Lien Notes holders opposed the Plan on the ground that the replacement notes they received did not provide for the make-whole premium, and carried a largely risk-free interest rate that failed to comply with the Code because it was well below ascertainable market rates for similar debt obligations and thus was not fair and equitable because it failed to give them the present value of their claim.

Despite these objections, the bankruptcy court confirmed the Plan following a four-day hearing.  [In re MPM Silicones, LLC, 2014 WL 4436335 \(Bankr. S.D.N.Y. Sept. 9, 2014\)](#), [aff'd, 531 B.R. 321 \(S.D.N.Y. 2015\)](#). Confirmation was facilitated by Chapter 11's “cramdown” provision, which allows a bankruptcy court to confirm a reorganization plan notwithstanding non-accepting classes 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.”  [11 U.S.C. § 1129\(b\)\(1\)](#).

The bankruptcy court concluded that the Plan was fair to the Subordinated Notes holders, despite no recovery, because the 2006 Indenture called for their subordination to the Second-Lien Notes.  [In re MPM Silicones, LLC, 2014 WL 4436335, at *2-*11](#). It held the plan was fair to the Senior-Lien Notes holders because the 2012 Indentures did not require payment of the make-whole premium in the bankruptcy context and because the interest rate on the proposed replacement notes, even though well below a “market” rate, was determined by a formula that complied with the Code's cramdown provision.  [Id. at *11-*32](#).

The bankruptcy court's confirmation order triggered an automatic 14-day stay during which Debtors could not consummate the Plan. *See* [Fed. R. Bankr. P. 3020\(e\)](#). Appellants aggressively took advantage of this period and attempted to block the implementation of the Plan. Specifically, prior to the expiration of the automatic stay, appellants moved in the bankruptcy court to extend the stay pending their appeal of the confirmation order, which the court denied. *See* 15-1682 JA 4099, 4173. They then promptly

moved the district court for a stay, which was also denied. *See* 15-1682 JA 183, 185. Appellants then appealed the denial of the stay to this Court, and we dismissed the appeal for lack of jurisdiction. 15-1682 JA 4872-73. Despite these efforts, the Debtors contend this appeal is equitably moot, a contention with which we do not agree.

The appellants appealed the confirmation order to the district court which affirmed the bankruptcy court's confirmation order.  [531 B.R. 321](#). The district court essentially agreed with the bankruptcy court, concluding that: (i) the relevant indentures unambiguously prioritize the Second-Lien Notes over the Subordinated Notes,  [id. at 326-31](#); (ii) the below market interest rate selected by the bankruptcy court complied with the Code,  [id. at 331-34](#); and (iii) under their indentures, the Senior-Lien Notes holders are not entitled to the make-whole premium in the context of a bankruptcy,  [id. at 335-38](#). The Subordinated Notes holders, the First-Lien Notes holders, and the 1.5-Lien Notes holders separately appealed. ⁴

*794 III

[1] “We exercise plenary review over a district court's affirmance of a bankruptcy court's decisions, reviewing *de novo* the bankruptcy court's conclusions of law, and reviewing its findings of facts for clear error.” *In re Lehman Bros., Inc.*, [808 F.3d 942, 946 \(2d Cir. 2015\)](#) (internal quotation marks omitted).

IV

These appeals raise four issues. First, the Subordinated Notes holders challenge the lower courts' conclusions that their claims are subordinate to the Second-Lien Notes holders' claims. Second, the Senior-Lien Notes holders contend that the lower courts erroneously applied a below-market interest rate to their replacement notes. Third, the Senior-Lien Notes holders challenge the lower courts' rulings that they are not entitled to a make-whole premium. Finally, Debtors argue that we should dismiss these appeals as equitably moot. We find merit only in the Senior-Lien Notes holders' contention with respect to the method of calculating the appropriate interest rate for the replacement notes. We reject the others.

A

The lower courts concluded that the Plan, which provided no distribution to the Subordinated Notes holders, complied with the governing 2006 Indenture. The Subordinated Notes holders argue this conclusion was erroneous because, under the terms of the 2006 Indenture, their claims are not subordinate to the Second-Lien Notes, whose holders recovered under the plan. The Debtors, on the other hand, contend that the 2006 Indenture gives the Second-Lien Notes priority over the Subordinated Notes. We agree with the Debtors, although for somewhat different reasons from the lower courts which found the relevant indenture provisions unambiguous. We find them to be ambiguous, but resolve the ambiguities in favor of the Debtors.

The Subordinated Notes holders' argument begins with Section 10.01 of the 2006 Indenture, which states that the Subordinated Notes are “subordinated in right of payment ... to the prior payment in full of all existing and future Senior Indebtedness of the Company,” and that “only Indebtedness of the Company that is Senior Indebtedness of the Company shall rank senior to the Securities in accordance with the provisions set forth herein.” 15-1771 JA 404. Accordingly, the Second-Lien Notes stand in priority to the Subordinated Notes only if they constitute “Senior Indebtedness.”

“Senior Indebtedness” in the 2006 Indenture begins with what the parties refer to as the “Baseline Definition,” which defines Senior Indebtedness as:

all Indebtedness ... unless the instrument creating or evidencing the same or pursuant to which the same is outstanding expressly provides that such obligations are subordinated in right of payment to any other Indebtedness of the Company ...

15-1771 JA 341.

It is undisputed that the Second-Lien Notes are not subordinated in right of payment to any other indebtedness and that therefore they satisfy the Baseline Definition of Senior Indebtedness. However, the Baseline Definition is then

subject to six enumerated exceptions, the fourth of which (the “Fourth Proviso”) excepts from Senior Indebtedness:

***795** any Indebtedness or obligation of the Company ... that by its terms is subordinate or junior *in any respect* to any other Indebtedness or obligation of the Company ... including any *Pari Passu* Indebtedness.

15-1771 JA 342 (emphasis added).

The Subordinated Notes holders argue that the Fourth Proviso carves out the Second-Lien Notes from the Baseline Definition, *i.e.*, that the Second-Lien Notes are an “[i]ndebtedness or obligation of the Company ... that by its terms is subordinate or junior in any respect to any other Indebtedness of the Company.” The Subordinated Notes holders rely heavily on the “in any respect” language. They argue that the Second-Lien Notes are subordinate to, for example, the First-Lien Notes—because, pursuant to the Intercreditor Agreement, the liens supporting the Second-Lien Notes are junior to the liens supporting the First-Lien Notes—and that they are therefore subordinate to other Indebtedness of the company.

The lower courts rejected this argument, and concluded that the Second-Lien Notes unambiguously constitute Senior Indebtedness despite the Fourth Proviso. They did so in reliance on a distinction between “lien subordination” and “payment (or debt) subordination,” concluding that the Fourth Proviso unambiguously carves out from the Baseline Definition only the latter and not the former.⁵ Because the Second-Lien Notes are not subordinate in *payment* to other note classes—but rather, the *liens* supporting their notes are subordinate—the lower courts concluded that the Second-Lien Notes are not covered by the Fourth Proviso.

We do not agree with the lower courts that the Fourth Proviso unambiguously incorporates a distinction between lien subordination and payment subordination. Rather, we conclude that the Fourth Proviso renders the definition of Senior Indebtedness ambiguous as to whether it includes the Second-Lien Notes. Nevertheless, we conclude that this ambiguity should be resolved in Debtors' favor given the plethora of evidence in the record that the parties intended the Second-Lien Notes to be Senior Indebtedness.

1

[2] [3] As discussed, the lower courts concluded that the Second-Lien Notes are unambiguously Senior Indebtedness. Under New York law, which governs the Indenture, a fundamental objective of contract interpretation is to give effect to the expressed intention of the parties. The initial inquiry is whether the contractual language, without reference to sources outside the text of the contract, is ambiguous. Contract language is ambiguous if it is capable of more than one meaning.

[4] We are not persuaded by the Debtors' (and lower courts') conclusion that the Fourth Proviso's reference to "subordinate ... in any respect" unambiguously refers only to payment subordination and not to lien subordination. The Debtors read the Fourth Proviso as if it states "subordinate ... *in right of payment*," which of course it does not. In so doing, the Debtors disregard the breadth of the term "in any respect," a term which is generally thought *796 to be as broadly encompassing as possible.⁶ And, as a practical matter, it seems to us illogical to believe that a second-lien holder does not possess an obligation that is meaningfully subordinate in some respect to a first-lien holder. These sophisticated parties knew how to cabin the type of subordination to which they refer; the indenture uses the term "subordinate ... in right of payment" many times, including in the Baseline Definition itself.

Moreover, the Debtors' interpretation renders language in the indenture superfluous, which is a common sign of ambiguity. See *RJE Corp. v. Northville Indus. Corp.*, 329 F.3d 310, 314 (2d Cir. 2003) (in assessing ambiguity, courts consider the entire contract "to safeguard against adopting an interpretation that would render any individual provision superfluous" (internal quotation marks omitted)); see also *Lawyers' Fund for Client Protection of State of N.Y. v. Bank Leumi Trust Co. of New York*, 94 N.Y.2d 398, 404, 706 N.Y.S.2d 66, 727 N.E.2d 563 (N.Y. 2000) (concluding that an interpretation that renders a portion of a contract superfluous is "unsupportable: under standard principles of contract interpretation"). Specifically, if the Fourth Proviso only excepts debt subordinate in right of payment, there is no purpose for the "in right of payment" carve-out in the Baseline Definition. We disagree with the lower courts' attempts to interpret away this superfluity by finding a distinction

between "expressly" (in the Baseline Definition) and "by its terms" (in the Fourth Proviso). We see no meaningful distinction between those terms.

Nevertheless, we also conclude that the Subordinated Notes holders' interpretation, that the Fourth Proviso unambiguously excludes the Second-Line Notes from the definition of Senior Indebtedness, is incorrect. As the lower courts correctly concluded, the Subordinated Notes holders' interpretation renders key parts of the Baseline Definition superfluous. Under their reading, that definition excludes from Senior Indebtedness only obligations subordinate "in right of payment," but the Fourth Proviso excludes all obligations that stand behind any type of other obligation. If so, the Baseline Definition's more limited carve-out for debt subordinate "in right of payment" would be unnecessary, because all such debt would be carved out from the definition of Senior Indebtedness by the Fourth Proviso.

As the Subordinated Notes holders correctly acknowledge, "[f]or this indenture, it simply is *not* possible to avoid superfluity." 15-1771 Br. of Appellant 54 (internal quotation marks omitted). Where, as here, varying interpretations render contractual language superfluous, we are not obligated to arbitrarily select one as opposed to another. Because the 2006 Indenture is open to differing reasonable interpretations as to whether the Second-Lien Notes constitute Senior Indebtedness, we conclude that it is ambiguous as a matter of law.

2

[5] Where a contract term is ambiguous, we look to extrinsic evidence to determine the intention of the parties. That evidence can include the parties' apparent intention, *Walk-In Medical Centers, Inc. v. Breuer Capital Corp.*, 818 F.2d 260, 264 (2d Cir. 1987), what would be commercially reasonable, *Fundamental Long Term Care Holdings, LLC v. Cammeby's Funding LLC*, 20 N.Y.3d 438, 445, 962 N.Y.S.2d 583, 985 N.E.2d 893 (2013), and the "parties' *797 interpretation of the contract in practice, prior to litigation," *Ocean Transp., Inc. v. American Philippine Fiber Indus., Inc.*, 743 F.2d 85, 91 (2d Cir. 1984). Applying these tools, we conclude, as did the district court, that the parties understood that the Second-Lien Notes constituted Senior Indebtedness. See *531 B.R. at 331 n.7*.

First, MPM repeatedly represented to the Securities Exchange Commission and to the financial community that the Second-Lien Notes were Senior Indebtedness. It did so in its prospectuses, 8-Ks and 10-Ks. For example, it disclosed in a November 2010 8-K that the Second-Lien Notes are “senior indebtedness of the Company ... and will rank ... senior in right of payment to all existing and future subordinated indebtedness.” 15-1771 JA 3057; *see also* 15-1771 JA 2231. It went further when it subsequently resold certain Subordinated Notes. In a May 2013 prospectus, MPM restated that the Subordinated Notes “are subordinated to all our existing and future senior debt, including the ... Second-Priority Springing-Lien Notes.” MPM also specifically identified as the first risk related to the Subordinated Notes that those holders’ “right to receive payments on the Notes is junior to those lenders who have a security interest in our assets.” 15-1771 JA 3007, 3010. MPM further asserted that in the event it were to file for bankruptcy and were unable to repay its secured debt, “it is possible that there would be no assets remaining from which your claims could be satisfied.” 15-1771 JA 3010. The Subordinated Note holders knew all of this because the Debtors were contractually obligated, pursuant to Section 4.02 of the 2006 Indenture, to provide copies of its 10-Ks, 10-Qs, 8-Ks, and all other required disclosures both to the Subordinated Note holders as well as to their Trustee—a highly sophisticated group of investors. 15-1771 JA 357. There is no dispute that these disclosures occurred. Consequently, it was widely understood in the investment community that the Second-Lien Notes had priority.

Second, the Subordinated Notes holders’ interpretation generates the irrational outcome that the springing of the Second-Lien Notes’ security interest, which was meant to enhance the note holders’ protection, would actually strip those notes of their status as Senior Indebtedness and therefore their priority over the Subordinated Notes. As the bankruptcy court concluded, “[t]here is no logical reason for such a distinction, notwithstanding the subordinated noteholders’ attempt to find one.”  [2014 WL 4436335, at *9](#).

Third, the Subordinated Notes holders’ proposed interpretation that “in any respect” covers all junior liens would mean that no senior note classes would qualify as Senior Indebtedness because each was secured in some respect by a junior lien. For example, the First-Lien Notes were secured in part by a second priority lien on collateral securing a prepetition revolving credit facility. *See* 15-1771

JA 2425-26. We think it highly improbable that anyone understood this interpretation to be correct. Certainly MPM did not. For example, in a December 2012 prospectus MPM represented to the SEC that the Senior-Lien Notes were Senior Indebtedness. 15-1771 JA 3725. Because those note classes are subordinate to pre-existing liens as to the Debtors’ collateral, they, too, would seemingly not qualify as Senior Indebtedness under the Subordinated Notes holders’ interpretation. In light of these factors, we have little trouble concluding that the extrinsic evidence establishes that the most reasonable interpretation of the Indenture is that the Second-Lien Notes are Senior Indebtedness. The judgment of the district court on that issue is, therefore, affirmed.

*798 B

As a consequence of rejecting the Plan, the Senior-Lien Notes holders received replacement notes which pay out their claim over time. The Code permits debtors to make such “deferred cash payments” to secured creditors (*i.e.*, to “cramdown”).  [11 U.S.C. § 1129\(b\)\(2\)\(A\)\(i\)\(II\)](#). However, those payments must ultimately amount to the full value of the secured creditors’ claims. *Id.* To ensure the creditor receives the full present value of its secured claim, the deferred payments must carry an appropriate rate of interest. *See*  [Rake v. Wade, 508 U.S. 464, 472 n.8, 113 S.Ct. 2187, 124 L.Ed.2d 424 \(1993\)](#).

The rate selected by the lower courts for the Senior-Lien Note holders’ replacement notes was based on the “formula” rate. The bankruptcy court selected interest rates of 4.1% and 4.85%, respectively, which were largely risk-free rates slightly adjusted for appropriate risk factors. It is not disputed that this rate is below market in comparison with rates associated with comparable debt obligations. The Debtors defend the application of the “formula” method on the ground that it is required by the plurality opinion in the Chapter 13 case of  [Till v. SCS Credit Corp., 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 \(2004\)](#).

The Senior-Lien Notes holders contend that because this rate is too low, the Plan is not “fair and equitable” as required by  [§ 1129\(b\)](#). They argue that the lower courts should have applied a market rate of interest which is the rate MPM would pay to a contemporaneous sophisticated arms-length lender in the open market. The Senior-Lien Notes holders argued in the

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bankruptcy court that such a market exists and would generate interest in the 5-6+% range. *See* 15-1682 JA 464, 1941. ⁷

The bankruptcy court rejected this approach, and concluded that a cramdown interest rate should “not take market factors into account.” ⁸ 2014 WL 4436335, at *25. Viewing itself as “largely governed by the principles enunciated by the plurality opinion in ⁹ *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004),” it concluded that the proper rate was what the plurality in ¹⁰ *Till* referred to as the “formula” or “prime-plus” rate (discussed more fully below). ¹¹ *Id.* at *24, *26. The district court agreed. ¹² 531 B.R. at 332-34. The Senior-Lien Notes holders argue on appeal that the lower courts erred in concluding that the ¹³ *Till* plurality opinion is wholly applicable to this Chapter 11 proceeding. In substantial part, we agree.

At issue in ¹⁴ *Till* was a Chapter 13 debtor's sub-prime auto loan, carrying an interest rate of 21% and providing the creditor with a \$4,000 secured claim. As with Chapter 11, Chapter 13 allows debtors to provide secured creditors with future property distributions (such as deferred cash payments) whose total “value, as of the effective date of the plan, ... is not less than the allowed amount of such claim.” ¹⁵ 11 U.S.C. § 1325(a)(5)(B)(ii). The question became, as here, how to calculate the interest on the deferred payments such that the creditor would receive the full value of its claim. No single interest-calculation method secured a majority vote on the Court, *799 resulting in a plurality opinion endorsing the “formula” method.

The “formula” approach endorsed by the ¹⁶ *Till* plurality instructs the bankruptcy court to begin with a largely risk-free interest rate, specifically, the “national prime rate ... which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the opportunity costs of the loan, the risk of inflation, and the relatively slight risk of default.” ¹⁷ 541 U.S. at 479, 124 S.Ct. 1951. The bankruptcy court should then hold a hearing to determine a proper plan-specific risk adjustment to that prime rate “at which the debtor and any creditors may present evidence.” ¹⁸ *Id.* Using this approach, “courts have generally approved adjustments

[above the prime rate] of 1% to 3%.” ¹⁹ *Id.* at 480, 124 S.Ct. 1951. ⁸

The ²⁰ *Till* plurality arrived at the “formula” rate after rejecting a number of alternative methods relied on by the lower courts. Significantly, it rejected methods relying on purported “market” rates of interest because those rates “must be high enough to cover factors, like lenders' transactions costs and overall profits, that are no longer relevant in the context of court-administered and court-supervised cramdown loans.” ²¹ 541 U.S. at 477, 124 S.Ct. 1951. The plurality then identified the only factors it viewed as relevant in properly ensuring that the sum of deferred payments equals present value: (i) the time-value of money; (ii) inflation; and (iii) the risk of non-payment. ²² *Id.* at 474, 124 S.Ct. 1951. The plurality concluded that the “formula” or “prime-plus” method best reflects those considerations.

Although ²³ *Till* involved a Chapter 13 petition, the plurality intimated that the “formula” method might be applicable to rate calculations made pursuant to other similarly worded Code provisions. In fact, it cited the Chapter 11 cramdown provision, ²⁴ 11 U.S.C. § 1129(b)(2)(A)(i)(II), among many other provisions, when it noted that “[w]e think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these [Code] provisions.” ²⁵ *Id.* at 474 & n.10, 124 S.Ct. 1951.

Despite that language, however, the plurality made no conclusive statement as to whether the “formula” rate was generally required in Chapter 11 cases. And, notably, the plurality went on to state, in the opinion's much-discussed footnote 14, that the approach it felt best applied in the Chapter 13 context may *not* be suited to Chapter 11. Specifically, in that footnote, the Court stated that in Chapter 13 cramdowns “there is no free market of willing cramdown lenders.” ²⁶ 541 U.S. at 476 n.14, 124 S.Ct. 1951. It continued: “[i]nterestingly, the same is *not* true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. Thus, when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce.” ²⁷ *Id.* (internal citations omitted) (emphasis in original). ⁹

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***800** [6] Many courts have relied on footnote 14 to conclude that efficient market rates for cramdown loans cannot be ignored in Chapter 11 cases. Most notably, the Sixth Circuit, “tak[ing] [its] cue from Footnote 14” of the  [Till](#) plurality, adopted a two-part process for selecting an interest rate in Chapter 11 cramdowns:

[T]he market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the  [Till](#) plurality.

 [In re American HomePatient, Inc.](#), 420 F.3d 559, 568 (6th Cir. 2005). In applying this rule, courts have held that markets for financing are ‘efficient’ where, for example, “they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan.”  [In re Texas Grand Prairie Hotel Realty, L.L.C.](#), 710 F.3d 324, 337 (5th Cir. 2013).¹⁰

We adopt the Sixth Circuit's two-step approach, which, in our view, best aligns with the Code and relevant precedent.

We do not read the  [Till](#) plurality as stating that efficient market rates are irrelevant in determining value in the Chapter 11 cramdown context. And, disregarding available efficient market rates would be a major departure from long-standing precedent dictating that “the best way to determine value is exposure to a market.”  [Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship](#), 526 U.S. 434, 457, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) (assessing a Chapter 11 cramdown); see also  [United States v. 50 Acres of Land](#), 469 U.S. 24, 25 & n.1, 105 S.Ct. 451, 83 L.Ed.2d 376 (1984) (“fair market value” is “what a willing buyer would pay in cash to a willing seller” (internal quotation marks omitted)). In  [Bank of America](#), the Court noted that “one of the Code's innovations [was] to narrow the occasions for courts to make valuation judgments,” and expressed a “disfavor for decisions untested by competitive choice ... when some form of market valuation may be available.”  [Bank of America](#), 526 U.S. at 457-58, 119 S.Ct. 1411.

The Senior-Lien Notes holders presented expert testimony in the bankruptcy court that, if credited, would have established a market rate. This evidence showed that if the Senior-Lien Noteholders were to have approved the Plan and accepted a cash-out payment for their notes, MPM would have had to secure exit financing to cover the lump-sum payment. In preparation for that possible eventuality (which did not come to pass in light of the Senior-Lien Notes holders' rejection of the Plan), MPM went out into the market seeking lenders to provide that financing. Those lenders quoted MPM rates of interest ranging between 5 and 6+%. See  [In re MPM Silicones, LLC](#), 2014 WL 4436335, at *29.

At these rates, the First-Lien Note holders contend that they would have received around \$150 million more than the Plan offered, Br. of First-Lien Appellant 25, 33. The 1.5-Lien Note holders claim that the interest rate chosen by the lower courts led them to receive notes “valued by the market at *less than 93 cents* on the value of the secured claims,” Br. of 1.5-Lien Appellant 20.¹¹ The Plan was objectionable ***801** to the Senior-Lien Notes holders because, in essence, it required them to lend Debtors a significant sum of money and receive a much lower rate of interest than any other lender would have received for offering the same loan to MPM on the open market.

When dealing with a sub-prime loan in the Chapter 13 context, “value” can be elusive because the market is not necessarily efficient and the borrower is typically unsophisticated. However, where, as here, an efficient market may exist that generates an interest rate that is apparently acceptable to sophisticated parties dealing at arms-length, we conclude, consistent with footnote 14, that such a rate is preferable to a formula improvised by a court. See  [Bank of America](#), 526 U.S. at 457, 119 S.Ct. 1411; see also  [In re Valenti](#), 105 F.3d 55, 63 (2d Cir. 1997) (the goal of the cramdown rate “is to put the creditor in the same economic position that it would have been in had it received the value of its allowed claim immediately”); see also 15-1682 JA 3428 (First-Lien Notes holders' expert testifying that because the First-Lien Notes holders “are pricing it at the market ... they're being compensated for the underlying risk that they are taking,” and not for any “imbedded profit”).

We understand that the complexity of the task of determining an appropriate market rate will vary from case to case. In some cases the task will be straightforward, in others it will

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be more complex. But, at the end of the day, we have no reason to believe the task varies materially in difficulty from the myriad tasks which we regularly rely on the expertise of our bankruptcy courts to resolve.

[7] We therefore conclude that the lower courts erred in categorically dismissing the probative value of market rates of interest. We remand so that the bankruptcy court can ascertain if an efficient market rate exists and, if so, apply that rate, instead of the formula rate.¹² We arrive at no conclusion with regard to the outcome of this inquiry.

C

[8] The 2012 Indentures governing the Senior-Lien Notes contain Optional Redemption Clauses, which provide for the payment of a make-whole premium¹³ (referred to as the “Applicable Premium” in the indentures) if MPM were to “redeem the Notes at its option” prior to October 15, 2015. 15-1682 JA 2322.¹⁴ The make-whole *802 premium was intended to ensure that the Senior-Lien Notes holders received additional compensation to make up for the interest they would not receive if the Notes were redeemed prior to their maturity date.

[9] In October 2014, the Debtors, pursuant to the Plan, issued replacement notes to the Senior-Lien Notes holders, which did not account for the make-whole premium. These holders contended that the failure to include that premium violated the 2012 Indentures. The bankruptcy court concluded that the Senior-Lien Notes holders were not entitled to the premium. It reasoned that under the 2012 Indentures the make-whole premium would be due only in the case of an “optional redemption” and not in the case of an acceleration brought about by a bankruptcy filing.  [2014 WL 4436335, at *11-15](#). The district court agreed.  [531 B.R. at 335-38](#). We too agree.

The Senior-Lien Notes holders claim entitlement to the make-whole premium for essentially three reasons: (i) they are entitled to the make-whole under the 2012 Indentures' Optional Redemption Clauses; (ii) they are entitled to it under the 2012 Indentures' Acceleration Clauses; and (iii) even if the indentures did not allow for a make-whole premium upon acceleration, they should not have been permanently barred

from exercising their contractual right to rescind acceleration and thereby obtain the make-whole premium.

1

The Senior-Lien Notes holders' principal argument is that they are entitled to the make-whole premium because when MPM issued the replacement notes under the Plan, it “redeemed” the Notes “at its option” prior to maturity. This argument fails for the same reasons we rejected nearly identical arguments in  [In re AMR Corp., 730 F.3d 88 \(2d Cir. 2013\)](#). There we rejected the note holders' argument that they were entitled to a make-whole premium following a debtor's bankruptcy filing. We concluded that:

American's bankruptcy petition triggered a default, and this default automatically accelerated the debt. That acceleration changed the date of maturity from some point in the future ... to an earlier date based on the debtor's default under the contract. ... When the event of default occurred and the debt accelerated, the new maturity for the debt was November 29, 2011 [the date of the bankruptcy petition]. Consequently, American's attempt to repay the debt in October 2012 was not a voluntary prepayment because [p]repayment can only occur *prior* to the maturity date.

 [Id. at 103](#) (internal citations and quotation marks omitted).

The Senior-Lien Notes holders argue  [AMR](#) is inapplicable because it spoke only to “prepayment” rather than “redemption.” As the district court noted, the principle of  [AMR](#) does not turn on the distinction between “prepayment” and “redemption.”  [531 B.R. at 336-37](#). In fact, in  [AMR](#) we stated that because “American's debt was accelerated ... upon its bankruptcy filing [it] is not now voluntarily redeeming the notes.”  [AMR, 730 F.3d at 109](#).

We also held in [*AMR*](#) that acceleration brought about by a bankruptcy filing changes the date of maturity of the accelerated notes to the date of the petition. [730 F.3d at 103](#). Therefore, any payment on the accelerated notes following a bankruptcy filing would be a *post*-maturity payment. And, as the First-Lien Notes holders *803 concede, the “plain meaning of the term ‘redeem’ is to ‘repay[] ... a debt security ... *at or before* maturity.’ ” 15-1682 Br. of First-Lien Appellant 39 (emphasis added). Here, Debtors’ payment was *post*-maturity, not “at or before” maturity. *But see* [*In re Energy Future Holdings Corp.*, 842 F.3d 247, 255 \(3d Cir. 2016\)](#). Moreover, even assuming MPM’s issuance of the replacement notes was a “redemption,” it would not have been “at [MPM’s] option,” as required to trigger the Optional Redemption Clauses. Rather, the obligation to issue the replacement notes came about automatically by operation of separate indenture provisions, the Automatic Acceleration Clauses. A payment made mandatory by operation of an automatic acceleration clause is not one made at MPM’s option. *See* [*AMR*, 730 F.3d at 100B01](#).

2

As discussed, the 2012 Indentures each contain an Acceleration Clause, which calls for the acceleration of payment of the Senior-Lien Notes under certain conditions constituting an Event of Default. Pursuant to Section 6.01(g), one such event is MPM’s filing of a voluntary bankruptcy petition. Although most Events of Default allow the Senior-Lien Notes holders the *option* of accelerating payment, a default brought about by MPM’s voluntary bankruptcy petition leads to an *automatic* acceleration under Section 6.02. ¹⁵

The Senior-Lien Notes holders argue that the term “premium, if any” in the Acceleration Clauses requires that the make-whole premium is due upon an automatic acceleration. This argument fails in light of our conclusion that the Senior-Lien Notes holders are not entitled to the make-whole premium under the Optional Redemption Clauses. In other words, the make-whole premium is not due pursuant to the Acceleration Clauses’ reference to “premium, if any,” for the simple reason that the more specific Optional Redemption Clauses which grant the make-whole are not triggered and thus no premium has been generated. *See* [*Aramony v. United Way*](#)

[*of Am.*, 254 F.3d 403, 413 \(2d Cir. 2001\)](#) (noting that “it is a fundamental rule of contract construction that specific terms and exact terms are given greater weight than general language” (internal quotation marks omitted)).

3

[10] Finally, the Senior-Lien Notes holders argue that the lower courts erred in disregarding their contractual right to rescind acceleration, ¹⁶ a right that if invoked would have reinstated the original maturity date and thereby kept the Optional Redemption Clauses (and therefore the make-whole premium) in effect.

[*AMR*](#) forecloses this argument as well. There, considering nearly identical indenture language, we concluded that a creditor’s post-petition invocation of a contractual right to rescind an acceleration triggered automatically by a bankruptcy filing is barred because it would be “an attempt to modify contract rights and would therefore be subject to the automatic *804 stay.” [730 F.3d at 102](#); *see also* [*id.* at 102-03](#) (“any attempt by U.S. Bank to rescind acceleration now—after the automatic stay has taken effect—is an effort to affect American’s contract rights, and thus the property of the estate”).

The Senior-Lien Notes holders again attempt to distinguish

[*AMR*](#) by relying on the fact that the acceleration provision there, unlike the one here, expressly disavowed the make-whole premium. According to the 1.5-Lien Notes holders, our concern in [*AMR*](#) was therefore with not allowing the creditors “an end-run around their bargain by rescission.” 15-1682 Br. of 1.5-Lien Appellant 45. This argument fails because, although the provisions at issue here do not expressly disallow the make-whole premium, the Optional Redemption Clauses, as we have seen, achieve this result. Therefore, just as in [*AMR*](#), because the right to rescind acceleration here would serve as “an end-run around their bargain by rescission,” the lower courts correctly concluded that the automatic stay barred rescission of the acceleration of the Notes.

V

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[11] [12] [13] Debtors seek dismissal of these appeals under the principle of equitable mootness, a “prudential doctrine that is invoked to avoid disturbing a reorganization plan once implemented.”  [In re Metromedia Fiber Network, Inc.](#), 416 F.3d 136, 144 (2d Cir. 2005).¹⁷ The doctrine “allows appellate courts to dismiss bankruptcy appeals ‘when, during the pendency of an appeal, events occur’ such that ‘even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable.’ ”  [In re Motors Liquidation Co.](#), 829 F.3d 135, 167 (2d Cir. 2016) (quoting  [In re Chateaugay Corp.](#), 988 F.2d 322, 325 (2d Cir. 1993) (“ [Chateaugay II](#)”). The doctrine requires us to “carefully balance the importance of finality in bankruptcy proceedings against the appellant’s right to review and relief.”  [In re Charter Commc’ns, Inc.](#), 691 F.3d 476, 481 (2d Cir. 2012). With these principles in mind, we decline to dismiss any of these appeals as equitably moot.

[14] Where, as here, a reorganization plan has been substantially consummated, we presume that an appeal of that plan is equitably moot. [In re BGI, Inc.](#), 772 F.3d 102, 104 (2d Cir. 2014). That presumption, however, gives way where five factors first identified in  [Chateaugay II](#) are met. They are, where: (i) effective relief can be ordered; (ii) relief will not affect the debtor’s re-emergence; (iii) relief “will not unravel intricate transactions”; (iv) affected third-parties are notified and able to participate in the appeal; and (v) appellant diligently sought a stay of the reorganization plan.  [In re Charter](#), 691 F.3d at 482.

[15] Although we require satisfaction of each  [Chateaugay II](#) factor to overcome a mootness presumption, we have placed significant reliance on the fifth factor, concluding that a “chief consideration under  [Chateaugay II](#) is whether the appellant sought a stay of confirmation.”  [In re Metromedia](#), 416 F.3d at 144. Along these lines, we concluded that “[i]f a stay was sought, we will provide relief if it is at all *805 feasible, that is, unless relief would ‘knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court.’ ”  [Id.](#) (quoting [Chateaugay II](#), 10 F.3d 944, 953 (2d Cir. 1993)).

A special emphasis on this factor is sound. Equitable mootness issues only arise in earnest following a judicial determination that some facet of a reorganization plan violates the Code. It is generally considered inappropriately harsh to deny relief to which one is entitled on the purportedly equitable ground that the unfair (or illegal) plan has been put into effect, especially where a creditor took all appropriate steps to secure judicial relief. In such a case, we have held that it is proper to “provide relief if it is at all feasible.”  [Id.](#)

[16] Here, the appellants immediately objected to various provisions of the Plan and promptly and consistently sought a stay in three different courts. Thus their diligence is not in question. Debtors nevertheless argue that these appeals should be dismissed as moot because of the cascading effects of rewriting the plan were the appellants to prevail. Specifically, they argue that “granting the Noteholders’ relief would alter a critical piece of the Plan resulting from the intense-multi-party negotiation, thereby impact[ing] other terms of the agreement and throw[ing] into doubt the viability of the Plan,” and that according such relief “would cause debilitating financial uncertainty” to the emergent Debtor. 15-1682 Br. of Appellees 69, 71 (internal quotation marks omitted).

In light of the limited nature of the remand we order, we do not believe these concerns will materialize. On remand, the bankruptcy court will only be called on to re-evaluate the interest to be received on the replacement notes held by the Senior-Lien Notes holders. The Debtors acknowledge that this might require, at most, \$32 million of additional annual payments over seven years. 15-1682 Br. of Appellees 69. The Debtors will not have to pay out the nearly \$200 million they assert would be required to pay the Senior-Lien Notes holders’ make-whole premium, nor will any redistribution be required to the Subordinated Notes holders, as to which the plan is fair. In fact, our judgment allows for no redistribution other than that from the Debtors to the Senior-Lien Notes holders.

Given the scale of Debtors’ reorganization, we are not persuaded that a payment of, perhaps, \$32 million in annual payments over seven years, with no other redistribution from other creditors or third parties, would unravel the plan, threaten Debtors’ emergence, or otherwise materially implicate the concerns identified in  [Chateaugay II](#).

Our conclusion is supported by the findings of the lower courts, which had intimate familiarity with the Debtors’

financial condition and the transactions that will arise from the reorganization. Although it made no determinative ruling as to equitable mootness, the bankruptcy court opined that “the risk of equitable mootness is not strong here *for either set of movants* ... the senior secured lender set of movants and the senior subordinated noteholder movants.” 15-1682 JA 4165 (emphasis added). The district court agreed. 15-1682 JA 4837 (“I agree with Judge Drain that the risk of equitable mootness here is not very great ...”). Debtors' request that we dismiss these appeals as equitably moot is denied.

VI

To summarize, we conclude as follows:

1. The Second-Lien Notes stand in priority to the Subordinated Notes.
- *806 2. The Senior-Lien Notes holders are not entitled to the make-whole premium.

3. The lower court erred in the process it used to calculate the interest rate applicable to the replacement notes received by the Senior-Lien Notes holders. On remand, the bankruptcy court should assess whether an efficient market rate can be ascertained, and, if so, apply it to the replacement notes.
4. We decline to dismiss any of these appeals as equitably moot.

For the foregoing reasons, we **AFFIRM** the District Court's order in part, with respect to the priority of the Subordinated Notes and the Senior-Lien Notes holders' entitlement to a make-whole premium; **REVERSE** the order in part, with respect to the method of calculating the interest rate on the Senior-Lien Notes holders' replacement notes; and **REMAND** the matter for further proceedings consistent with this opinion.

All Citations

874 F.3d 787, Bankr. L. Rep. P 83,176

Footnotes

- ¹ Momentive Performance Materials, Inc.'s “MPM,” and with affiliated debtors, “Debtors”.
- ² The facts recounted herein derive principally from the bankruptcy court's decision confirming Debtors' reorganization plan,  [In re MPM Silicones, LLC, 2014 WL 4436335 \(Bankr. S.D.N.Y. Sept. 9, 2014\)](#), *aff'd*  [531 B.R. 321 \(S.D.N.Y. 2015\)](#), as well as the public disclosures made part of the record. We rely on the facts recounted in the bankruptcy court's ruling in light of our “oblig[ation] to accept the bankruptcy court's undisturbed findings of fact unless they are clearly erroneous.”  [Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395, 396 \(2d Cir. 1987\)](#).
- ³ As discussed, *infra* note 4, we resolve with this opinion three separate appeals. Our citations to the respective records will begin with the relevant docket number on appeal, and references to “JA” are to the respective joint appendices filed with that appeal. For example, our citation to “15-1771 JA 286-88” is to pages 286-88 of the joint appendix filed in the appeal brought by U.S. Bank, docketed No. 15-1771.
- ⁴ The appeals by the First-Lien Notes holders (No. 15-1682) and 1.5-Lien Notes holders (No. 15-1824) were consolidated and heard in tandem with the appeal by the Subordinated Notes holders (No. 15-1771).
- ⁵ The district court discussed in some detail the distinction between lien subordination and payment/debt subordination.  [531 B.R. at 328](#). In short, “[l]ien subordination involves two senior creditors with security interests in the same collateral, one of which has lien priority over the other. ... By contrast, in payment subordination, the senior lender enjoys the right to be paid first from all assets of the borrower or any

applicable guarantor, whether or not constituting collateral security for the senior or subordinated lenders.”

 [Id.](#)

[6](#) Debtors' attempt to downplay the significance of the term “in any respect” in this context is unconvincing given that the term appears nowhere else in the indenture other than in the Fourth Proviso.

[7](#) Debtors' reorganization plan proposed interest rates of 3.6% and 4.09%.  See [2014 WL 4436335, at *24](#). However, the bankruptcy court concluded that those rates should be increased by 0.5% and 0.75%, respectively, in light of the fact that the base interest rate was pegged to the Treasury rate, rather than the prime rate (which reflects additional risk).  [Id. at *32](#). On appeal to the district court, the Senior-Lien Notes holders argued the bankruptcy court erred in not requiring the prime rate, an argument the district court rejected.  [531 B.R. at 334-35](#). The Senior-Lien Notes holders do not press this argument here.

[8](#) Here, the bankruptcy court applied risk adjustments of 2.0% and 2.75%, which it added to the Treasury rate of 2.1% to arrive at interest rates of 4.1% and 4.85%, respectively.  [2014 WL 4436335, at *32](#). Debtors assert in their briefing that the Treasury rate dropped by approximately 0.2% between the confirmation date and the plan's effective date, which thereby further lowered their notes' interest rate. 15-1682 Br. of Appellee at 11 n.3.

[9](#) The Supreme Court has not subsequently spoken about the interest-calculation method to be applied in a Chapter 11 case. Nor have we.

[10](#) Numerous courts, included in this Circuit, have followed the  [American HomePatient](#) approach. See, e.g.,  [In re 20 Bayard Views, LLC, 445 B.R. 83, 108-09 \(E.D.N.Y. 2011\)](#) (collecting cases and deciding to “follow the majority approach” first outlined in  [American HomePatient](#)).

[11](#) The Senior-Lien Notes holders offered evidence that the market price for their notes dropped, respectively, from 101.375% and 104.000% six days prior to the bankruptcy court's oral decision, to 94.375% and 92.563% nine days after that decision. 15-1682 JA 3991 ¶¶ 5-6, 8-9.

[12](#) We acknowledge that the lower courts grappled with the Senior-Lien Notes holders' evidence regarding MPM's quoted exit financing, and made express their view that the rate produced by that process may not in fact have been produced by an efficient market.  [2014 WL 4436335, at *26, *29](#);  [531 B.R. at 334 n.9](#). Nevertheless, Judge Drain left no ambiguity that he applied the “formula” approach for Chapter 13 individual bankruptcy cases as dictated by the  [Till](#) plurality and, in so doing, explicitly declined to consider market forces. See  [2014 WL 4436335, at *25-*26](#); see also  [id. at *28](#) (“I conclude that [the  [American HomePatient](#)] two-step method, generally speaking, misinterprets  [Till](#)”). Judge Briccetti agreed with this approach.  [531 B.R. at 334](#). As discussed, this was in error. The bankruptcy court should have the opportunity to engage the  [American HomePatient](#) analysis in earnest.

[13](#) A make-whole premium is a “contractual substitute for interest lost on Notes redeemed before their expected due date.”  [In re Energy Future Holdings Corp., 842 F.3d 247, 251 \(3d Cir. 2016\)](#) (“ [EFH](#)”). As stated by the bankruptcy court, its purpose “is to ensure that the lender is compensated for being paid earlier than the original maturity of the loan for the interest it will not receive”  [2014 WL 4436335, at *15](#).

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- [14](#) We cite in this section to the indenture for the First-Lien Notes; the indenture for the 1.5-Lien Notes is identical for relevant purposes.
- [15](#) Section 6.02 provides: “If an Event of Default specified in Section 6.01(f) or (g) with respect to MPM occurs, the principal of, premium, if any, and interest on all the Notes shall ipso facto become and be immediately due and payable without any declaration or other act on the part of the Trustee or any Holders.” 15-1682 JA 2260.
- [16](#) “Holders of a majority in principal amount of outstanding Notes by notice to the Trustee may rescind any such acceleration with respect to the Notes and its consequences.” 15-1682 JA 2260.
- [17](#) Debtors filed with the district court a motion to dismiss the appeal of the bankruptcy court's confirmation order on the basis of equitable mootness. 15-1771 JA 4570-88. The district court made no ruling on the motion, concluding it was “mooted by this Court's decision to affirm the Orders of the Bankruptcy Court.”  [531 B.R. at 338 n.14](#). Debtors then filed motions to dismiss on equitable mootness grounds with this Court, 15-1682 Doc. 58; 15-1771 Doc. 62, which we summarily denied without prejudice to Debtors “rais[ing] the issue ... in their merits brief,” 15-1682 Doc. 159; 15-1771 Doc. 102.

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629 B.R. 154

United States Bankruptcy Court, D. Delaware.

IN RE: ASHINC CORPORATION, et al., Debtors.

Catherine E. Youngman, Litigation Trustee for
Ashinc Corporation, et al., as Successor To the
Official Committee of Unsecured Creditors of Ashinc
Corporation, and Its Affiliated Debtors Plaintiff,
BDCM Opportunity Fund II, LP, Black
Diamond CLO 2005-1 Ltd., and Spetrum
Investment Partners, L.P., Intervenor,

v.

Yucaipa American Alliance Fund I, L.P., and Yucaipa
American Alliance (Parallel) Fund I, L.P., Defendants.

Catherine E. Youngman, Litigation Trustee for
Ashinc Corporation, et al., as Successor To BDCM
Opportunity Fund II, LP., Black Diamond CLO
2005-1 Ltd., [Spectrum Investment Partners L.P.](#),
Black Diamond Commerical Finance, L.L.C., as [Co-](#)
Administrative Agent, and Spectrum Commerical
Finance LLC, as [Co-](#)Administrative Agent, Plaintiff,

v.

Yucaipa American Alliance Fund I, L.P., and Yucaipa
American Alliance (Parallel) Fund I, L.P., Defendants

Case No. 12-11564 (CSS) (Jointly Administered)

|

Adv. Proc. No.: 13-50530 (CSS)

|

Adv. Pro. No. 14-50971 (CSS)

|

Signed May 4, 2021

Synopsis

Background: Trustee of litigation trust established under debtor's confirmed Chapter 11 plan brought adversary proceeding to recover on breach of contract, breach of implied covenant of good faith and fair dealing, fraudulent transfer, breach of fiduciary duty, tortious interference, equitable subordination, and debt recharacterization theories from corporate debtor's controlling equity holder and others. Parties cross-moved for summary judgment.

Holdings: The Bankruptcy Court, [Christopher S. Sontchi](#), Chief Judge, held that:

[1] language in contract could not reasonably be interpreted as a release of any claims that debtor might have for equity holder's failure to make an agreed 50% capital contribution;

[2] statute of limitations on action for controlling equity holder's continuous breach of terms of first lien credit agreement and amendment thereto did not begin to run until extent of monetary damages caused by equity holder's continuous breaches were ascertainable;

[3] debtor did not receive any direct value, for constructive fraudulent transfer avoidance purposes, for payments that it made to obtain a bad faith amendment of first lien credit agreement that eliminated protections that it had previously enjoyed

[4] even if debtor benefited indirectly, lack of evidence comparing the value of such indirect benefits with the very substantial payments that debtor made foreclosed argument that such indirect benefits were reasonably equivalent to what debtor gave up;

[5] genuine issue of material fact precluded entry of summary judgment for controlling equity holder on breach of fiduciary duty claims asserted by litigation trustee;

[6] controlling equity holder engaged in inequitable conduct that benefited itself and harmed debtor and its creditors, in manner warranting the equitable subordination of its inside claim; but

[7] actions that occurred subsequent to the advance of funds to Chapter 11 debtor, when first lien credit agreement was amended to modify restrictions on equity holder's ability to acquire debtor's debt, did not permit recharacterization of the debt.

Motions granted in part and denied in part.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (71)

[1] [Contracts](#)  [Grounds of action](#)

Under New York law, elements of claim for breach of contract are (1) the existence of

contract, (2) plaintiff's performance under that contract, (3) defendant's breach thereof, and (4) resulting damages.

In action for breach of contract under New York law, there must be certainty as to fact of damages, not the amount.

[2] [Damages](#) ➡ [Mode of estimating damages in general](#)

Debtor was damaged by controlling equity holder's breach of contract, in not making a capital contribution of 50% of the amount of any term loans that it purchased from debtor's lender, and the amount of its damages was the capital contribution that equity holder failed to make in exchange for modification of restrictions that prevented it from acquiring debtor's debt; while bankruptcy court could not say with certainty that debtor would not have burned through this \$57.4 million capital contribution and would not have been forced to file for bankruptcy regardless, equity holder's actions ensured a future bankruptcy filing, and equity holder bore the burden of any uncertainty as to amount of damages caused by its breach.

[3] [Damages](#) ➡ [Mode of estimating damages in general](#)

Under New York law, damages for breach of contract must be measured as of the date of the breach.

[4] [Damages](#) ➡ [Breach of contract in general](#)

Under New York law, once a breach of contract is established, mathematical precision is unnecessary to recover damages.

[5] [Damages](#) ➡ [Breach of contract in general](#)

Under New York law, in order to establish its damages for breach of contract, plaintiff need establish only a stable foundation for a reasonable estimate of damage incurred as result of the breach.

[6] [Damages](#) ➡ [Breach of contract in general](#)

[7] [Damages](#) ➡ [Amount of damages](#)

Under New York law, burden of uncertainty as to amount of damages for breach of contract is upon wrongdoer.

[8] [Interest](#) ➡ [Contract and sales matters](#)

Under New York law, prejudgment interest is recoverable upon a sum awarded for a breach of contract.

[9] [Interest](#) ➡ [Computation of rate in general](#)

[Interest](#) ➡ [Creation or accrual of indebtedness](#)

Under New York law, prejudgment interest on damages awarded for breach of contract accrues at the 9% rate, running from the date of the breach.

[10] [Compromise, Settlement, and Release](#) ➡ [Finance, banking, and credit](#)

Mere fact that a third amendment to first lien credit agreement, which modified restrictions that prevented controlling equity holder from purchasing debtor's debt in exchange for promise by equity holder to contribute 50% of the amount of any term loans so purchased to debtor, also contained provision detailing lenders' rights, but not the rights of debtor, if equity holder were to breach its obligations under the third amendment, could not reasonably be interpreted as a release of any claims that debtor might have for equity holder's failure to make this 50% contribution; amendment could not be interpreted as both granting the debtor a right to a capital contribution and, simultaneously, barring debtor from enforcing that right.

[11] [Compromise, Settlement, and Release](#) ➡ [Covenant not to sue](#)

Under New York law, covenant not to sue is governed by principles of contract law.

New York law disfavors agreements intended to absolve a party from the consequences of its wrongdoing, and thus releases and covenants not to sue are subject to the closest of judicial scrutiny to determine the parties' intent.

[12] [Contracts](#) ➡ [Ambiguity in general](#)

Under New York law, ambiguous or unambiguous nature of contract is question for the court.

[18] [Compromise, Settlement, and Release](#) ➡ [Certainty and definiteness](#)

Under New York law, in order for document to constitute a release from liability, it must contain an explicit, unmistakable and unequivocal statement by one party that it intends to abandon its right to prosecute present or future claim against the other party.

[13] [Compromise, Settlement, and Release](#) ➡ [Questions of Law or Fact](#)

[Contracts](#) ➡ [Ambiguity in general](#)
Under New York law, interpretation of unambiguous contract, including a release, is question of law reserved for the court.

[19] [Contracts](#) ➡ [Construction as a whole](#)

Under New York law, court must give effect and meaning to every term of the contract, and reasonable effort must be made to harmonize all of its terms.

[14] [Contracts](#) ➡ [Ambiguity in general](#)

Under New York law, when contract language is ambiguous, choice among differing interpretations of contract presents a triable issue of fact for fact-finder.

[20] [Contracts](#) ➡ [Construction to give validity and effect to contract](#)

Under New York law, contract must be interpreted to give effect to, not nullify, its general or primary purpose.

[15] [Compromise, Settlement, and Release](#) ➡ [Covenant not to sue](#)

In general, covenants not to sue are permitted under New York law.

[21] [Contracts](#) ➡ [Application to Contracts in General](#)

[Contracts](#) ➡ [Language of Instrument](#)

Under New York law, written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.

[16] [Compromise, Settlement, and Release](#) ➡ [Covenant not to sue](#)

Under New York law, if two parties sign a covenant not to sue each other, then a dispute arising out of conduct covered by their agreement cannot provide the basis for a justiciable controversy, and lawsuit must be dismissed.

[22] [Limitation of Actions](#) ➡ [Continuing Contracts](#)

Under Delaware law, statute of limitations does not generally run on a cause of action for a continuing breach of contract until the termination of the contract. [10 Del. Code § 8106](#).

[17] [Compromise, Settlement, and Release](#) ➡ [Language and intent in general](#)

[23] [Limitation of Actions](#) [Contracts:](#)
[warranties](#)

Under Delaware law, in cases of continuous contracts and continuing breaches, the statute of limitations on breach of contract action begins to run only when full damages can be ascertained and recovered. [10 Del. Code § 8106](#).

[24] [Contracts](#) [Entire or Severable Contracts](#)

Under Delaware law, determining whether obligations under a contract are continuous or severable, turns upon the parties' intent, which may be ascertained through the contract's terms and subject matter, taken together with the pertinent facts and circumstances' surrounding its formation.

[25] [Limitation of Actions](#) [Contracts:](#)
[warranties](#)

Under Delaware law, statute of limitations on action for controlling equity holder's continuous breach of terms of first lien credit agreement and amendment thereto, not just in failing to make an agreed capital contribution, but in causing debtor to cease to make required principal and interest payments, in blocking lenders from debtor's financial information, in preventing any restructuring dialogue among lenders, in preventing lenders from exercising remedies for debtor's ongoing defaults, and in routinely asserting claims against lenders in contravention of express covenant not to sue, did not begin to run until extent of monetary damages caused by equity holder's continuous breaches were ascertainable, when third party purchased substantially all of debtor's assets for price that resulted in only \$53.8 million available for distribution on the \$244 million owed to first lien lenders. [10 Del. Code § 8106](#).

[26] [Specific Performance](#) [Enforcement](#)
[ineffectual or not beneficial](#)

Any claim for specific performance of controlling equity holder's obligation, in

exchange for modification of first lien credit agreement to allow it to purchase debtor's debt, to make a capital contribution to debtor in amount of 50 percent of amount of any term loans that it purchased, was moot once debtor filed for bankruptcy and obtained confirmation of Chapter 11 plan, when there was no longer any corporate entity to which equity holder could contribute capital.

[27] [Bankruptcy](#) ["Reasonably equivalent value" in general](#)

To determine whether transfer was made for less than "reasonably equivalent value," as required to be avoidable as constructively fraudulent transfer, courts must first make factual determination as to whether debtor received any value at all.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[28] [Bankruptcy](#) ["Reasonably equivalent value" in general](#)

Question of whether debtor received less than "reasonably equivalent value" for transfer, as required for avoidance thereof as constructively fraudulent to creditors, must be determined from standpoint of the creditors.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[1 Cases that cite this headnote](#)

[29] [Bankruptcy](#) ["Reasonably equivalent value" in general](#)

In constructive fraudulent transfer avoidance proceeding, it is only if debtor received value in exchange for transfer that court considers whether that value was reasonably equivalent to what debtor gave up.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[1 Cases that cite this headnote](#)

[30] [Bankruptcy](#) [Consideration](#)

Value, for constructive fraudulent transfer avoidance purposes, is determined based on the

benefit, direct or indirect, that debtor received.

 [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[31] [Bankruptcy](#) [Future or indirect benefit; benefit to third party](#)

When debtor makes a transfer solely for the benefit of third party, debtor does not receive “reasonably equivalent value,” and thus transfer is potentially subject to avoidance as constructively fraudulent to creditors.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[32] [Bankruptcy](#) [Future or indirect benefit; benefit to third party](#)

Even if transfer was made for the benefit of third party, if the benefit ultimately flowed to debtor, debtor likely received indirect value, such as may preclude avoidance of transfer as constructively fraudulent to creditors.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[33] [Bankruptcy](#) [Future or indirect benefit; benefit to third party](#)

Even losing investments, or money spent on investments that fail to stabilize or improve debtor's condition, can confer value, for constructive fraudulent transfer avoidance purposes.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[34] [Bankruptcy](#) [Future or indirect benefit; benefit to third party](#)

When debtor makes a losing investment, value can be conferred, such as may preclude avoidance of transaction as constructively fraudulent transfer, only when there is an expectation of perceived value that is legitimate and reasonable; as long as there is some chance that contemplated investment will generate a positive return at the time of the disputed transaction, court will find that value has been conferred.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[35] [Bankruptcy](#) [Future or indirect benefit; benefit to third party](#)

In constructive fraudulent transfer avoidance proceeding, court, on determining that debtor received indirect value from transfer, must focus on whether that indirect value was reasonably equivalent to what the debtor transferred for it; the indirect benefit must be quantified by party that claims to have delivered it.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[1 Cases that cite this headnote](#)

[36] [Bankruptcy](#) ["Reasonably equivalent value" in general](#)

In constructive fraudulent transfer avoidance proceedings, courts consider whether the value received was the reasonable, or rough, equivalent, of what debtor gave up by examining the totality of the circumstances.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[37] [Bankruptcy](#) [Fraudulent transfers](#)

At trial of constructive fraudulent transfer claim, trustee bears the burden of persuasion to prove that there was no direct value received by debtor in exchange for the challenged payment(s).  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[1 Cases that cite this headnote](#)

[38] [Bankruptcy](#) [Fraudulent transfers](#)

If, in constructive fraudulent transfer avoidance proceeding, the trustee satisfies burden of showing that debtor received no direct value for the challenged transfer, the burden shifts to transferee to prove that debtor received indirect, economically quantifiable value.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\).](#)

[39] [Bankruptcy](#) [Consideration](#)

Chapter 11 debtor did not receive any direct value, for constructive fraudulent transfer avoidance purposes, for payments that it made to obtain a bad faith amendment of first lien credit agreement that eliminated protections that it had previously enjoyed and that permitted its controlling equity holder to acquire debtor's debt contrary to the parties' intent when first lien credit agreement was negotiated.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[40] **Bankruptcy** [Future or indirect benefit; benefit to third party](#)

In constructive fraudulent transfer avoidance proceeding, there is a very low bar for finding that indirect value was received in exchange for challenged transfer; there need only be, at time of transfer, facts showing that, from the standpoint of debtor's creditors, debtor had at least some chance of receiving a future economic benefit in exchange for the challenged transfer.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[41] **Bankruptcy** [Future or indirect benefit; benefit to third party](#)

Even if Chapter 11 debtor benefited indirectly from payments that it made to obtain a bad faith amendment of first lien credit agreement eliminating protections that it previously enjoyed and permitting its controlling equity holder to acquire debtor's debt contrary to the parties' intent when first lien credit agreement was negotiated, lack of evidence in record comparing the value of such indirect benefits with the very substantial payments that debtor made, including payments to lender, to counsel representing equity holder, and to another party acting as go-between in negotiations between equity holder and lender, foreclosed argument that such indirect benefits were reasonably equivalent to what debtor gave up, as required to prevent avoidance of payments, which were made at time when debtor was insolvent for no direct value to debtor, as constructively fraudulent transfers.  [11 U.S.C.A. § 548\(a\)\(1\)\(B\)](#).

[42] **Fraud** [Effect of existence of remedy by action on contract](#)

Under Delaware law, breach of fiduciary duty claims are duplicative of breach of contract claims that either were substantially identical or involved remedies that were likely to be equivalent.

[43] **Fraud** [Effect of existence of remedy by action on contract](#)

Delaware courts allow parallel breach of fiduciary duty and contract claims, where fiduciary duty claims are grounded on additional and distinct facts.

[44] **Fraud** [Effect of existence of remedy by action on contract](#)

Delaware courts will allow parallel breach of fiduciary duty and contract claims, even when the claims all share common nucleus of operative fact, as long as the fiduciary duty claims depend on additional facts as well, are broader in scope, and involve different considerations in terms of a potential remedy.

[45] **Corporations and Business Organizations** [Dealings with corporation](#)

Litigation trustee's breach of fiduciary duty claim against corporate Chapter 11 debtor's controlling equity holder, for allegedly using its control in order to negotiate amendment to first lien credit agreement that modified restrictions on its ability to purchase debtor's debt, in manner that allegedly served no corporate purpose but carried significant benefits for itself, was not duplicative of trustee's breach of contract claim against controlling equity holder, for not making the capital contribution that it agreed to make for modification of these restrictions; while both claims arose out of same nucleus of operative fact, the fiduciary duty claim was not centered on equity holder's failure to make capital contribution but on its alleged breach of

duty of loyalty in negotiating amendment, and both claims sought distinct damages.

- [46] [Corporations and Business Organizations](#) ➡ [Fiduciary nature of relation Corporations and Business Organizations](#) ➡ [Evidence](#)

Delaware law requires that corporate fiduciaries observe high standards of fidelity, and when self-dealing is involved, places upon them the burden of demonstrating the intrinsic fairness of transactions that they authorize.

- [47] [Corporations and Business Organizations](#) ➡ [Controlling or majority shareholders and minority shareholders in general Corporations and Business Organizations](#) ➡ [Dealings with corporation Corporations and Business Organizations](#) ➡ [Entire fairness of transaction in general](#)

While Delaware law requires that corporate fiduciaries observe high standards of fidelity, it does not require more than fairness, and specifically does not, absent a showing of culpability, require that directors or controlling shareholders sacrifice their own financial interest in enterprise for sake of corporation or its minority shareholders.

- [48] [Corporations and Business Organizations](#) ➡ [Controlling or majority shareholders and minority shareholders in general](#)

Under Delaware law, controlling shareholders of corporation, while not allowed to use their control over corporate property or processes to exploit the minority, are not required to act altruistically towards them.

- [49] [Bankruptcy](#) ➡ [Judgment or Order](#)

Genuine issue of material fact as to whether corporate Chapter 11 debtor's controlling equity holder, by virtue of its prepetition conduct in allegedly torpedoing negotiations that might have produced real benefits for corporation, while instead negotiating amendment to first lien credit agreement that modified restrictions on its ability to acquire debtor's debt, had thereby breached its duty of loyalty to corporation, precluded entry of summary judgment for equity holder on breach of fiduciary duty claims asserted by litigation trustee.

[1 Cases that cite this headnote](#)

- [50] [Corporations and Business Organizations](#) ➡ [Good faith](#)

Under Delaware law, breach of duty of good faith may be shown where corporate fiduciary intentionally acts with a purpose other than that of advancing best interests of corporation, where fiduciary acts with intent to violate applicable positive law, or where fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.

- [51] [Bankruptcy](#) ➡ [Inequitable conduct](#)

Bankruptcy courts do not have the power to equitably subordinate claims on a categorical basis, based on the type of claim being asserted. [11 U.S.C.A. § 510\(c\)](#).

- [52] [Bankruptcy](#) ➡ [Inequitable conduct](#)

While some types of claims may be more suspect than others when it comes to whether they should be equitably subordinated, a court sitting in equity must nonetheless consider whether subordinating a particular claim would be fair based on totality of the circumstances in the individual case. [11 U.S.C.A. § 510\(c\)](#).

- [53] [Bankruptcy](#) ➡ [Inequitable conduct](#)

Claims of insiders are generally more suspect when it comes to equitable subordination than the claims of non-insiders. [11 U.S.C.A. § 510\(c\)](#).

equitable subordination of insider claim; instead, parent's conduct must advantage parent entity at disadvantage of debtor-subsidary. [11 U.S.C.A. § 510\(c\)](#).

[54] [Bankruptcy](#) [Inequitable conduct](#)

For a non-inside creditor's claim to be equitably subordinated, creditor's inequitable conduct must be egregious, such as by involving fraud, overreaching, or spoliation. [11 U.S.C.A. § 510\(c\)](#).

[59] [Bankruptcy](#) [Inequitable conduct](#)

Inequitable conduct may warrant equitable subordination of a claim, even if the conduct is unrelated to the assertion of that claim. [11 U.S.C.A. § 510\(c\)](#).

[55] [Bankruptcy](#) [Inequitable conduct](#)

For an inside creditor's claim to be equitably subordinated, it is enough that there is material evidence of any unfair conduct, or of any unfair act, by creditor that affects the bankruptcy results of other creditors. [11 U.S.C.A. § 510\(c\)](#).

[60] [Bankruptcy](#) [Inequitable conduct](#)

Claims should be equitably subordinated only to the extent necessary to offset the harm suffered as a result of claimant's inequitable conduct. [11 U.S.C.A. § 510\(c\)](#).

[56] [Bankruptcy](#) [Determination of priority](#)

If, on motion for equitable subordination of claim, the claimant's conduct is sufficiently challenged, the claimant then bears burden of proving the good faith and inherent fairness of its conduct from the viewpoint of corporate debtor and those interested therein. [11 U.S.C.A. § 510\(c\)](#).

[61] [Bankruptcy](#) [Inequitable conduct](#)

Controlling equity holder with right to control every tranche of the corporate Chapter 11 debtor's capital structure, which had used its authority to negotiate amendment to first lien credit agreement in order to modify restrictions that prevented it from acquiring debtor's debt, while torpedoing refinancing with another entity, and while failing to make the capital contribution that it had agreed to make in order to obtain this amendment, thereby engaged in inequitable conduct that benefited itself and harmed debtor and its creditors, in manner warranting the equitable subordination of its insider claim; however, fact issues as to extent of the harm from controlling equity holder's conduct and the extent of the benefit to equity holder prevented bankruptcy court from determining to what the equity holder's claim should be subordinated, prior to trial, on motion for summary judgment. [11 U.S.C.A. § 510\(c\)](#).

[57] [Bankruptcy](#) [Inequitable conduct](#)

There is no standardized test for what constitutes "unfair conduct," such as may warrant the equitable subordination of an inside creditor's claim; instead, courts look to the particularized facts before them to determine whether the conduct and injury demand equitable subordination. [11 U.S.C.A. § 510\(c\)](#).

[1 Cases that cite this headline](#)

[58] [Bankruptcy](#) [Inequitable conduct](#)

Where parent entity dominates a debtor-subsidary and occupies position of fiduciary, mere domination is insufficient to show inequitable conduct, such as may warrant

[62] [Bankruptcy](#) [Construction and Operation](#)

Business entities in control of debtor-corporation, in the sense that they have a legal right or ability to exercise control over a corporate entity, are "insiders," at that term is

used in the Bankruptcy Code.  [11 U.S.C.A. § 101\(31\)\(B\)\(iii\)](#).

[63] [Bankruptcy](#) [Inequitable conduct](#)

[Bankruptcy](#) [Determination of priority](#)

Party moving to equitably subordinate a claim bears the burden of persuasion, and must show that there was inequitable conduct, that this inequitable conduct resulted in injury to debtor or creditors or created unfair advantage for claimant, and that equitable subordination is consistent with Bankruptcy Code. [11 U.S.C.A. § 510\(c\)](#).

[64] [Bankruptcy](#) [Claims by insiders and by attorneys in excess of value](#)

In a recharacterization action, someone challenges the assertion of a claim based on alleged debt owed by the bankruptcy estate on the ground that loaned capital was actually an equity investment.

[65] [Corporations and Business Organizations](#) [Distinction between debt and equity; capital contributions](#)

Determinative inquiry in classifying advances to corporation as debt or equity is the intent of the parties as it existed at time of the transaction.

[66] [Bankruptcy](#) [Claims by insiders and by attorneys in excess of value](#)

Recharacterization of advance to corporate debtor as debt or equity is court's attempt to discern whether the parties called an instrument one thing when, in fact, they intended it as something else.

[67] [Corporations and Business Organizations](#) [Distinction between debt and equity; capital contributions](#)

Parties' intent that corporate advance should be treated as debt or equity may be inferred from

what they say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances; the answers lie in facts that confer context case-by-case.

[68] [Corporations and Business Organizations](#) [Distinction between debt and equity; capital contributions](#)

While the form of corporate advance is no doubt a factor for court in deciding whether the advance is a loan or a capital contribution, in the end, it is no more than an indicator of what the parties actually intended and acted on.

[69] [Bankruptcy](#) [Claims by insiders and by attorneys in excess of value](#)

If recharacterization from debt to equity of an advance to corporate debtor is warranted, the recharacterization occurs ab initio, from the beginning of the advance.

[70] [Bankruptcy](#) [Claims by insiders and by attorneys in excess of value](#)

Among factors that may warrant recharacterization of advance to corporate debtor from debt to equity are the following: (1) name given to the instrument evidencing the advance; (2) intent of the parties; (3) presence or absence of a fixed maturity date; (4) right to enforce payment of principal and interest; (5) presence or absence of voting rights; (6) status of the contribution in relation to regular corporate contributors; and (7) certainty of payment in the event of the corporation's insolvency or liquidation.

[71] [Bankruptcy](#) [Claims by insiders and by attorneys in excess of value](#)

Actions that occurred subsequent to the advance of funds to Chapter 11 debtor, when first lien credit agreement was amended to modify restrictions on equity holder's ability to acquire debtor's debt, did not permit recharacterization

of the debt, on theory that amendment had so altered the nature of the first lien debt as to warrant recharacterization; in deciding whether debt should be recharacterized, bankruptcy court had to look to the beginning of the investment, not to events that occurred long thereafter when first lien credit agreement was amended.

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OPINION¹

[Sontchi](#), C.J.

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INTRODUCTION²

Before the Court is the (i) *Motion for Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P. and Yucaipa American Alliance (Parallel) Fund I, L.P.*³ and (ii) the *Litigation Trustee's *164 Motion for Partial Summary Judgment.*⁴ The dispute before the Court results from two complaints asserted against Defendants Yucaipa American Alliance Fund I, L.P. and Yucaipa American Alliance (Parallel) Fund I, L.P. (collectively, “Yucaipa”) and certain

individuals filed by (a) the Official Committee of Unsecured Creditors (the “Committee”) and (b) BDCM Opportunity Fund II, LP, Black Diamond CLO 2005-1 Ltd. (collectively, “Black Diamond”), and Spectrum Investment Partners, L.P. (“Spectrum,” and together with Black Diamond, “BD/S”) (the Committee action and the BD/S action are not being pursued by the Trustee on behalf of the Trust, described more fulsomely below). The Trustee asserts a bevy of claims against Yucaipa related to the First Lien Credit Agreement⁵ (“FLCA,” the lenders therein the “First Lien Lenders,” and the debt therein, the “First Lien Debt”) and its various amendments. The claims include breach of contract, breach of fiduciary duty, equitable subordination, recharacterization, tortious interference, fraudulent transfers, and disallowance of claims. The Trustee and Yucaipa each moved for summary judgment on a variety of these claims. This is the Court's opinion on the Cross-Motions for Summary Judgment. As detailed below (and summarily in a chart attached as [Appendix](#) hereto), the Court will grant, in part, and deny, in part, each motion. The Court will also enter judgment and award damages in favor of the Trustee on behalf of the Trust against Yucaipa on Estate Claims 5, 10, 11 and 13 and Lender Claim 2. The Court will also enter judgment, in part, in favor of the Trustee on behalf of the Trust against Yucaipa on Estate Claims 1 and 2 and Lender Claim 1. Finally, the Court will enter judgment in favor of Yucaipa against the Trust on Estate Claims 3, 4, and 6.

JURISDICTION

This Court has jurisdiction over this matter, pursuant to [28 U.S.C. § 1334](#). This is a core proceeding, pursuant to [28 U.S.C. § 157\(b\)](#). Venue is proper in this District, pursuant to [28 U.S.C. §§ 1408 and 1409](#).

FACTUAL HISTORY

A. Procedural History

The Official Committee of Unsecured Creditors began litigation against Yucaipa on February 1, 2013⁶ (Del. Bankr. Adv. *165 13-50530); thereafter, BD/S filed their own complaint against Yucaipa on November 19, 2014⁷ (Del. Bankr. 14-50971). Under the Debtors' Modified First Amended Joint Chapter 11 Plan of Reorganization dated December 3, 2015⁸ and a Litigation Trust Agreement dated

December 20, 2016, the Estate Claims and Lender Claims are now jointly prosecuted by the Trustee.⁹

The litigation history between these parties has been long and arduous.¹⁰ Before the Court herein are Cross-Motions for Summary Judgment and their attendant briefs and declarations.¹¹ The Court heard *166 argument on these motions on February 4, 2021. This is the Court's decision thereon.

B. Facts/Background Applicable to this Matter

i. 2005 Bankruptcy and Yucaipa's Investment in Allied

The above-captioned debtor ("Allied" or the "Company") was a unionized car hauling company engaged in the transport of new vehicles in North America. On July 31, 2005, Allied filed a petition for relief under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Northern District of Georgia¹² (the "2005 Bankruptcy"). Yucaipa — a private equity firm founded by Ron Burkle — began analyzing investment opportunities in the Company in an effort spearheaded by Derex Walker, a Transaction Partner hired by Yucaipa in January 2006 to provide experience with restructuring and distressed debt investing. Yucaipa purchased approximately 66% of Allied's then outstanding \$150 million in pre-petition senior secured notes for \$81.6 million in May 2006. Yucaipa also financed Allied's purchase of used rigs for approximately \$12.6 million, and later purchased \$1.5 million in claims tendered by unsecured creditors for 25¢ on the dollar. Yucaipa's initial investments in Allied totaled approximately \$95 million.

Allied emerged from the 2005 Bankruptcy in May 2007 under a Plan of Reorganization sponsored by Yucaipa and the International Brotherhood of Teamsters.¹³ *167 Yucaipa converted its \$95 million investment in Allied into 67% of reorganized Allied's equity under the Plan. Yucaipa obtained the ability to control Allied's Board of Directors (the "Board"), with the right to appoint three of Allied's five Board members and Allied's Chief Executive Officer (the fourth Board member), and a veto over Allied's fifth Board member, who was to be selected by the Creditors' Committee from the 2005 Bankruptcy.

ii. Allied's First and Second Lien Credit Agreements.

To finance its exit from the prior bankruptcy, Allied entered into a two-tiered financing structure with various lenders

("Lenders") comprising \$265 million in first lien debt, governed by the FLCA, and \$50 million in second lien debt, governed by a Second Lien Credit Agreement¹⁴ ("SLCA"). Both credit agreements were approved by the Georgia bankruptcy court in connection with the Joint Plan.

The first lien facility consisted of three types of debt: \$180 million in term loans (the "Term Loans"), a \$35 million revolving credit facility from the CIT Group/Business Credit, Inc. ("CIT"), and \$50 million in letter of credit commitments ("LC Commitments"). The FLCA and SLCA were secured by a pledge of substantially all of Allied's assets, and both contained fixed interest rates. The Georgia bankruptcy court approved Allied's entry into both the FLCA and SLCA. As initially executed, the FLCA excluded Yucaipa from being an "Eligible Assignee," meaning that a holder of first lien debt could not sell, assign, or transfer any portion of its debt, rights, or obligations to Yucaipa. The SLCA contained a similar provision.

Further, the FLCA provided for a "Requisite Lender" that was entitled to take certain actions and exercise particular remedies (or refrain from doing so) on behalf of all Lenders. Under the FLCA, the Requisite Lender was one or more Lenders holding more than 50% of the term loans, LC Commitments, and revolving credit.

Although the 2005 Bankruptcy right-sided Allied's business, the 2007 recession greatly impacted Allied (and the rest of the automotive market), again putting Allied in financial distress.

iii. Third Amendment to the Credit Agreements

Allied's distressed financial condition in early 2008 meant that the company's first lien debt was trading well below par and many of its Lenders were trying to sell their debt holdings but lacked buyers. As a result, Yucaipa intended to contribute a portion of the acquired debt to Allied's equity, which would deleverage Allied's balance sheet and with the hope that it would increase customer confidence and avoid the triggering of any defaults under the credit agreements.

However, both the FLCA and SLCA precluded Allied's Lenders from assigning their debt to Yucaipa because it was not an "Eligible Assignee." Accordingly, for the deleveraging transaction to occur, Yucaipa, Allied, and its Lenders negotiated amendments to the FLCA and SLCA.

Allied's board of directors formed a special committee (the "Special Committee") comprised of two directors whom Allied's counsel deemed to be independent of Yucaipa. On April 28, 2008, the Special Committee approved and recommended to the Allied board that Allied enter into a Third *168 Amendment to the FLCA¹⁵ ("Third Amendment") and a similar amendment to the SLCA.¹⁶ The amendments passed with the approval of the majority of Allied's Lenders.

The Third Amendment to the FLCA expressly allowed Yucaipa to acquire a limited amount of Term Loans and made Yucaipa a "Restricted Sponsor Affiliate."¹⁷ The Third Amendment also restricted Yucaipa's rights as a Lender with respect to any first lien debt it acquired. In particular, the Third Amendment purported to:

- i. Limit the amount of Term Loans that Lenders could sell or assign to Yucaipa to the lesser of 25% of the total Term Loan Exposure or \$50 million.¹⁸
- ii. Restrict the voting rights Yucaipa would otherwise have as a Lender "for all purposes."¹⁹
- iii. Require Yucaipa to contribute no less than 50% of the aggregate principal amount of any Term Loans it acquired to Allied's capital (the "Capital Contribution" in the "Capital Contribution Provision"), with those Term Loans then deemed to be cancelled.²⁰
- iv. Restrict Yucaipa's legal rights through a covenant not to sue specific to Yucaipa and adding a covenant not to sue and restricting remedies against Yucaipa.²¹

The parties similarly amended the SLCA, however, the Third Amendment to the SLCA did not contain a Capital Contribution Provision or limit the amount of second lien debt that Yucaipa could acquire. Yucaipa proceeded to acquire \$40 million of the outstanding \$50 million in Allied's second lien debt. Yucaipa then converted \$20 million of its newly acquired second lien debt to Allied's equity, in a "debt-to-equity swap."

Allied's financial condition continue to deteriorate due to the economy's recession. Allied informed the Lenders that it would like to discuss another amendment to the FLCA that would reset various covenants.

In September 2008, Allied and several First Lien Lenders, including Spectrum, entered a Forbearance Agreement²² in order for Allied to negotiate with its Lenders *169 regarding the defaults. In the Forbearance Agreement, the First Lien Lenders agreed to temporarily refrain from exercising remedies in return for various concessions, a 2% increase in the interest rate payable on the debt, a \$250,000 fee, and the payment of hundreds of thousands of dollars to the Lenders' lawyers and financial advisors. The Forbearance Agreement was renewed in late October of 2008, signed by both Black Diamond and Spectrum, among other Lenders.

The forbearance period expired in mid-November 2008, but the Lenders did not require another Forbearance Agreement, and no deal was reached to restructure Allied's debt or cure its defaults. With the absence of a forbearance agreement, the Lenders were free to exercise remedies under the FLCA against Allied but chose not to—even though Allied remained in default under the FLCA through the May 2012 involuntary bankruptcy filing.

iv. Tender Offer by Allied and Yucaipa

Lenders holding the majority of first lien debt, including Spectrum, actively explored selling their debt—and with it, the Requisite Lender position—to Yucaipa. During a December 10, 2008 board meeting, Derex Walker, chairman of the Allied board, notified the board about a possible transaction between Yucaipa and Lenders holding a majority of the first lien debt.

To effectuate this transaction, Allied and its Lenders would again need to amend the FLCA to remove the Third Amendment's restrictions on assigning first lien debt to Yucaipa, amend the financial covenants, and provide Allied with the ability to repurchase its own debt. The board reconvened the Special Committee, which considered the proposed transaction and recommended that the board approve it. The board then approved the transaction and authorized Allied's officers to pursue it.

In February 2009, Allied and Yucaipa launched a tender offer to purchase first lien debt at approximately 26 cents on the dollar to all First Lien Lenders, including Black Diamond and Spectrum. However, during that same period, ComVest Investment Partners ("ComVest") was also negotiating with the Lenders to purchase a majority of the first lien debt.

v. ComVest Acquires the Majority of Allied's First Lien Debt

By mid-February 2009, ComVest acquired approximately 54% of Allied's first lien debt and became the Requisite Lender under the FLCA.

Allied, Yucaipa, and several of the Lenders—including Black Diamond—believed that ComVest wanted to take Allied into a second bankruptcy, which could lead to a liquidation. However, Allied, Yucaipa and certain Lenders were concerned that another bankruptcy, along with the existing climate for car haulers, would be harm Allied's business.

As a result, in March 2009, Yucaipa began negotiating with ComVest to purchase ComVest's majority stake in Allied's first lien debt. As with the tender offer, the transaction with ComVest was going to require an amendment to the FLCA to permit Lenders holding a majority stake in the first lien debt to assign that debt to Yucaipa, without the Third Amendment's voting- or capital-contribution restrictions.

On March 6, 2009, the Special Committee recommended Yucaipa's transaction with ComVest to the board, which unanimously approved the transaction. However, the March 2009 transaction did not close—so Yucaipa and ComVest continued to negotiate over the following months.

*170 At this same meeting, the board discussed whether to make a \$4.8 million interest payment to the First Lien Lenders due the next day. Allied's CFO advised, “if the Company were to make the \$4.8 million interest payment due that day, the Company would end the day with approximately \$5.5 million available for the Company's operations, which is well below the \$8 to \$10 threshold the Company believes to be its minimum operating liquidity.”²³ Under those circumstances, and based on the recommendations of Allied's management, the board unanimously voted to forgo the quarterly interest payment due under the FLCA. This constituted yet another default for Allied, which had continued to operate without a forbearance agreement since November 2008.

vi. Fourth Amendment and Yucaipa's Acquisition of ComVest's Debt.

In August 2009, Yucaipa and ComVest were preparing to move forward with Yucaipa's acquisition of Comvest's debt. The Special Committee recommended that the Allied Board

approve the Fourth Amendment to the FLCA²⁴ (the “Fourth Amendment”), so that ComVest could assign its majority stake of Allied's first lien debt to Yucaipa without the voting and capital contribution restrictions of the Third Amendment. On August 21, 2009, Yucaipa and ComVest entered a Loan Purchase Agreement (“LPA”), pursuant to which Yucaipa purchased ComVest's \$145.1 million (principal face amount) of First Lien Debt for approximately \$43 million (the “Yucaipa-ComVest Transaction”). Allied was not a party to the LPA, but the LPA's closing conditions required Allied to: (i) reimburse ComVest \$1.85 million for its associated legal fees and expenses, (ii) reimburse Yucaipa \$831,325.83 for its legal fees and expenses, and (iii) agree to the later-voided Fourth Amendment to the First Lien Credit Agreement. The Fourth Amendment did not purport to cure any of Allied's Events of Default or reset any financial covenants, as contemplated in earlier iterations of the amendment.

From the time the Fourth Amendment was executed and Yucaipa purchased ComVest's debt, BD/S believed the Fourth Amendment and the assignment of debt were invalid—because the Fourth Amendment was enacted with majority Lender support, not unanimous support—and breached the Third Amendment; they discussed this with their counsel, each other, and other Lenders. Nevertheless, when Yucaipa—in its capacity as Requisite Lender—directed CIT to terminate certain LC Commitments under the FLCA, resulting in a release of \$16,928,474.40, BD/S accepted its *pro rata* portion of the funds.

vii. Yucaipa Does Not Make Capital Contribution and CIT Litigation

Yucaipa did not make a capital contribution to Allied following its acquisition of ComVest's First Lien Debt. It did, however, develop a “Contingency Plan” focused on the “Validity of Amendment No. 4” with its litigation counsel. Yucaipa contemporaneously announced to its investors that:

[The ComVest] transaction makes us “requisite lender” for purposes of any amendments or consents to the Company's first lien credit facility. Our ownership of the first lien debt is not subject to any of the customary restrictions or limitations normally associated with a sponsor's acquisition of its bank debt.

*171 Our purchase of the first lien debt is also notable because it puts us in the position of controlling every tranche of the Company's capital structure. In addition to holding 56% of the first lien debt, we also hold 67% of

the second lien debt as well as 71% of the fully-diluted equity.²⁵

On September 17, 2009, Yucaipa's counsel sent CIT a "direction letter from the Requisite Lenders to the Agent," demanding that CIT immediately terminate account control agreements and enter new ones. When CIT did not heed this direction, Yucaipa sent another letter demanding that CIT comply on or before October 14, 2009. When CIT did not do so, Yucaipa and Allied sued CIT in Georgia seeking, among other things, a declaratory judgment holding that the Fourth Amendment was valid, and that Yucaipa was Requisite Lenders under the First Lien Credit Agreement (the "CIT Litigation").

On December 21, 2009, CIT filed a counterclaim in the CIT Litigation seeking, among other things, declaratory judgment that (i) the purported Fourth Amendment was ineffective, (ii) the Third Amendment remains in full force and effect, and (iii) Yucaipa cannot be "Requisite Lenders" under the First Lien Credit Agreement.

The CIT Litigation continued for two years, during which time Allied paid for Yucaipa's litigation counsel in the approximate amount of \$2.5 million for legal fees. In December 2011, CIT settled the CIT Litigation on its own behalf, but expressly not on behalf of any of Allied's other lenders. Under the CIT Litigation settlement, CIT agreed not to challenge the validity of the Fourth Amendment or Yucaipa's status as Requisite Lender. CIT also recognized Yucaipa's status as a "Lender" under the FLCA.

viii. Potential Sale to Jack Cooper Transportation

In the spring of 2011, Jack Cooper Transportation ("JCT"), another car hauling company, made a series of offers to purchase Allied debt from Yucaipa and BD/S at the same price, ranging up to about 84 cents on the dollar. In late 2011, Yucaipa, BD/S, and CIT were each in negotiations with JCT (the "JCT Negotiations"), regarding JCT's potential acquisition of their first lien debt in Allied, which JCT would then use to acquire Allied in a 363 Sale in connection with a bankruptcy proceeding.²⁶ However, the parties were unable to close a transaction with JCT.

ix. BD/S Sues Yucaipa in New York State Court

On February 15, 2012, lawyers for BD/S wrote to the Allied Board stating that the Company was insolvent and

offering to "engage the Board of Directors immediately in a discussion regarding an appropriate *172 restructuring and/or recapitalization ... to preserve and protect the Company's assets, and to maximize the value available for all interested parties."²⁷

BD/S filed a lawsuit against Yucaipa in New York state court, seeking a declaration that the Fourth Amendment was invalid, and that Yucaipa was not the Requisite Lender (the "NY Action"). The New York state court eventually issued a written decision in March 2013, finding that the Fourth Amendment was invalid because it was not passed with unanimous consent from all Lenders, and therefore Yucaipa was not Requisite Lender.²⁸ The Court held that: (i) Yucaipa caused Allied to enter into the Fourth Amendment, which was "flatly prohibited under the Credit Agreement;" (ii) the Fourth Amendment "is not, and never was, effective;" and (iii) "Yucaipa [was] not the Requisite Lender."²⁹ Yucaipa appealed, and the New York appellate court reversed summary judgment as to Black Diamond, finding that there were triable issues of material fact as to whether Black Diamond had waived its ability to challenge the Fourth Amendment and Yucaipa's Requisite Lender status through Black Diamond's "active involvement" in Yucaipa's efforts to become Requisite Lender.³⁰

x. BD/S File Involuntary Bankruptcy Against Allied

On May 17, 2012, the same day that BD/S informed JCT that it decided not to continue with negotiations, BD/S filed a petition for an involuntary bankruptcy against Allied in this Court. A few weeks later, Allied consented to the bankruptcy, and its affiliates filed voluntary Chapter 11 petitions for relief.

xi. Fourth Amendment Voided and BD/S Recognized as Requisite Lender

On August 8, 2013, the Court granted summary judgment to BD/S, holding that they, not Yucaipa, were Requisite Lenders,³¹ that the Third Amendment governed,³² and that Yucaipa was collaterally estopped from asserting the Fourth Amendment's validity.³³ The District Court and Third Circuit both affirmed.³⁴

xii. JCT Buys Substantially All of Allied's Assets

An auction for the Debtors' assets under  [11 U.S.C. § 363](#) was held in September 2013. JCT submitted a bid to buy

substantially all of Allied's assets for \$135 million, which the Court approved.³⁵ The sale (the *173 “JCT 363 Sale”) closed on December 27, 2013.³⁶

xiii. The Trustee Assumes Prosecution of These Adversary Proceedings

Under the Debtors' Modified First Amended Joint Chapter 11 Plan of Reorganization dated December 3, 2015³⁷ and a Litigation Trust Agreement dated December 20, 2016, the Estate Claims and Lender Claims are now jointly prosecuted by the Trustee.³⁸ These claims seek recovery on behalf of Allied and, if successful, all stakeholder constituents will recover under a Litigation Proceeds Waterfall approved by the Court.³⁹

The Estate Claims and Lender Claims have been coordinated for purposes of discovery and are subject to a joint schedule through dispositive motions. Fact discovery closed on July 26, 2019, and expert discovery closed on January 10, 2020.⁴⁰

ANALYSIS

A. Summary Judgment Standard

Summary judgment is a mechanism used to ascertain the existence of a genuine factual dispute between the parties that would necessitate a trial. *Fed. R. Civ. P. 56*, made applicable by *Fed. R. Bank. P. 7056* is appropriate “if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.”⁴¹

When seeking summary judgment, the movant bears the initial burden of “establishing the absence of a genuine issue of material fact.”⁴² A genuine issue is not simply based on opposing opinions or unsupported assertions but rather on conflicting factual evidence over which “reasonable minds could disagree on the result.”⁴³ Furthermore, a fact is material if it could “alter the outcome of a case.”⁴⁴ In other words, the movant's goal is “to establish an absence of evidence to support the nonmoving party's case.”⁴⁵

If the movant meets this initial burden, the burden shifts to the nonmoving party to defeat summary judgment by producing “evidence in the record creating a genuine issue of

material fact.”⁴⁶ To demonstrate a genuine issue of material fact, the nonmoving party “must do more than simply show that there is some metaphysical doubt as to the material facts.”⁴⁷ The nonmoving *174 party must demonstrate “sufficient evidence (not mere allegations) upon which a reasonable trier of fact could return a verdict in favor of a nonmoving party.”⁴⁸ This evidence “cannot be conjectural or problematic; it must have substance in the sense that it [highlights] differing versions of the truth which a factfinder must resolve at an ensuing trial.”⁴⁹

When considering a motion for summary judgment, “the court does not weigh the evidence and determine the truth of the matter; rather, the court determines whether there is a genuine issue for trial.”⁵⁰ The Court must “view the facts in the light most favorable to the nonmoving party and draw all inferences in that party's favor.”⁵¹ “If the opposition evidence is merely colorable or not significantly probative, summary judgment may be granted.”⁵² However, where the record could lead reasonable minds to draw “conflicting inferences, summary judgment is improper, and the action must proceed to trial.”⁵³ Summary judgment is proper only where one reasonable inference or interpretation of the facts can be drawn in favor of the moving party.⁵⁴

A cross-motion filing does not change the standards or analysis by which to grant or deny summary judgment to the moving party. Each moving party still bears the initial burden of demonstrating the absence of a genuine issue of material fact. “[T]he court must rule on each party's motion on an individual and separate basis, determining, for each side, whether a judgment may be entered in accordance with the [summary judgment] standard.”⁵⁵ Although the filing of a cross motion may imply that the parties agree that no material issue of fact exists, “the court is not bound by this implicit agreement and is not required to enter a judgment for either party.”⁵⁶

B. Summary of Cross-Motions for Summary Judgment

The Trustee is seeking summary judgment on Estate Claims and Lender Claims. More specifically, and as summarized in a chart attached as an Appendix:

- Estate Claims: (i) Claims 1 and 2 (equitable subordination (against Yucaipa)), (ii) Claim 5 (breach of contract (against Yucaipa)), (iii) Claims 10 and 11 (avoidance and recovery

of fraudulent transfers (against Yucaipa)), and (iv) Claim 13 (disallowance of claims (against Yucaipa)); and

*175 • Lender Claims: (i) Claim 1 (equitable subordination (against Yucaipa)), (ii) Claim 2 (breach of contract (against Yucaipa)), and (iii) Claim 4 (tortious interference with contract (against the Yucaipa Directors and Burkle)).

In turn, Yucaipa is seeking summary judgment on:

• Estate Claims: (i) Claim 3 (recharacterization); (ii) Claim 4 (specific performance of the Third Amendment (Capital Contribution Provision)); (iii) Claim 5 (breach of the Third Amendment (Capital Contribution Provision)) (collectively with Claim 4, the “Capital Contribution Claims”); (iv) Claim 6 (specific performance of the Third Amendment (divestiture of debt)); (v) Claim 7 (breach of fiduciary duty); (vi) Claim 10 (avoidance and recovery of intentional and constructive fraudulent transfers pursuant to [11 U.S.C. §§ 548\(a\)](#) and [550](#)); and (vii) Claim 11 (avoidance and recovery of intentional and constructive fraudulent transfers pursuant to [11 U.S.C. §§ 544\(b\)](#) and [550](#)); and

• Lender Claims: (i) Claim 2 (breach of contract); and (ii) Claim 3 (breach of the covenant of good faith and fair dealing).

C. Estate Claim 5 and Lender Claim 2: Breach of Contract⁵⁷

i. Capital Contribution Provision and the Trustee's Allegations

The Trustee seeks summary judgment on Yucaipa's failure to make the Capital Contribution required by section 2.7(e) of the Third Amendment. The Trustee asserts that Fourth Amendment's purpose was to delete the restrictions and obligations of the Third Amendment imposed on Yucaipa, such as the Capital Contribution Provision. Following the implementation of the Fourth Amendment, Yucaipa failed to make the Capital Contribution to Allied on or before the deadline of August 31, 2009, in the amount of 50% of the first lien term loans Yucaipa had purchased (i.e. \$57.4 million).

Section 10.6(j) of the FLCA, through language added by the Third Amendment, required Yucaipa to make a capital contribution to Allied of 50% of the face amount of these Term Loans on or before August 31, 2009:

The Restricted Sponsor Affiliates [i.e. Yucaipa and its affiliates] ... agree[] ... that no later than ten days after the date of such assignment or transfer of such Term Loans ... such Restricted Sponsor Affiliates shall make a capital contribution to [Allied] of no less than 50% of the aggregate principal amount of such Term Loans in accordance with Section 10.6(k) ... ⁵⁸

The Trustee asserted that Yucaipa breached the FLCA and the Third Amendment by not making that Capital Contribution.

a. Elements of Breach of Contract

[1] Under New York law, a claim for breach of contract is comprised of (i) existence of a contract, (ii) plaintiff's performance under that contract, (iii) defendant's breach thereof, and (iv) resulting damages. *176 ⁵⁹

Here, the FLCA and the Third Amendment are valid and binding on Yucaipa. Allied and BD/S, along with other First Lien Lenders, are signatories to the Third Amendment, and Yucaipa became bound by the Third Amendment with it purchased First Lien Debt in August 2009. ⁶⁰

There is no doubt that the Trustee has established the first three elements of a breach of contract claim – nor does Yucaipa present any material evidence to the contrary. The only remaining element to be established is whether the Trustee can establish damages.

b. Damages – Cash versus Contribution

[2] As damages are the remedy for breach of contract, the Trustee must establish damages as part of its motion for summary judgment. However, Yucaipa has cross-moved for summary judgment (in the alternative) on the issue that damages cannot be determined. Yucaipa makes this damages argument for both Count 2 (breach of contract claim) and Count 3 (breach of duty of good faith and fair dealing claim).

Here, the Court will discuss the breach of contract claim (Lender Count 2) *only*. The Court will address Yucaipa's Motion for Summary Judgment (and the alternative motion for partial summary judgment on the issue of damages) on Lender Claim 3 (breach of duty of good faith and fair dealing) *infra*.

Under sections 2.1(c)⁶¹ and 2.7(c)⁶² and 2.7(e)⁶³ of the Third Amendment, Yucaipa was obligated to make a capital contribution equal to 50% of any Term Loans it purchased within 10 days of the purchase. Yucaipa purchased \$114,712,088.66 in Term Loans in the Yucaipa-ComVest Transaction, and \$30,400,458.40 in LC Commitments.⁶⁴

Yucaipa argues that the Third Amendment's recitals states:

Whereas, [Allied] ha[s] requested that Requisite Lenders agree to amend the Credit Agreement to permit [Yucaipa] to become Lenders ... by purchasing and assuming the rights and obligations of *177 one or more Lenders ... and to contribute such rights and obligations to [Allied] in the form of capital contributions.⁶⁵

Yucaipa asserts that for any “capital contributions” that may become due, Yucaipa would contribute the “rights and obligations” of its newly acquired debt—not cash—to Allied. As discussed below, Yucaipa is correct that Yucaipa *could have* made the Capital Contribution in the form of debt or cash. However, this language in the Third Amendment's preamble is general permission for Yucaipa to purchase Term Loans and to participate and to contribute such rights and obligations under the FLCA. Reading the entire FLCA and the Third Amendment together, the specific provisions as to the form of the Capital Contribution outweigh the general provisions of the recital.⁶⁶

More specifically, the section 2.7(f) of the Third Amendment modifies section 10.6 of the FLCA by adding subsection (k) which states in relevant part (the “Form of Capital Contribution Provision”):

A Restricted Sponsor Affiliate **may** at any time make a capital contribution of its Term Loans to [Allied] in exchange for Equity Interests [and upon such contribution the Term Loans will] ... be deemed to be irrevocably prepaid, terminated, extinguished, cancelled and of no further force and effect.⁶⁷

As a result, Yucaipa asserts that a Capital Contribution under section 10.6(k) could take the form of “Term Loans” rather than cash. Reading both the Capital Contribution Provision (section 10.6(j)(iii)) and the Form of Capital Contribution Provision (section 10.6(k)(ii)) together and giving meaning to all the provisions – the Court finds that Yucaipa was obligated (shall - mandatory) to make a Capital Contribution and could (may - permissively) make that Capital Contribution in as an exchange for equity interests.⁶⁸

*178 [3] By August 31, 2009, Allied should have received \$57.4 million in cash *or* \$57.4 million of debt it owed to Yucaipa should have been extinguished.⁶⁹ Allied received neither. Under New York law, the Court must measure damages as of August 31, 2009, the date of the breach.⁷⁰

Allied was insolvent at the date of the breach.⁷¹ It is illogical to think that Yucaipa would exchange its Term Loans in favor of worthless equity in Allied – however, the reduction of debt would have benefitted Allied. Furthermore, if Allied's enterprise value was greater than Allied's First Lien Debt (as represented by Yucaipa in quarterly auditor memos from 2008 through 2011), then debt reduction would have benefitted Allied in the full amount of \$57.4 million.⁷²

[4] [5] [6] [7] Under New York law, once breach is established, mathematical precision is unnecessary to recover damages. To prove damages, “a plaintiff need only show a stable foundation for a reasonable estimate of the damage incurred as a result of the breach.”⁷³ There must be a certainty as to the “fact of damage, not the amount.”⁷⁴ “The burden of uncertainty as to the amount of damage is upon the wrongdoer.”⁷⁵

*179 There appears to be a certain amount of speculation as to what would have happened to the \$57.4 million had Yucaipa contributed it – Professor Fischel appears to indicate that Allied would have “burned through” all the money and it would add no value to Allied. Respectfully, this is speculative.⁷⁶ Indeed, Professor Fischel appears to indicate that \$57.4 million would have had no impact on Allied whatsoever.⁷⁷ The Court understands that a cash contribution of \$57.4 million might not have changed Allied's ultimate fate⁷⁸ – it *could* be that Allied's second bankruptcy was inevitable. However, Yucaipa's failure to make the Capital Contribution *ensured* such a result. Here, the reasonable foundation for the amount of damages is the full value of the Capital Contribution that Yucaipa failed to pay.

The Court finds that Allied was damaged in the full amount of the Capital Contribution that Yucaipa failed to make on the date of the breach. It is now impossible for Yucaipa to contribute its Term Loans at this stage of the bankruptcy case, in other words, Yucaipa's original option of cash *or* contribution of Term Loans is now precluded. Thus, the full cash value of the Capital Contribution is the appropriate measure of damages.

ii. Prejudgment Interest

[8] [9] The Trustee also requests statutory prejudgment interest on its contractual damages. New York law provides that “[i]nterest shall be recovered upon a sum awarded because of a breach of performance of a contract.”⁷⁹ Prejudgment interest accrues at the 9% statutory rate under New York law, running from the date of the breach.⁸⁰

*180 iii. Covenant Not to Sue⁸¹

[10] Yucaipa argues that the Trustee's Claim 5 is barred by the Third Amendment's covenant not to sue (the “Covenant Not to Sue”).⁸² Section 2.7(f) of the Third Amendment (adding clause (k)(v) to section 10.6 of the FLCA) states:

(v) To the extent permitted by applicable law, no Credit Party shall assert, and each Credit Party hereby irrevocably waives, any claim or cause of action against any Lender, any Agent and their respective Affiliates,

directors, employees, attorneys, agents or sub-agents (whether or not the claim therefor is based on contract, tort or duty imposed by any applicable legal requirement or otherwise) **arising out of, in connection with, as a result of, or in any way related to, any capital contribution of Term Loans made by a Restricted Sponsor Affiliate to such Borrower** *or* any act or omission or event occurring in connection therewith, and each Credit Party hereby irrevocably waives, releases and agrees not to sue upon any such claim or any such cause of action, whether or not accrued and whether or not suspected to exist in its favor ...⁸³

The Covenant Not to Sue was made by “Credit Party,” which is defined as “each Borrower and each Guarantor.”⁸⁴ Here, the Trustee stands in the shoes of the Debtor (i.e., the Credit Party) and the Trustee's right to pursue claims on behalf of Allied's Estate is necessarily no greater than the rights inherited from Allied.⁸⁵

*181 [11] [12] [13] [14] A covenant not to sue is governed by principles of contract law.⁸⁶ “Whether a contract is ambiguous is a question for the court. The interpretation of an unambiguous contract—including a release—is also a question of law reserved for the court. Where contract language is ambiguous, the differing interpretations of the contract present a triable issue of fact.”⁸⁷

[15] [16] [17] [18] [19] [20] In general, covenants not to sue are permitted under New York law.⁸⁸

If two parties sign a covenant not to sue each other, then a dispute arising out of the conduct covered by that agreement cannot provide the basis for a justiciable controversy, and the case must be dismissed. Because the law disfavors agreements intended to absolve a party from the consequences

of its wrongdoing, however, releases and covenants not to sue are subject to the “**closest of judicial scrutiny**” to determine the intent of the parties. For a document to constitute a release from liability, it must contain an **explicit, unmistakable and unequivocal statement** by one party that it intends to abandon its right to prosecute a present or future claim against the other party.⁸⁹

Furthermore, the Court must give effect and meaning to every term of the contract and “reasonable effort must be made to harmonize all of its terms.”⁹⁰ A “contract *must* be interpreted to give effect to, not nullify, its general or primary purpose.”⁹¹

Yucaipa asserts that section 2.7(e) of the Third Amendment, which added the Capital Contribution Provision, omits Allied from the list of parties entitled to damages or specific performance for breach. Section 2.7(e) provides that

a breach by [Yucaipa] of ... this Section 10.6(j) will cause the other Lenders and Agents to sustain damages for which it would not have an adequate remedy at law for money damages, and therefore [Yucaipa] agrees that on the event of any such breach, each of the other Lenders and Agents shall be entitled to specific performance of such covenants and agreements and injunctive and other equitable relief in addition to any other remedy to which it may be entitled, at law or in equity.⁹²

Yucaipa continues that Allied is neither a *182 Lender nor an Agent under the FLCA⁹³ and as the section 2.7(e) Third Amendment set forth specific instructions regarding the enforcements of the provisions of the Third Amendment, the

omission of Allied in section 2.7(e) (in Yucaipa's view) is dispositive.

The Court disagrees. Section 2.7(e) specifically speaks to the Lenders and their *equitable* remedies if Yucaipa were to breach *any* of the covenants in the Third Amendment. It does not limit Allied's remedies at law, which is what the Trustee is seeking in its breach of contract claim. It is incongruous that the Third Amendment both grants Allied's right to the Capital Contribution and, simultaneously, bars Allied from enforcing that right.

[21] Section 2.7(f)(v) provides a Covenant Not to Sue related to “any capital contribution of Term Loans **made** by [Yucaipa] to [Allied].”⁹⁴ However, it is undisputed that Yucaipa made no capital contribution of Term Loans (or cash) to Allied. Under New York law, “a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.”⁹⁵ Because Yucaipa did not actually “make” any “contribution of Term Loans,” its “covenant-not-to-sue” defense is barred by the plain language of § 2.7(f)(v).

Yucaipa response to this plain meaning is that the Covenant Not to Sue continues to waive claims related to “any act or omission or event occurring in connection therewith.” Yucaipa asserts that the *only* possible “omission” is the failure to pay the Capital Contribution entirely. Again, this cannot be the result. The Court can conceive of many omissions that could have occurred *if* Yucaipa made a contribution of Term Loans – paperwork could have been omitted, requisite state filings not made, notice to various parties not given – *all of these are possible* omissions that could occur in connection with the contribution of Term Loans.⁹⁶

Under New York law, covenants not to sue are disfavored because “agreements intended to absolve a party from the consequences of its wrongdoing.”⁹⁷ With the policy in mind and instructions to review the Covenant Not to Sue with strict scrutiny, the Court rejects on the merits Yucaipa's defense of the Estate's breach of contract claim based on the Covenant Not to Sue. The language is clear and unambiguous that the Covenant Not to Sue *only* applies when Yucaipa *makes* a Capital Contribution of its Term Loans, which Yucaipa did not do. Furthermore, any “omission” can only follow if Yucaipa actually *made* the Capital Contribution. The Court will grant summary judgment in favor of the Trustee on Count 5 of

In re Ashinc Corporation, 629 B.R. 154 (2021)

the Complaint and will deny Yucaipa's motion for summary judgment regarding Count 5.

***183 D. Lender Claims 2 and 3: Breach of Contract and Breach of Duty of Good Faith and Fair Dealing - Statute of Limitations**

Yucaipa asserts that Lender Claims 2 (Breach of Contract) and 3 (Breach of Duty of Good Faith and Fair Dealing) are barred by Delaware's three-year statute of limitations. The Lender Complaint was filed on November 14, 2014. Yucaipa asserts that under the applicable Delaware three-year statute of limitations, the Lenders' contract-based claims are time-barred unless they accrued on or after November 19, 2011. Yucaipa argues that despite the FLCA and Third Amendment's choice of law provision, as these actions are pending in federal court in Delaware, that this Court must look to Delaware's choice-of-law rules to determine whether "the Delaware or New York statute of limitations applies." This Court has previously held that the Delaware statute of limitations applies as it relates to the FLCA and its various amendments.⁹⁸

Yucaipa asserts that the Lender Complaint's contract-based claims arise from the ComVest transaction in August 2009, when Yucaipa acquired the majority of Allied's first lien debt.⁹⁹ Yucaipa asserts that this occurred more than five years before the filing of the Lender Complaint.

In response, the Trustee assert that the statute of limitations did not accrue until full damages were ascertainable because of the "continuous contract" and "continuous breach" doctrines. The Trustee asserts that the FLCA grants the Lender reoccurring and continuous rights, and that Yucaipa continuously breached the FLCA for 4 years on the pretext that it was Requisite Lender. The Trustee continues that it was not until the JCT 363 Sale was consummated on December 27, 2013, that the *184 cumulative effect of Yucaipa's breaches could be determined.

[22] [23] [24] [Delaware Code Title 10, Section 8106](#) specifies a three-year limitations period for the Contract-Based Claims:

no action based on a statute, and no action to recover damages caused by an injury unaccompanied with force

or resulting indirectly from the act of the defendant shall be brought after the expiration of 3 years from the accruing of the cause of such action.¹⁰⁰

However, "the statute of limitations does not typically run against a continuing cause of action until the termination of the contract."¹⁰¹ In cases of continuous contract and continuing breach, "the statute begins to run only when full damages can be ascertained and recovered."¹⁰² Determining the application of these exceptions requires an analysis of "[w]hether the obligations under a contract are continuous or severable." This "turns on the parties' intent, which may be ascertained through the contract's terms and subject matter, 'taken together with the pertinent facts and circumstances' surrounding its formation."¹⁰³

[25] The Trustee asserts that the FLCA and the Third Amendment is a continuing contract. More specifically, in return for providing hundreds of millions of dollars in loans, the non-Yucaipa Lenders were entitled over time to, among other things: (i) recurring principal and interest payments;¹⁰⁴ (ii) recurring financial information from the Company and reasonable access to its management;¹⁰⁵ (iii) the right to direct the Agent — through the Requisite Lenders — to exercise certain *185 remedies in the case of an Event of Default;¹⁰⁶ (iv) Capital Contributions in the amount of 50% of Term Loans acquired by Yucaipa;¹⁰⁷ (v) Yucaipa never serving or acting as Requisite Lender;¹⁰⁸ and (vi) Yucaipa never asserting any claims against them, or the Agent, in any way relating to the Credit Agreement or related documents.¹⁰⁹ The Trustee claims that Yucaipa continually breached these obligations under the FLCA and the Third Amendment, and that the full damages of Yucaipa's continuous breaches could not be ascertained and recovered until 2013. The Trustee accuses Yucaipa of isolating just one of its breaches — its purchase of ComVest's debt and declaration that it was Requisite Lender on August 21, 2009 — to bar claims arising from all of its breaches. The Trustee asserts that this breach was just an initial trigger, which then enabled Yucaipa to continuously breach the FLCA by (i) causing Allied to cease making principal or interest payments from that point onward; (ii) blocking Lenders from the Company's financial information and access to management; (iii) preventing any restructuring dialogue among the Lenders; (iv) preventing Lenders from exercising

remedies for the Company's ongoing Events of Defaults; (v) routinely asserting claims against the Agent and Lenders in contravention of the express covenant not to sue; and (vi) demanding JCT pay Yucaipa, and no other Lender, a premium of \$1.15 for each dollar of its First Lien Debt. The Trustee claims that these were all independent and did not have to occur but that Yucaipa's proclamation that it was Requisite Lender in 2009 afforded Yucaipa the ability to commit its later breaches of the FLCA and the Third Amendment.

The Trustee further asserts that the continuous nature of Yucaipa's breaches was acknowledged by Derex Walker in an internal Yucaipa email discussing whether Allied should withhold financial statements to Lenders in spring 2011. In it, Walker admitted that withholding the financials would "simply [be] another breach (one of many) under the credit agreement."¹¹⁰ The Trustee contends that the extent of monetary damages caused by Yucaipa's continuous breaches of the First Lien Credit Agreement was not ascertainable until December 27, 2013, when JCT purchased substantially all of Allied's assets for \$135 million — generating only \$53.8 million to the Company's First Lien Lenders, who held about \$244 million of loans.¹¹¹

The case law supports the Trustee's argument. In *Branin v. Stein Roe Investment Counsel, LLC*,¹¹² the Chancery Court held the defendant-employer was in continuous breach of an operating agreement by declining (at least 5 times) to indemnify the plaintiff-employee.¹¹³ The *Branin* Court ruled that the statute of limitations was "appropriately suspended for the period during which [plaintiff's] liabilities grew," and it observed that requiring plaintiff "to sue continually to enforce his *186 indemnification right would have been inefficient."¹¹⁴

In *Matter of Burger*,¹¹⁵ the parties entered into a service contract where Burger would purchase a herd of cattle with the investor's money, manage, maintain and expand the herd as well as improve the quality of the herd.¹¹⁶ The investor agreed to pay all feed and upkeep expenses while Burger would pay over all milk revenues and any sale proceeds from bulls or cull cows.¹¹⁷ The investor and Burger also executed a seven-year lease agreement, wherein the investor would pay monthly rent for keeping the herd at Burger's ranch. At the end of the seven-year period, the investor and Burger would liquidate the herd.¹¹⁸ In *Burger*, the Court held

that the statute of limitations for investors claims against a farm manager's breach of contract did not accrue when he first allegedly breached the contract (in 1981).¹¹⁹ The Court continues that there was a continuous contract for a "fixed seven-year period where full and complete damages could not be determined by either party until the end of that time."¹²⁰

The *Burger* Court stated:

Moreover, any claim by the Investors for damages necessarily relies on the liquidation of the herd which, under the terms of the contract, was scheduled to take place on or about September 1, 1988. Furthermore, this contract was continuously acknowledged by both parties throughout the seven-year period by the various payments made between the parties. These payments toll the statute because a new promise to pay is implied therefrom.¹²¹

The similarity to the case here is remarkable. Here, the Lenders invested in Allied, pursuant to the FLCA, just as the cattle-investor paid for the initial herd of cattle. As part of that transaction, the Lenders expected to receive financial information, interest and principal payments, among other things. If BD/S had to run into court at each and every breach — it would have been impossible to adjudicate let alone assess damages. Here, the Court agrees that the failure to pay the Capital Contribution is just one of the breaches of the FLCA and the Third Amendment made by Yucaipa and that the parties had a continuous contract that Yucaipa continuously breached. Furthermore, the Court finds that it would have been impossible to determine the extent of the breach until such time as the JCT 363 Sale, which determined the bulk of the damages. In other words, like in *Burger*, the full and complete damages could not be determined until the JCT 363 Sale.

Thus, the FLCA and the Third Amendments are continuous contracts and the statute of limitations did not begin to run until the JCT 363 Sale. As a result, Yucaipa's Summary Judgment Motion as to Lender Claim 2 (breach of contract) based on the statute of limitations is denied. Similarly,

Yucaipa's Summary Judgment Motion as to Lender Claim 3 (breach of good faith and fair dealing) based on the statute of limitations is denied.

In the alternative, Yucaipa also moved for partial summary judgment on the issue *187 of damages as it relates to both of these counts (Lender Count 2 and Lender Count 3). As discussed *supra*, damages have been established as it relates to Lender Count 2 (breach of contract).¹²² As such, Yucaipa's motion for partial summary judgment on the ground of failure to establish damages as to the Lender Claim of breach of damages is denied. Yucaipa has similarly moved for summary judgment on the basis that the Trustee could not establish damages as it relates to breach of good faith and fair dealing (Lender Count 3). This portion of Yucaipa's motion will be discussed below.

E. Lender Count 3 – Breach of Duty of Good Faith and Fair Dealing Against Yucaipa

As stated above, Yucaipa's Summary Judgment Motion on Lender Count 3 on the basis of the statute of limitations has been denied. In the alternative, Yucaipa moves for partial summary judgment on whether the Trustee has met its burden of proving damages. Here the Trustee did not similarly move for summary judgment based on Lender Count 3 the (alleged) breach of the duty of good faith and fair dealing against Yucaipa. As a result, none of the elements and arguments of Lender Count 3 have been fleshed out by the Trustee to prove the affirmative claim; the Court would be in the impossible and illogical position of deciding that the Trustee, who has no pending motion on Lender Count 3, did not meet their burden of damages in relation to that count. Thus, the Court finds that there are genuine issues of material facts with respect to the damages portion of Lender Count 3 and will deny Yucaipa's Summary Judgment Motion as to this point.

F. Estate Claims 4 and 6: Specific Performance

The Trustee has abandoned Estate Claim 6 (specific performance related to the divestiture of \$32 million of first lien debt). As such, Yucaipa's Summary Judgment Motion as to Estate Claim 6 will be granted.

[26] The Trustee's briefs appear to be silent on Estate Claim 4 (specific performance related to the Capital Contribution Provision). As specific performance is not the Trustee's only remedy, the Court will address Yucaipa's Motion for Summary Judgment as to Estate Claim 4. As argued by Yucaipa, this claim for specific performance has been moot

since the Court confirmed the 2016 Joint Plan. It would be impossible for Yucaipa to perform in accordance with the Capital Contribution Provisions because there is no corporation to which Yucaipa can contribute capital. The Court agrees. As such, Yucaipa's Summary Judgment as to Estate Claim 4 will be granted.

***188 G. Estate Claims 10, 11 and 13: Fraudulent Transfer and Disallowance of Claims Pursuant to § 502(d)**

i. Relief Requested

The Trustee seeks summary judgement on Claims 10–11 to avoid certain transactions as constructive fraudulent transfers under  [11 U.S.C. section 548\(a\)\(1\)\(B\)](#) and under the state law fraudulent transfer statutes of either Arizona, California, Delaware, Florida, Georgia, or New York pursuant to [section 544\(b\)](#).¹²³ If successful, the Trustee seeks summary judgment on Claim 13 to recover the transferred property or the value of the transferred property pursuant to [section 550](#) and disallow the avoidable or recoverable claim under [11 U.S.C. § 502\(d\)](#).

ii. Relevant and Reiterated Facts

May 17, 2010 is two years prior to the Petition Date (the “548 Lookback Period”). May 17, 2008 is four-years prior to the Petition Date (the “544 Lookback Period”).

The Trustee asserts that the transfers contained in the table below (the “Contested Payments”) are constructive fraudulent transfers under 548(a)(1)(B) and 544(b):¹²⁴

*189

Transfer Period	Date	Amount
544 Kasowitz	October 15, 2008	\$36,461.28
	December 31, 2008	\$1,280,000.00
	December 23, 2009	\$15,276.86
	December 31, 2009	\$26,961.67
	February 4, 2010	\$4,495.50
544 Latham	December 23, 2009	\$19,155.09
	March 8, 2010	\$100,379.58
	April 13, 2010	\$38,128.38
	April 16, 2010	\$13,359.04
	May 13, 2010	\$98,894.79
Kasowitz 544/548	July 26, 2010	\$101,538.66
	September 15, 2010	\$191,526.39
	September 20, 2010	\$304,033.11
	October 6, 2010	\$209,165.47
	November 2, 2010	\$360,447.42
	December 16, 2010	\$111,808.98
	December 21, 2010	\$4,897.50
	March 7, 2011	\$237,893.64
	June 30, 2011	\$100,000.00
	September 7, 2011	\$117,321.71
	October 12, 2011	\$200,000.00
	November 23, 2011	\$100,000.00
	December 9, 2011	\$75,000.00
	December 15, 2011	\$75,000.00
	September 23, 2010	\$33,220.53
Latham 544/548	October 6, 2010	\$46,285.93
	December 9, 2010	\$1,235.00
	December 31, 2010	\$39,106.45
	March 11, 2011	\$26,536.16
	December 27, 2011	\$139,256.33
Yucaipa Payment (544)	August 21, 2009	\$831,325.83
ComVest Payment (544)	August 21, 2009	\$1,850,000
Ornstein Payment (544)	January 2009	\$250,000
Total		\$7,038,711.30
Latham Total		\$1,648,835.71
Kasowitz Total		\$2,458,549.76
ComVest, Yucaipa Total		\$2,681,325.83
Ornstein		\$250,000

a. ComVest and Yucaipa Payment Facts

Prior to the Yucaipa-Comvest Transaction, the facts suggest that there was a possibility that Allied was facing a second bankruptcy. For example, the record reveals that as of December 2008, certain members of Allied's Board believed that actions of CIT and other lenders "had the clear intent of driving [Allied] into bankruptcy."¹²⁵ As of October 2, 2008, the record indicates that at least Mr. Tomczak of Allied believed that a second bankruptcy could lead to the possibility of a liquidation *190 which might benefit CIT, but not Allied or its other lenders.¹²⁶

Nevertheless, the record, as cited by the parties, reveals that by 2009, Allied, Allied's Lenders, and interested parties mention the possibility of bankruptcy, but only in the context of a sale or restructuring. For instance, on January 28, 2009, JCT's CEO, Mike Riggs, sent to Mark Hughes of Comvest, an email stating: "[CIT] clearly wants to push Allied Holdings into bankruptcy, so they would be supportive of our go forward strategy."¹²⁷ A July 29, 2009 email from Richard Ehlich of Black Diamond sent to Jeffrey Shaffer and Jeffrey Buller of Spectrum after Mr. Ehlich spoke with ComVest, reveals Mr. Ehlich's belief that ComVest's primary objective is to place Allied in bankruptcy and credit bid for the company.¹²⁸ In corroboration, Mr. Walker, of Yucaipa

and Allied, reported at a March 6, 2009 Board meeting, "that Com-Vest's stated intention was to push [Allied] into bankruptcy and force a 363 sale."¹²⁹

Allied was insolvent when the Board determined to forego a quarterly interest payment due August 4, 2009.¹³⁰ The Board chose to forego the payment despite Scott Macaulay's, Allied's then Chief Financial Officer, advice that Allied would have \$5.5 million in cash after making the \$4.8 million quarterly interest payment from their \$10.3 million in available funds.¹³¹

Only 18 days after Allied's failure to make the payments due on its debt, Yucaipa finalized the LPA—a bilateral contract between Yucaipa and ComVest, where Yucaipa purchased from ComVest a majority of Allied's First Lien Debt—in which Allied was neither a signatory nor a beneficiary.¹³² Yucaipa and ComVest structured the LPA such that the closing conditions required Allied to pay, in total, \$2.7 million for fees and expenses related to the Fourth Amendment and the LPA.¹³³ This totals over 50% of the entire required debt payment to lenders that Allied refused to make eighteen days prior.

ComVest did not care if it received its payment from Yucaipa or Allied.¹³⁴ Yet Allied, a non-party to the transaction, was required to pay and, in exchange, received only an invalid amendment to the FLCA.¹³⁵ *191 The record is clear that these payments covered legal fees and expenses that were not incurred by Allied, for services that were not rendered for Allied.¹³⁶

The record also shows that the Fourth Amendment eliminated provisions of the Third Amendment that:¹³⁷

- (i) prohibited Yucaipa from acquiring more than \$50 million of the principal amount of Term Loans (or 25% of the aggregate Term Loan Exposure, whichever was less);
- (ii) restricted Yucaipa's right to vote (a) on modification to the Credit Agreement and (b) as a debtholder in a bankruptcy proceeding;
- (iii) required that Yucaipa make a capital contribution to Allied of 50% of the aggregate principal amount of Term Loans it acquired; and

- (iv) restricted the existing definition of “Eligible Assignee” in the Credit Agreement, which prohibited the Sponsor from becoming an Eligible Assignee.

The record provides evidence that after the Fourth Amendment, at least some of Allied's creditors believed that Yucaipa was operating Allied in good faith to add value to the company. For instance, Spectrum, after forming a steering committee to protect its “rights in the event that the Sponsor does not operate in good faith to restructure the company and improve operations and add value” believed, as of December 31, 2009, that Yucaipa was “operating in good faith to add value to the company.”¹³⁸ Also, on May 31, 2010 a Spectrum internal memorandum stated: “It is our belief that Yucaipa will be able to extract value from the first lien in order to protect this investment and we will benefit from that.”¹³⁹ Finally, BDCM's Steve Deckhoff emailed Ron Burkle on February 2, 2011 stating: “[o]n Allied, the strategy you outlined seemed right and you have our support.”¹⁴⁰

b. The Ornstein Payment

It is uncontroverted that the Ornstein Payment was made by Allied, at Mr. Burkle's request,¹⁴¹ for services that were rendered to Yucaipa rather than Allied.¹⁴² Instead, Ornstein performed the following services for Yucaipa:¹⁴³ (i) introduced Yucaipa and ComVest shortly after ComVest became a Requisite Lender,¹⁴⁴ (ii) acted as *192 a go-between in the negotiations between Yucaipa and ComVest,¹⁴⁵ and (iii) provided to Burkle advice on the transaction.¹⁴⁶

c. The Legal Payments

Regarding the Legal Payments, it is uncontroverted that (i) Yucaipa did not share its legal counsel with Allied—Allied retained its own legal advisors; (ii) the legal invoices Allied made payments on were billed to Yucaipa; and (iii) the legal work was done for Yucaipa.¹⁴⁷

Yucaipa points to two Latham transactions revealed by the record. The first concerns Allied payment of Yucaipa's legal fees related to the \$17 million financing Yucaipa provided to Allied so that Allied could purchase rigs from a competitor.

The second concerns Allied's payment of Yucaipa's legal fees related to the Third Amendment.

On December 21, 2009, Yucaipa sued CIT in Georgia seeking, *inter alia*, declaratory judgment on the validity of the Fourth Amendment in Georgia.¹⁴⁸ CIT countersued seeking declaratory judgment that the Fourth Amendment is invalid.¹⁴⁹ CIT and Yucaipa settled.¹⁵⁰ It is uncontroverted that the Kasowitz Legal Payments were made in connection with the CIT Litigation. After settling with CIT, Yucaipa directed CIT to release (i) \$17 million of letter of credit deposits, pro rata, to first lien lenders, and (ii) certain liens on rigs.¹⁵¹

iii. Shifting Standard and Law

The Trustee must introduce “evidence to support its burden of showing that”¹⁵² Allied transferred the Contested Payments (i) while Allied was insolvent, or resulting in its insolvency; (ii) within two years (548) or four years (544(b)) prior to the petition *193 date; (iii) with funds that constituted an interest of Allied in property; and (iv) received less than reasonably equivalent value in exchange.¹⁵³ The state law elements under [section 544\(b\)](#) are substantially similar to  [section 548\(a\)\(1\)\(B\)](#) except that the transfers must be made within four years, not two.¹⁵⁴ The Trustee, bears the burden of proving that it has established all the elements of its case entitling it to judgment in its favor and that there is no genuine issue of material fact in dispute.”¹⁵⁵

The Trustee established her prima facie case as to the first three elements. Allied was insolvent in early 2008.¹⁵⁶ The Contested Payments occurred within the 548 or 544 Lookback Periods.¹⁵⁷ Allied had an interest in the money used to make the Contested Payments, made from Allied's corporate assets, constitute an “interest of the debtor in property.”¹⁵⁸

*194 Yucaipa argues that the Trustee has failed to meet her burden, on summary judgment, as she has not established her prima facie case as to the fourth element—that Allied did not receive reasonably equivalent value in exchange for the transfers. The Trustee counters, arguing that, at trial, she bears the burden of proving that Allied received no direct value in exchange for the Contested Payments—a burden she asserts she met; and that Yucaipa then bears the burden of persuasion that Allied (i) received indirect value in exchange

for the Contested Payments and (ii) that the indirect value Allied received was the roughly equivalent to what Allied paid for it.

a. Law: Reasonably Equivalent Value

[27] [28] [29] [30] [31] [32] In determining whether the transfer was made for “less than reasonably equivalent value,” courts must first make the “factual determination of whether the debtor received any value at all.”¹⁵⁹ “[T]he question whether the debtor *received* reasonable value must be determined from the standpoint of the creditors.”¹⁶⁰ Only if the debtor receives value in exchange for the transfer do courts consider “whether the value was ‘reasonably equivalent’ to what the debtor gave up.”¹⁶¹ Value is determined based on the benefit, direct or indirect, the debtor received.¹⁶² When a debtor makes a transfer solely for the benefit of a third party, the debtor does not receive reasonably equivalent value.¹⁶³ However, if the transfer is for the benefit of a third party and the benefit “ultimately flows to the debtor,” the debtor likely indirectly received value for the transfer.¹⁶⁴

[33] [34] Even losing investments—or, “money spent on investments that fail to stabilize or improve the debtor’s condition”—can *195 confer value.¹⁶⁵ Nevertheless, where a debtor makes a losing investment to improve its condition, value can only be conferred where there is an expectation of perceived value that is “*legitimate and reasonable*.”¹⁶⁶ Accordingly, “so long as there is some chance that a contemplated investment will generate a positive return at the time of the disputed transfer, we will find that value has been conferred.”¹⁶⁷

[35] [36] Upon determining that a debtor received indirect value from a transfer, courts must focus on whether that indirect value is reasonably equivalent to what the debtor transferred for it. In the event where a debtor indirectly benefits from paying the debt of a third party, the economic benefit of the value the debtor received must be quantified, by “[t]he party claiming to have delivered” it.¹⁶⁸ If the indirect value is reasonably equivalent, the transfer cannot be avoided as fraudulent but if not, it can be avoided.¹⁶⁹ Courts consider whether the value received was the reasonable, or rough,

equivalent, to what the debtor gave for it by examining the totality of the circumstances.¹⁷⁰

b. Standard: Reasonably Equivalent Value

[37] [38] At trial, the Trustee bears the burden of persuasion to prove that there was no direct value received.¹⁷¹ If proven, Yucaipa then carries the burden of proving that Allied received an indirect economically quantifiable value in exchange for the Contested Payments.¹⁷²

On summary judgment, the Trustee must show evidence establishing that there is an absence of material fact that would allow this Court to find that direct value was given to Allied in exchange for the Contested Payments. As for the indirect value defense, the Trustee must produce evidence that negates Yucaipa’s argument that indirect value was provided or establish an absence of evidence supporting Yucaipa’s argument.¹⁷³

***196 c. Discussion: Reasonably Equivalent Value**

Other than the question of whether the Contested Payments were contractually obligated, the record reveals no facts supporting the argument that Allied received direct benefits from any of the Contested Payments. Yucaipa argues that certain of the Contested Payments were made as Allied’s contractual obligations under § 2(b) of the Monitoring and Management Services Agreement (“MMSA”), or under § 10.2 of the FLCA. Yucaipa also argues that under § 6 of the MMSA, Allied is barred from seeking recovery for the Kasowitz Legal Payments in connection with the CIT Litigation.

i. Allied Received No Direct Benefits

A. § 2(b) of the MMSA

[39] Yucaipa asserts, for the first time at the hearing, that each of the Contested Payments were made as contractual obligations under § 2(b) of the Monitoring and Management Services Agreement (“MMSA”).¹⁷⁴ Under Local Rule 7007–2(b)(ii), a “party filing the opening brief shall not reserve material for the reply brief that should have been included in a full and fair opening brief.”¹⁷⁵ Yucaipa failed

to make this argument in its motion for summary judgment. It likewise did not reserve it for its reply brief. Instead, it brought it forward at the hearing. “Plaintiff has not had a fair chance to contend with this new argument, ... and should not be harmed for not having done so.”¹⁷⁶ At this stage in this lengthy litigation it would be unconscionable to allow Yucaipa to spring arguments on the Trustee in violation of the local rules.

B. § 10.2 of the FLCA

Yucaipa also asserts that Allied received direct value for making the ComVest and Yucaipa Payments because it was contractually obligated to make those payments under § 10.2 of the FLCA as Allied was in default and was required to reimburse its Lenders' costs and expenses incurred “in connection with any refinancing or restructuring of the credit arrangements provided.”¹⁷⁷ Yucaipa states: “[t]here is no dispute ... that ComVest and Yucaipa were, at the relevant times, ‘Lenders’ under the FLCA.”¹⁷⁸

[A]fter the occurrence of a Default or an Event of Default, all reasonable costs and expenses, including reasonable attorneys' fees ... incurred by any Agent and Lenders in enforcing any Obligations ... or in connection with any refinancing or restructuring of the credit arrangements provided hereunder in the nature of a “work-out”¹⁷⁹

Although Yucaipa is correct that there is no dispute as to whether ComVest was a Lender, Yucaipa is barred by the doctrine of collateral estoppel from asserting that it was a Lender under the FLCA. Both the Third Circuit and New York Supreme Court have clearly determined that “[t]here is no credible dispute that under the terms of the Credit Agreement as initially drafted and executed, Yucaipa, as the ‘Sponsors’ and controlling shareholders of Allied, were absolutely prohibited *197 from being a Lender to Allied, or an Eligible Assignee of a Lender.”¹⁸⁰

Yucaipa asserts that the ComVest and Yucaipa Payments were reasonable because, it is “common practice for the borrower to pay all fees incurred relating to any and all loan amendments ... [i]n fact, I can't recall any of the over 200 transactions that I have worked on where the borrower did not pay all the fees for a loan amendment.”¹⁸¹

The Trustee counters, arguing that the ComVest Payment is unreasonable because (i) the \$1,850,000 that Allied paid to ComVest under the terms of the LPA were for the costs of negotiating and drafting an invalid amendment to the credit arrangements, (ii) Allied, a non-party to the LPA, did not directly receive anything other than burdens under the LPA or Fourth Amendment in exchange for the \$1,850,000, (iii) the Fourth Amendment remove benefits Allied was to have received,¹⁸² and (iv) Yucaipa's debt purchase allowed it to gain favorable treatment of its equity claims in Allied at the expense of Allied's legitimate contract creditors because it allowed Yucaipa to (a) cut to the front of the line of Allied's creditors, (b) gain administrative control over insolvency proceedings, and (c) gain the power to prevent other creditors from exercising their contractual rights against Allied.¹⁸³

Indeed, it is unreasonable for an insolvent company to default in order to “provide runway for negotiations” between Yucaipa and ComVest for an amendment to a credit agreement that was invalid and that Yucaipa knew was contrary to the intent of the parties.¹⁸⁴ The Yucaipa and ComVest *198 Payments were not contractually obligated under § 10.2 of the FLCA.¹⁸⁵ Other than the contractual obligation argument, Yucaipa makes no other serious contentions that Allied would directly benefit from the Yucaipa and ComVest Payments.

C. § 6 of the MMSA

Yucaipa asserts, as an affirmative defense to the Kasowitz Legal Payments made in connection with the CIT Litigation, that Allied indemnified Yucaipa from any losses arising under § 6 of the MMSA. Section 6 of the MMSA provide that Allied will indemnify Yucaipa from losses (costs, fees, and expenses) related to or arising out of acts or failure to act (i) at Allied's request or with Allied's consent or (ii) otherwise related to or arising out of services provided by Yucaipa under this Agreement but § 6 will not apply if it is finally judicially determined that the losses arose out of the sole gross negligence or bad faith of Yucaipa.¹⁸⁶

The Trustee argues that it was finally judicially determined that Yucaipa acted in bad faith as the New York Court found that: “Yucaipa caused Allied to enter into that certain Amendment No. 4 ..., which purported to eliminate any restrictions on Yucaipa's ownership of Allied debt [Yucaipa] seiz[ed] control of the Lenders' rights and remedies under the Credit Facility.”¹⁸⁷ “This was, of course, flatly prohibited under the Credit Agreement, and thus the Purported Fourth Amendment is invalid and of no force or effect.”¹⁸⁸ The Third Circuit has found, “[a]s discussed above, those provisions made clear that the parties' intent was to prohibit Yucaipa from ever becoming the Requisite Lender.”¹⁸⁹ Citing to  *LightSquared Inc.*, the Third Circuit determined that “[i]t would be inequitable to allow Yucaipa to achieve an ‘end run’ around the substance of the Eligible Assignee restrictions in the Credit Agreement and undercut what Yucaipa certainly knew the restrictions were designed to prevent.”¹⁹⁰

Yucaipa argues that the courts failed to determine that its losses were incurred from its acts of bad faith. The Court disagrees.  *LightSquared, Inc.*, determined that a “[party's conduct] was an end-run around the Eligible Assignee provisions of the Credit Agreement that breached the implied covenant of good faith and fair dealing arising under the Credit Agreement.”¹⁹¹ Implicit in the Third Circuit's findings is the determination that Yucaipa did not act in good faith by amending the FLCA. It is uncontroverted that the Kasowitz Legal Payments made towards the CIT Litigation arose from the Yucaipa's *199 execution of the Fourth Amendment to the FLCA. And that Yucaipa executed the Fourth Amendment adding provisions it knew to be against the intent of the contracting parties.¹⁹² Indeed, all of Yucaipa's expenses arising out of or related to the Fourth Amendment to the FLCA arose from the bad faith of Yucaipa. Accordingly, the record undisputedly reveals that Yucaipa acted in bad faith where it intentionally worked around the bargained-for-rights of the contractual parties to the Third Amendment.¹⁹³ The Trustee is not prohibited from pursuing recovery related to the CIT Litigation under § 6 of the MMSA.

ii. Indirect Benefits and Rough Equivalent

A. ComVest and Yucaipa Payments

The Trustee has met her burden in showing that there is no genuine issue of material fact that Allied did not receive direct value in exchange for the Contested Payments. The Court now considers whether the Trustee has proven an absence of evidence that the Contested Payments indirectly benefited Allied in an amount roughly equivalent to what Allied exchanged for them. Evidence proving that Allied indirectly benefited from a Contested Payment, alone, is insufficient. The evidence must also show a comparison establishing that the indirect value Allied received was roughly equivalent to the Contested Payment exchanged for it.

[40] The bar for finding indirect value is very low. There need only be, at the time of the transfer, facts showing that Allied had “at least *some* chance of receiving a future economic benefit”¹⁹⁴ in exchange for the Contested Payment from the standpoint of Allied's creditors.¹⁹⁵

[41] Yucaipa argues that Allied benefited from the ComVest Transaction because the ComVest Transaction (i) was *200 necessary to prevent Allied's liquidation and (ii) after the CIT Litigation and settlement, Yucaipa's actions as Requisite Lender benefited Allied.

There was a remote chance in 2008 that Allied believed CIT and other creditors may push it into liquidation. However, by 2009, the record clearly shows that Allied's creditors were interested in selling Allied through bankruptcy, not liquidating Allied. There is no evidence that, from the viewpoint of the creditors, Allied benefited by paying Yucaipa and ComVest's legal fees in connection with the LPA and Fourth Amendment to the FLCA. In fact, pushing Allied into a bankruptcy restructuring or 363 sale would have likely benefited Allied's creditors more than watching an insolvent debtor pay the legal fees and expenses necessary to subvert their contractually obligated rights.

There is a sliver of factual evidence supporting the idea that Yucaipa added value to Allied as seen in the internal emails or memoranda of BD/S. The record also establishes that as Requisite Lender, Yucaipa took acts that benefited Allied from the standpoint of its creditors—such as releasing letter of credit deposits and liens. The record also supports the idea that Allied thought Yucaipa would benefit it as Requisite Lender. As the bar for finding indirect value is low, the Court finds that the record supports the argument that Allied received indirect value in exchange for the ComVest and Yucaipa Payments.

Notwithstanding the finding that Allied indirectly benefited from the ComVest and Yucaipa Payments, the Trustee has met her burden by establishing the absence of fact supporting the argument that any indirect value Allied received from the ComVest and Yucaipa Payments was roughly equivalent to what Allied paid for it. The release of liens and letter of credit deposits is never compared to the \$2.7 million that Allied paid in exchange for them. Likewise, the value Yucaipa added to Allied as the “Requisite Lender” has not been calculated or compared to the \$2.7 million Allied exchanged for it.

B. Ornstein Payment

There is no real dispute that Allied did not directly receive anything, including consulting services, from Ornstein in exchange for the \$250,000 payment he received from Allied. Yucaipa argues that Ornstein added value to the ComVest Transaction by: (i) introducing Yucaipa and ComVest shortly after ComVest became a Requisite Lender,¹⁹⁶ (ii) acting as a go-between in the negotiations between Yucaipa and ComVest,¹⁹⁷ and (iii) providing to Burkle advice on the transaction.¹⁹⁸ As any indirect value must be tied to the benefits Allied received from the completion of the Yucaipa-Comvest transaction, as explained above, the Trustee need only establish an absence of evidence in the record that such indirect benefit is comparable to the \$250,000 Allied paid Ornstein for the services he provided Yucaipa and ComVest. The Trustee has met her burden.

C. Kasowitz Legal Payments

Yucaipa argues that Allied and Allied's lenders, in exchange for the Kasowitz Legal Payments, received benefits from the litigation because: (i) the litigation sought for certainty that the Fourth Amendment was valid and Yucaipa was legitimately the Requisite Lender; (ii) as a result of the *201 negotiated settlement with CIT, CIT recognized Yucaipa as the Requisite Lender and took direction from Yucaipa to release (a) \$17 million of letter of credit deposits, *pro rata*, to first lien lenders, and (b) certain liens on rigs; and (iii) Allied's lenders acknowledged the value that Yucaipa was adding.¹⁹⁹

There is likely some benefit associated with the certainty of the CIT Litigation and the actions Yucaipa took as Requisite Lender. However, as explained above, even if Yucaipa's assertion that litigation to enforce amendment it made in

bad faith indirectly benefited Allied were true, it must also establish that the record provides evidence comparing the indirect benefit and showing that it is roughly equivalent to the millions Allied paid in exchange. Additionally, Yucaipa must differentiate the indirect benefits Allied received from paying for Yucaipa's legal counsel when it was receiving direct benefits from the same litigation by paying for its own counsel.²⁰⁰ The Trustee has met her burden in establishing an absence of evidence on the record comparing the indirect value, Allied received with the price Allied paid for it and showing that it was roughly equivalent.

D. Latham Legal Payments

1. Blue Thunder Financing

Yucaipa argues that the Latham Legal Payments relating to the “Blue Thunder Financing” provided value to Allied as Allied was paying the legal fees Yucaipa owed to Latham in relation to Allied's receipt of \$17 million in financing to purchase rigs from a competitor.²⁰¹ The Court finds that there is at least some economic benefit to paying a creditor's legal fees to obtain financing—the debtor can receive the financing. Yet, the Trustee points to an absence of evidence in the record comparing the indirect economic benefit Allied received with the amount Allied paid for it. The Trustee has met her burden.

2. Third Amendment

There is no dispute that Yucaipa owed Latham money for services Latham provided on Yucaipa's behalf and that Allied paid to Latham the fees Yucaipa incurred. As such, there is no dispute that Allied did not directly benefit from the legal services Latham provided to Yucaipa. Instead, Yucaipa argues that the fees incurred in connection with the Third Amendment and the subsequent debt-to-equity swap by Yucaipa in 2008 benefited Allied by allowing it to deleverage its balance sheet, increase *202 its cash flow, and avoid a going-concern opinion.

In support, Yucaipa provides (i) an email with the Latham invoices attached, (ii) a citation to the deposition of Mr. Jeffrey Shaffer who testified, “I do recall, that the entire negotiation was regarding the first amendment, and at the end, it turned out to be something that was more geared towards the second lien, because that's the only acquisition that

Yucaipa did immediately following the process,”²⁰² and (iii) the declaration of Mr. Walker who states, “Yucaipa elected not to purchase first lien debt because of the restrictions and conditions limiting Yucaipa’s potential ownership rights. But Yucaipa did invest an additional \$26 million in Allied, purchasing \$40 million of the \$50 million in outstanding second lien debt.”²⁰³

The Trustee asserts that while the Third Amendment to the SLCA resulted in Yucaipa’s debt-to-equity swap, the majority of the Latham legal fees relate to negotiating and finalizing the Third Amendment to the FLCA— which “only allowed Yucaipa to purchase very limited amounts of term loans, and by Yucaipa’s own admission, imposed onerous restrictions on such purchases” such that no purchases under the Third Amendment to the FLCA were ever made.²⁰⁴ As such, Yucaipa would need to show that an Amendment it was not interested in purchasing debt under, indirectly benefited Allied in an amount “roughly equivalent” to what Allied paid for it.

While a portion of the legal bill may have been in relation to the Third Amendment to the SLCA, the Trustee has met her burden in showing that the record contains an absence of evidence supporting Yucaipa’s burden at trial to compare the economic benefit Allied indirectly received from the debt-to-equity swap with the amount Allied paid for it and establishing that it was roughly equivalent. The Trustee has met her burden.

iii. Yucaipa Benefited

The Trustee may only recover the value of the Contested Payments from Yucaipa if the Court finds that Yucaipa is “the entity for whose benefit such transfer was made” or is “the initial transferee of such transfer.”²⁰⁵

It is undisputed that Yucaipa is the initial transferee of the Yucaipa ComVest Payment. Yucaipa argues that the Trustee has failed to show that the record established undisputed evidence that the remaining Contested Payments were made for Yucaipa’s benefit. There is no genuine issue of material fact as to whether the Legal Payments were made for the benefit of Yucaipa. Indeed, Yucaipa was the beneficiary as Yucaipa (i) received the direct benefit of the work performed, (ii) did not share its legal counsel with Allied—they retained their own legal advisors, and (iii) the invoices Allied paid were addressed to Yucaipa. No evidence exists in contravention of these facts.

The uncontroverted facts show that Yucaipa benefited from Allied’s payment to Ornstein as the payment was made at Mr. *203 Burkle’s request for services that were rendered to Yucaipa rather than Allied.

The uncontroverted facts show that the ComVest Payment was a necessary component of the ComVest Transaction and that ComVest did not care whether the payment came from Allied or Yucaipa.²⁰⁶ The uncontroverted facts also show that Allied was not a party to the transaction and did not receive direct benefits from the transaction. To close the deal, Yucaipa had Allied pay \$1,850,000, that it would have otherwise had to pay. Yucaipa benefited from the payment because (i) it did not have to make the payment itself and (ii) the transaction closed as a result.

The Trustee seeks to disallow Yucaipa’s bankruptcy claim under 11 U.S.C. § 502(d) until Yucaipa “has paid the amount ... for which [it] ... is liable.” It is undisputed that Yucaipa has not returned the Contested Payments to Allied.

iv. Summary

In sum, the Trustee established her prima facie case that Allied transferred the Contested Payments (i) while Allied was insolvent or resulting in its insolvency; (ii) within two years (548) or four years (544(b)) prior to the petition date; (iii) with funds that constituted an interest of Allied in property.

The Trustee established her prima facie case that Allied did not receive the reasonably equivalent value of the Contested Payments as she: (i) established that Allied received no direct value in exchange for the Contested Payments; and (ii) established an absence of fact that the indirect benefit Allied received, if any, was compared to what Allied paid for it such that what Allied received and what Allied paid were roughly equivalent to each other.

The Trustee has met her burden and may recover the value of the fraudulent transfers under  11 U.S.C. §§ 548(a)(1)(B), 544, and 550. For the reasons discussed above, the Court grants the Trustee’s motion for summary judgment on Estate Claim 13 and disallows Yucaipa’s bankruptcy claims in the amount of the Contested Payments under 11 U.S.C. § 502(d).

H. Estate Claim 7 – Breach of Fiduciary Duty²⁰⁷

In part, the Trustee claims that Yucaipa breached its fiduciary duty by engaging in self-dealing, culminating in the lost JCT deal in late 2011/early 2012. The Trustee asserts that damages as a result of this breach of fiduciary duty is the difference between the value of the lost JCT deal and the value realized from the later JCT 363 Sale.²⁰⁸

*204 The Trustee further asserts that Yucaipa obstructed the potential transaction with JCT to benefit itself and that Yucaipa caused Allied to pay millions in attorney's fees and expenses that were patently unreasonable and not in connection with the workout.

It is undisputed that Yucaipa owed a fiduciary duty to Allied.²⁰⁹ As the Court is only considering Yucaipa's motion for summary judgment on this claim. The Court will only considering the defenses Yucaipa has enumerated to the Trustee's claims.

i. The Fiduciary Duty Claim is not Duplicative of the Breach of Contract Claim

Yucaipa argues that the Trustee's breach of fiduciary duty claim is duplicative of the Trustee's breach of contract claims.

[42] Under Delaware law, a "breach of fiduciary duty claims is duplicative of breach of contract claims that either were substantially identical, such that the fiduciary duty claim would have been 'superfluous,' or involved remedies that were likely to be equivalent"²¹⁰ In  *Gale v. Bershad*,²¹¹ the plaintiff alleged that the defendants breached both contractual and fiduciary duties owed to stockholders.

The  *Gale* plaintiff sued the company and its directors for breach of contract, breach of the implied covenant of good faith and fair dealing, and breach of fiduciary duty for allegedly redeeming the preferred stock at an unreasonably low and unfair price in violation of the certificate of incorporation. The court determined that (i) the same facts that underlie the plaintiff's implied contract claim also form the basis of his fiduciary duty claim,²¹² and that (ii) the duty sought to be enforced arose out of the parties' contractual, as opposed to their fiduciary, relationship.²¹³ The  *Gale* court held: "[t]o allow a fiduciary duty claim to coexist in parallel with an implied contractual claim, would undermine the primacy of contract law over fiduciary law in matters involving the essentially contractual rights and obligations of preferred stockholders."²¹⁴ Therefore, it held that "because

the contract claim addresses the alleged wrongdoing by the board, any fiduciary duty claim arising out of the same conduct is superfluous."²¹⁵

[43] [44] However, Delaware courts allow parallel fiduciary duty and contract claims where, as here, the fiduciary duty claims are "grounded on an additional and distinct fact."²¹⁶ Although breach of fiduciary *205 duty claims may share a "common nucleus of operative facts" with breach of contract claims, they must depend on "additional facts as well, are broader in scope, and involve different considerations in terms of a potential remedy."²¹⁷

[45] Here, the Estate Claim for breach of contract (Estate Claim 5) relates to Yucaipa's breach of the Capital Contribution Provision in section 2.7(e) of the Third Amendment. The fiduciary duty claim is centered on Yucaipa's breach of duty of loyalty by causing Allied to enter into the Fourth Amendment, which "serve no valid corporate purpose for Allied" but carried "significant benefits to Yucaipa."²¹⁸ Furthermore, the damages for the Capital Contribution Claim (\$57.4 million, as discussed *supra*) are distinct and separate from the fiduciary duty damages being sought (the difference between the unconsummated JCT deal versus the JCT 363 Sale price). As a result, although the claims share a common nucleus of facts, the breach of fiduciary duty claim is broader in scope and involves a different remedy. Thus, the Court finds that the breach of fiduciary duty claim is not duplicative of the breach of contract claim.²¹⁹

ii. There is Enough Evidence to Go to Trial on the Issue of Whether Yucaipa Obstructed Board Consideration to Benefit Itself

Yucaipa asserts that "there is no evidence of any 'potential transactions' that could have benefitted Allied, but which the Board failed to consider at Yucaipa's urging."²²⁰ Here, the Trustee alleges that Yucaipa exploited Allied for its own benefit by not presenting alternative offers to the Board and by seeking a greater recovery than the other Lenders.

[46] [47] [48] Delaware law:

requires that corporate fiduciaries
observe high standards of fidelity

and, when self-dealing is involved, places upon them the burden of demonstrating the intrinsic fairness of transactions they authorize, the law does not require more than fairness. Specifically, it does not, absent a showing of culpability, require that directors or controlling shareholders sacrifice their own financial interest in the enterprise for the sake of the corporation or its minority shareholders.²²¹

Thus, it may not be a breach of a fiduciary duty for groups of shareholders to be apportioned ^{*206} different proceeds as long as it is fairly divided.²²² As the Chancery Court observed in *Thorpe v. CERBCO*, “controlling shareholders, while not allowed to use their control over corporate property or processes to exploit the minority, are not required to act altruistically towards them.”²²³ Here, the allegations, supported by, albeit contested material facts, are that Yucaipa used their control over Allied's processes to exploit Allied and the other Lender's holdings. This is not Yucaipa acting in its own self-interest, the allegations rise to the level of exploitation of Allied.

[49] For brevity – the Court will highlight some of that record:

- i. Mike Riggs (CEO of Active and later JCT) remained highly motivated to acquire the Company. Mr. Riggs testified that it was a “dream” of his to combine the entities, and that in the course of a five year “quest” he made several overtures and proposals.²²⁴
- ii. Yucaipa's 30(b)(6) witness admitted that “Riggs was certainly interested in trying to put together a transaction at various points in time.”²²⁵
- iii. Mr. Riggs e-mailed Mr. Walker in September 2008, to gauge Yucaipa's interest in selling its equity stake in Allied. There is no evidence that Yucaipa informed the non-Yucaipa Allied's Board members of Mr. Riggs' interest.²²⁶
- iv. In December 2009, Mr. Riggs began pitching various Allied Lenders and outside investors on a strategy to take

ownership of Allied, becomes CEO, and install a new management team.²²⁷

- v. In February 2009, Mark Hughes of ComVest wrote to Mr. Walker to arrange a due diligence meeting with Allied's management.²²⁸ Mr. Hughes testified that ComVest was concerned it was not “getting access to information” about Allied that it was entitled to receive as a Lender.²²⁹

^{*207} vi. In March 2009, ComVest met with Messrs. Burkle, Tocher and Walker at Burkle's home. At the meeting, ComVest explained its “intent to work with [Riggs] ... on a solution to recapitalize Allied.”²³⁰ Mr. Hughes testified that ComVest was “prepared to move forward and work on a restructuring to get the business properly capitalized.”²³¹ At this time, Mr. Burkle proposed that Yucaipa and ComVest agreed to a waterfall for recoveries in the event of liquidation, and that ComVest get a warrant for 25% of the outstanding shares of Allied.²³² However, ComVest did not agree.

- vii. In the spring of 2009, ComVest was locked out of talking with Allied and Mr. Burkle assured that ComVest would never run Allied.²³³

viii. In the summer of 2009, Mr. Riggs again reached out to Yucaipa about buying its stake in Allied.²³⁴ ^{*208} Mr. Riggs met with Messrs. Burkle and Walker in late June 2009 regarding a JCT transaction to buy-out Yucaipa's stake in Allied.²³⁵ Instead, Mr. Burkle tried to convince Mr. Riggs to sell JCT to Yucaipa.²³⁶ However, there is no evidence that Yucaipa informed Allied's Board of Mr. Riggs' ongoing interest in owning Allied at this time.²³⁷

- ix. In July 2010, Mr. Riggs sent a Letter of Intent (“LOI”) to Messrs. Gendregske and Walker, again seeking to acquire Allied.²³⁸ The offer included (a) \$100 million in cash, (b) \$50 million in JCT preferred equity with a redemption right (accruing a return of 7% annually and exercisable on the 5th anniversary of closing), and (c) the assumption of designated liabilities of the Company.²³⁹ The Allied Board discussed the JCT letter of intent, however, Mr. Walker stated that Yucaipa would “never accept such an offer and rather believes that the Company [Allied] is worth very significantly more than liquidation.”²⁴⁰ The Board, upon Mr. Walker's motion,

approved to allow the Letter of Intent to lapse would any response from Allied. ²⁴¹

*209 x. In late 2011 to 2012, Yucaipa demanded a 15% premium (\$20 million) premium for its debt. As set forth in the Expert Report of Jeffrey Risius, JCT's term sheets during this period reflected its willingness to pay approximately \$244.2 million to acquire substantially all of Allied's assets. ²⁴² This shrank to \$135 million by the time of the JCT 363 sale in December 2013. ²⁴³

As stated, the Court is not ruling on the breach of fiduciary duty claim at this time – the Court is only ruling on Yucaipa's motion for summary judgment, which is premised on the grounds that such allegations fail for lack of proof. As related to alternative transactions, the Trustee has presented ample evidence that in 2008-2009 there was a potential alternative transaction that Yucaipa did not present to Allied's Board for consideration and such failure went beyond Yucaipa's self-interest and had significant negative impact on Allied and its stakeholders.

iii. JCT Negotiations

Yucaipa asserts that the JCT 2011-2012 proposals were not specifically referenced in the Estate Complaint. ²⁴⁴ This is a summary judgment motion (and not a motion to dismiss) and this argument is a sufficiency of pleadings argument. Needless to say, [Federal Rule of Civil Procedure Rule 8](#), made applicable to these proceeds by [Federal Rule of Bankruptcy Procedure 7008](#), requires only “a short and plain statement of the claim showing that the pleader is entitled to relief.” ²⁴⁵ It would be unrealistic for the Estate (and now the Trustee) to make specific allegations in the Estate Complaint before discovery had begun. ²⁴⁶ “Plaintiffs are held only to the notice pleading standard and are not required to plead every factual allegation supporting their claims.” ²⁴⁷ Furthermore, here, the factual allegations do not state a new claim or legal theory, ²⁴⁸ instead, these *210 facts “directly relate to and support the initial claims made by” ²⁴⁹ the Estate (and now the Trustee). As a result, these allegations are admissible, and Yucaipa's argument is without merit.

iv. Could Any Transaction with JCT Benefit Allied?

Yucaipa further contends that there was “no transaction” with JCT that could benefit Allied. Again, only Yucaipa moved for summary judgment on the basis that “no facts” exist – as set

forth herein, there are material facts asserted by the Trustee (and supporting evidence) to allow the Court to determine that there are material facts in dispute for this issue to go forward at trial. In addition to the evidence outlined in bullet points above, the Trustee sets forth the following:

- i. Riggs testified that he did not care what form the transaction took. ²⁵⁰
- ii. The Trustee's 30(b)(6) witness, Stephen Deckoff (Black Diamond principal), testified that, after meeting with Riggs on multiple occasions, his understanding was that:

Yucaipa ... through [its] position as requisite lender tried to structure a transaction where instead of the company being sold to Jack Cooper in a normal M&A transaction, Jack Cooper would buy from Yucaipa their controlling interest in the debt and the requisite lender status that went along with that controlling position in the debt ... they tried to negotiate a transaction where they would get better treatment than the other lenders. ²⁵¹

- iii. JCT's corporate representative testified that in 2011 and 2012:

The goal was not to acquire any debt, the goal was to acquire Allied. In order to acquire Allied, one, you needed a requisite lender; and two, you wanted as much debt as possible so you could end up with as much of the equity as possible or the assets ... ²⁵²

The Trustee has shown that there is dispute of material fact for this allegation to go forward at trial.

v. Corporate Opportunity

Yucaipa continues that the Trustee's (purported) damages resulting from the JCT negotiations are rooted in the assumption that Yucaipa wrongfully usurped Allied's “corporate opportunity.” ²⁵³ However, *211 the Trustee alleges that Yucaipa usurped the *negotiations* with JCT and torpedoed a transaction that could have brought value to Allied and its stakeholders. In other words, Yucaipa asserts that the Trustee cannot make a case for breach of the “doctrine of corporate opportunity” – and the Trustee agrees. As the parties agree that the “doctrine of corporate opportunity” is not an issue in this litigation, the Court will not discuss it further.

vi. Unnecessary and Unreasonable Fees.

As the fees are recovered by the Trustee as fraudulent transfers in Estates Claims 10 and 11, the Court rules here in the alternative. In any event, the Court is only ruling on Yucaipa's defenses and not on the Trustee's *prima facie* case.

Yucaipa asserts that it could not have breached its fiduciary duties by causing Allied to pay unnecessary and unreasonable fees because Allied was contractually obligated to pay these fees. Yucaipa continues that if Allied was in default, Allied was contractually obligated to reimburse its Lenders' costs and expenses, including legal fees incurred in connection with any refinancing or restructuring of the credit agreements. Yucaipa also asserts that Allied was contractually obligated to pay Yucaipa's fees in connection with the CIT Litigation. The Court will take these two groups of fees in turn to determine if there is a dispute as to material fact.

a. Fees for Yucaipa-ComVest Transaction

Section 10.2 of the FLCA states:

Each Borrower agrees to pay promptly ... (h) after the occurrence of a Default of an Event of Default, all *reasonable* costs and expenses, including reasonable attorneys' fees (including reasonable allocated costs of internal counsel) and reasonable costs of settlement, incurred by any Agent and Lenders in enforcing any Obligations of or in collecting any payments due from any Credit Party hereunder or under the other Credit Documents by reason of such Default or Event of Default (including in connection with the sale, lease or license of, collection from, or other realization upon any of the Collateral or the enforcement of the Guaranty) or in connection with any refinancing or restructuring of the credit agreements provided hereunder in the nature of a "work-out" or pursuant to any

insolvency or bankruptcy cases of proceedings.²⁵⁴

Thus, fees must be (i) reasonable, (ii) after default, and (iii) in connection with any refinancing or restructuring of the credit arrangements provided under the FLCA in the nature of a work-out. The Fourth Amendment and Yucaipa's purchase of ComVest's debt were not in the nature of a *212 "work out." As stated by the Trustee, a "workout" is an "adjustment in the reasonable expectations of" stakeholders that results in "a business entity that has realigned its financial structure."²⁵⁵ Although Yucaipa attempted to characterize the Fourth Amendment as a "workout,"²⁵⁶ as argued by the Trustee, the Fourth Amendment did not "realign" Allied's financial structure (it only realigned the lenders' claims and rights).

Furthermore, the Trustee alleges that the Allied default on which Yucaipa premises its right to fees occurred *only* because Yucaipa (through Mr. Walker) requested it. Allied defaulted on its scheduled \$4.8 million principal and interest payment, weeks before Yucaipa executed the Yucaipa-ComVest transaction, because Mr. Walker advised the Board to do so. More specifically, the minutes of the Board of Directors meeting on August 3, 2009 reflect:

Mr. Blount called the meeting to order, and announced that the purpose of the meeting was to discuss the Company's liquidity, especially with respect to the approximately \$4.8 million interest payment due to the first lien lenders the next day. Mr. Blount advised the Board that Mr. Walker had suggested that the Company might be well-advised *not* to make the payment. ...

Mr. Walker then updated the Board on the status of negotiations with ComVest, stating that ComVest and Yucaipa were back in discussions and that Yucaipa was feeling optimistic that a consensual deal that would be beneficial to the Company could be accomplished in the near future. Mr. Walker warned, however, that it was critical that the Company have adequate liquidity to provide a sufficient runway for negotiations. ...²⁵⁷

After advising the Board to "default" on the payment, Yucaipa then caused Allied to pay \$2.7 million in fees to Yucaipa and ComVest as a closing condition to their deal.²⁵⁸ Yucaipa responds that Allied had *213 been in default for over a year

before the August 2009 default.²⁵⁹ However, at least some of the earlier defaults had been negotiated through a forbearance agreement. What is notable to the Court is that weeks prior to the transaction, a Yucaipa principal is recommending that Allied default. At the very least, this creates a dispute of material fact as to whether these fees were “reasonable” or even warranted under section 10.2 of the FLCA. Thus, the Court will deny Yucaipa's Summary Judgment motion on the basis of the fees for Yucaipa-ComVest Transaction.

b. Fees for CIT Litigation

Yucaipa asserts that Allied was contractually obligated to pay the fees incurred in connection with the CIT Litigation. Under the MMSA, Allied agreed to indemnify Yucaipa for any losses, fees, and expenses arising out of any “action or failure to act” by Allied or by Yucaipa “at the Company's request or with the Company's consent,” including fees incurred in “investigating, preparing or pursuing” any action or proceeding in connection with litigation.²⁶⁰ Yucaipa asserts that the Georgia bankruptcy court expressly approved the MMSA when Allied exited its prior bankruptcy. Thus, Yucaipa argues that any payment Allied made on behalf of Yucaipa for the CIT Litigation was consistent with its court-approved contractual obligations.

In response, the Trustee asserts that provisions of the MMSA requiring Allied to pay Yucaipa's legal fees are inapplicable “if it is finally judicially determined by a court of competent jurisdiction” that the fees incurred “arose solely out of [Yucaipa's] gross negligence or bad faith.”²⁶¹

The New York Supreme Court held:

Thus, on August 21, 2009, Yucaipa, as controlling shareholder of Allied, caused Allied to enter into that certain Amendment No. 4 to Credit Agreement with ComVest (the “Purported Fourth Amendment”), which purported to eliminate any restrictions on Yucaipa's ownership of Allied debt (including those that existed in the Credit Agreement as initially drafted and executed), including the provision disregarding Yucaipa-held debt in calculating “Term Loan Exposure,” which would otherwise have prevented Yucaipa from becoming the Requisite Lender. After the Purported Fourth Amendment was signed, Yucaipa consummated its transaction with ComVest and acquired a majority of the Obligations -

thereby **seizing control** of the Lenders' rights and remedies under the Credit Facility.

This was, of course, **flatly prohibited** under the Credit Agreement absent the consent of all of the Lenders, and thus the Purported Fourth Amendment is invalid and of no force or effect.²⁶²

***214** Yucaipa also litigated with it was an “Eligible Assignee” under the FLCA, where the Third Circuit held:

It would be **inequitable** to allow Yucaipa “to achieve an ‘end run’ around the substance of the Eligible Assignee restrictions in the Credit Agreement and **undercut** what Yucaipa certainly knew the restrictions were designed to prevent.

It is clear Yucaipa knew that it was prohibited from acquiring LC Commitments and that the Third Amendment restricted Yucaipa's rights as a Lender. Yucaipa's argument that the express language in the Third Amendment does not exclude LC Commitments is an attempted “end run” around the intent to limit Yucaipa's holdings and prevent Yucaipa from becoming the Requisite Lender.²⁶³

Yucaipa asserts that the New York court granted declaratory relief, it *at most* found that Yucaipa had breached the FLCA, it made no “good faith” or negligence determination.

[50] However, “ ‘[a] failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose **other than that of advancing the best interests of the corporation**, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.’ ”²⁶⁴ The New York Supreme Court and the Third Circuit have already made these determinations regarding Yucaipa making an “inequitable end run”²⁶⁵ around the substance of the restrictions in the FLCA. As a result, the MMSA's fee provisions relied upon Yucaipa in its motion, would be inapplicable.

Thus, the Court will deny Yucaipa's Motion for Summary Judgment with regard to the payment of the fees related to the CIT Litigation.

***215 I. Lender Claim 4: Tortious Interference Against the Yucaipa Directors and Ron Burkle**

The Trustee asserts that a claim of tortious interference against Yucaipa and Rob Burkle alleging that they intentionally interfered with the First Lien Lenders' rights under the FLCA. However, the Trustee has abandoned this claim.²⁶⁶ As a result, the Court will deny the Trustee Summary Judgment Motion on Lender Claim 4 (Tortious Interference).

J. Estate Claims 1-2 and Lender Claim 1: Equitable Subordination

The Trustee seeks summary judgment on Estate Claims 1-2 and Lender Claim 1 to subordinate Yucaipa's claim arising from its First and Second Lien Facilities, in its entirety, to all other debt claims under [11 U.S.C. section 510\(c\)](#) as Yucaipa acted in a way that harmed Allied, Allied's creditors, or advantaged Yucaipa by: (i) acquiring first lien debt in and Requisite Lender status (and causing Allied to foot the transaction costs) in willful breach of the Third Amendment; and (ii) using the illegitimate Requisite Lender Status to (a) litigate the validity of an invalid Fourth Amendment, (b) allow Allied to default on its obligations under the FLCA, (c) act unreasonably during the JCT Negotiations, and (d) cause Allied to make fraudulent transfer.²⁶⁷

Yucaipa argues that claims for inequitable subordination are inherently fact driven—unsuitable for disposition on summary judgment.²⁶⁸ Yucaipa also asserts that the factual narrative demonstrates the good faith or inherent fairness of its actions. *216 Yucaipa argues that because BD/S acquired its debt in 2011-2012, after most of the allegedly inequitable actions were conducted, BD/S is not entitled to equitable subordination.²⁶⁹

[Section 510\(c\)](#) permits the subordination of claims under principles of equitable subordination for:

purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or order that any lien securing such a subordinated claim be transferred to the estate.²⁷⁰

The Supreme Court has interpreted [§ 510\(c\)](#)'s reference to "principles of equitable subordination" as a clear indication of "congressional intent at least to start with existing doctrine."²⁷¹ The pre-1978 doctrine mentioned largely refers to the general application of equitable subordination where (i) the claimant engaged in inequitable conduct, (ii) the inequitable conduct resulted in: (a) injury to the debtor or creditors or (b) created an unfair advantage for the claimant, and (iii) granting equitable subordination must be consistent with the provisions of the Bankruptcy Code.²⁷² The consistency requirement reminds bankruptcy courts that they are "not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable."²⁷³ In keeping with pre-1978 doctrine, many Courts of Appeals have continued to require inequitable conduct before allowing the equitable subordination of most claims ²⁷⁴

While the  [Noland](#) court did not resolve the issue of "whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated,"²⁷⁵ it clarified that courts have "leeway to develop the doctrine" of equitable subordination "rather than to freeze the pre-1978 law in place."²⁷⁶ Indeed, "despite its earlier endorsement of  [Mobile Steel](#) as the benchmark of equitable subordination, the Court expressly declined to rule that equitable subordination was unavailable merely *217 because the IRS was not guilty of misconduct."²⁷⁷ As such, under [§ 510\(c\)](#), courts are permitted "to make exceptions to a general rule when justified by particular facts." "Such case-by-case adjudication is at the core of judicial competence."²⁷⁸

[51] [52] Although courts have the power to tweak pre-1978 law, they do not have the power to subordinate categorically claims based on the type of claim.²⁷⁹ Some types of claims may, generally, be more suspect to subordination than others, but "a court sitting in equity must nonetheless consider whether subordinating a *particular* claim would be fair based on the totality of the circumstances in the individual case."²⁸⁰

[53] In the Third Circuit, claims of insiders are generally more suspect to subordination than claims of non-insiders. This is expressed in differing standards of inequitable conduct for the two types of claims.²⁸¹

[54] [55] [56] For non-insiders, inequitable conduct must be “egregious conduct” such as “fraud, overreaching, or spoliation.”²⁸² Conversely, for insiders, inequitable conduct requires only “material evidence of unfair conduct” or, “any unfair act by the creditor as long as the conduct affects the bankruptcy results of the other creditors.”²⁸³ If sufficiently challenged, the claimant then bears the burden of proving the good faith of the conduct and “its inherent fairness from the viewpoint of the corporation and those interested therein.”²⁸⁴

[57] There is no standardized test for what constitutes “unfair conduct.” And courts look to the particularized facts before them to determine whether the conduct and injury demand equitable subordination.²⁸⁵ In cases of fiduciary or insider claimants, courts have found, based on the facts of the case before them, unfair conduct where the insider or fiduciary: (i) dominated and exploited the debtor; (ii) violated the “rules of fair play and good conscience;” (iii) engaged in illegal or fraudulent conduct; (iv) breached fiduciary duties owed to the debtor, stockholders, or creditors; (v) used “the debtor as a mere instrumentality or alter ego;”²⁸⁶ (vi) breached a contract;²⁸⁷ or (vii) if a controlling *218 stockholder, undercapitalized the debtor or capitalized the debtor with debt.²⁸⁸

[58] Where a parent entity dominates a subordinate and occupies the position of fiduciary, mere domination is insufficient to show inequitable conduct—instead, the parent’s conduct must advantage the parent entity at the disadvantage of the subsidiary.²⁸⁹

In *Comstock v. Group of Int’l Investors*, a parent entity dominated its subsidiary because it owned 58-83% of the subsidiary’s equity during the relevant time period. Importantly, while the parent entity made loans to the subsidiary, the parent’s conduct benefited the subsidiary’s creditors. As such, the court did not subordinate the claim.²⁹⁰

Conversely, in *Gannet Co. v. Larry*, the court found a parent entity’s actions inequitable where it caused the subsidiary to engage in a business experiment that benefited the parent entity regardless of the experiment’s financial profitability but only benefited the subsidiary’s creditors if the experiment proved financially profitable.²⁹¹ In other words,

the action benefited the parent entity at the disadvantage of the subsidiary and creditors.

[59] [60] While examining whether a claim should be equitably subordinated, courts should also remember that inequitable conduct can warrant subordination of a claim even if the conduct is unrelated to the “assertion of that claim,” and that claims should only be subordinated to the extent necessary to offset the harm suffered as a result of the conduct.²⁹²

i. Insider Status

[61] [62] Under  11 U.S.C. section 101(31)(B)(iii), business entities in control of a debtor are insiders. And control is the “legal right or ability to exercise control over a corporate entity.”²⁹³ The record shows that Yucaipa had the legal right to control every tranche of Allied’s capital structure as of August 21, 2009.²⁹⁴ The record contains no evidence suggesting that Yucaipa was not an insider of Allied, nor does Yucaipa dispute that it was an insider. Controlling every tranche of Allied’s capital structure grants Yucaipa the legal right to exercise authority over Allied. The Court finds that the Trustee has produced undisputed evidence showing Yucaipa’s status as an insider of Allied as Yucaipa was a person in control of Allied, under  11 U.S.C. § 101(31)(B)(iii) as of August 21, 2009, if not earlier.²⁹⁵ It is further *219 undisputed that Yucaipa owed a fiduciary duty to Allied.²⁹⁶

ii. Inequitable Conduct

[63] At trial, the Trustee will bear the burden of persuasion in showing that (i) there was inequitable conduct; (ii) the inequitable conduct resulted in: (a) injury to the debtor or creditors or (b) created an unfair advantage for the claimant; and (iii) equitable subordination is consistent with the Bankruptcy Code.²⁹⁷ Thus, on summary judgment, the Trustee must produce admissible, undisputed evidence proving each of the above elements.²⁹⁸

c. Undisputed Conduct

As to amending the FLCA in breach of the Third Amendment and invalidly assuming the title of Requisite Lender, the Trustee has shown that there is no genuine dispute of material fact that (i) Yucaipa knew that it was prohibited from

becoming Requisite Lender under the FLCA or acquiring LC Commitments under the FLCA; (ii) the Third Amendment burdened Yucaipa with onerous restrictions placed on its purchases of first lien debt; and (iii) by proclaiming an (invalid) amendment to the FLCA, Yucaipa advantaged itself by: (a) acquiring more than \$50 million in principal amount of Term Loans, (b) obtaining voting powers on future modifications to the Credit Agreements and bankruptcy proceedings, (c) avoiding the requirement that it make the Capital Contribution, and (d) enabling itself to become an Eligible Assignee; (iv) Yucaipa's actions heavily injured Allied's Lenders by subverting their contracted rights; (v) Yucaipa's actions injured Allied and creditors, as it withheld the Capital Contribution.

By subverting the bargained-for rights of the Lenders,²⁹⁹ Yucaipa advantaged itself while simultaneously causing the Lenders to suffer particularized harm. Yucaipa argues that but for the Fourth Amendment and the ComVest Transaction, Allied would have been forced into bankruptcy liquidation. There is no evidence in support of this argument.³⁰⁰ There is no credible dispute that these amendments were not made in good faith.³⁰¹

*220 The Trustee argues that, under the terms of the Third Amendment, Yucaipa was required to make a capital contribution of \$57.4 million to Allied in cash or debt cancellation in connection with the ComVest Transaction. As explained, *supra*, the undisputed facts show that Yucaipa's failure to contribute constitute a breach of the Third Amendment and resulted in injury to Allied in the amount of \$57.4 million plus prejudgment interest. As to the lenders, the Trustee provides an expert report demonstrating that in bankruptcy, the lenders would have received: (i) if cash contribution, an additional \$25.7 million without interest or \$39 million with interest³⁰² or (ii) if debt cancellation, an additional \$10.7 million without interest and \$16.3 million with interest.³⁰³ Yucaipa provides an expert report disputing the Trustee's experts report as to the degree of injury as to the Lenders.

Yucaipa caused an insolvent Allied to (i) pay nearly \$2.7 million in ComVest transaction fees (ii) pay Yucaipa's counsel approximately \$2.5 million in connection with the CIT Litigation and (iii) pay to Latham around \$1.6 million for Yucaipa's benefit.³⁰⁴ Because Yucaipa knowingly caused Allied, through the ComVest Transaction to enter the invalid Fourth Amendment, it was aware that litigation was likely

to follow, and in fact, filed the first suit against CIT in Georgia.³⁰⁵ As a result of the lawsuits and fees, Allied was injured to the extent of approximately \$6.8 million. Allied's Lenders were harmed because they could have benefited by receiving payments the insolvent Allied spent on fees and litigation, the fees and litigation expenses were all to Yucaipa's advantage as they would have otherwise been Yucaipa's responsibility.³⁰⁶ Furthermore, Yucaipa gained an advantage over Allied's Lenders by causing an insolvent Allied to pay the legal fees associated with drafting and negotiating the Fourth Amendment, which subverted Lenders' rights. The Lenders further incurred legal fees and invested time in validating their valid contractual rights after the ComVest Transaction and further suffered where Yucaipa caused Allied to fund its litigation against them.

As for the consulting services, Burkle emailed a ComVest principal that "we gave [Ornstein] 250k a few months ago."³⁰⁷ The *221 money was paid through Allied, while it was insolvent, for services rendered to Yucaipa, not Allied.³⁰⁸ This payment was to the advantage of Yucaipa, as it received the benefits from Ornstein while causing an insolvent Allied to pay for them.³⁰⁹ While the degree of injury to the creditors will be reserved for trial, the Trustee has met her burden as to one instance of inequitable conduct.

The Trustee has failed to prove, as undisputed, that: (i) Yucaipa's conduct in the JCT Negotiations was unreasonable as there still exist genuine issues of fact as to whether (a) the JCT Negotiations were a missed opportunity for Allied, (b) whether Yucaipa agreed to *pari passu* treatment, or (c) whether it was Yucaipa's or BDS's actions which terminated the JCT Negotiations; and (ii) Yucaipa caused Allied to commit events of default under the FLCA as there still exist genuine issues of fact as to whether Yucaipa was able to prevent the defaults. Left for trial are the above facts as well as whether acts (i) and (ii) above resulted in injury to Allied, creditors, or the advantage of Yucaipa.

d. Good Faith and Inherent Fairness

At trial, Yucaipa bears the burden of persuasion of proving not only "the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein."³¹⁰ The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does

not, equity will set it aside.”³¹¹ Thus, Yucaipa must establish that its dealings with Allied were arms-length transactions from the viewpoint of Allied and its creditors. The Trustee, on summary judgment, must produce evidence that negates this or provide an absence of evidence as the arms-length nature of Yucaipa's dealings. The Trustee provides the following facts as evidence that Yucaipa did not deal at arms-length with Yucaipa from the viewpoint of Allied and its creditors:

- i. Yucaipa caused Allied agree to the Fourth Amendment in connection with the Yucaipa-ComVest while (a) understanding that the validity of the Fourth Amendment was likely to be litigated, (b) usurping the position of Requisite Lender from BD/S, (c) causing Allied to pay legal fees relating to the transaction that it was not a party to while Allied was insolvent.³¹² Entering into a MMSA with Allied but never receiving payment. Advocating to buy first lien debt but not receiving payment for interest or principal.
- a. On August 19, 2009, Allied's Board resolved to authorized Allied *222 to enter into the Fourth Amendment prior to receiving a legal opinion from its counsel, dated the day after, that the Fourth Amendment “constitutes the legal, valid and binding obligation of [Yucaipa, ComVest, and Allied] enforceable in accordance with its terms.”³¹³ Notably, the legal opinion does not claim the Fourth Amendment binding on any other lender party.³¹⁴
- b. On August 21, 2009, Yucaipa and ComVest entered the LPA. In the LPA, Yucaipa specifically refused to represent or warrant that the LPA or Fourth Amendment breached the Third Amendment to the FLCA.³¹⁵
- c. Within two days of entering the Fourth Agreement, Yucaipa hired its counsel to develop a contingency plan on the validity of the Fourth Amendment.³¹⁶
- ii. On December 21, 2009, Yucaipa sued CIT in Georgia seeking, *inter alia*, declaratory judgment on the validity of the Fourth Amendment.³¹⁷ CIT countersued seeking declaratory judgment that the Fourth Amendment is invalid.³¹⁸ CIT and Yucaipa settled.³¹⁹ Despite arguing that the ComVest Transaction was not a “corporate opportunity,” (Allied was not a party to it) Yucaipa caused Allied to pay its legal fees in relation to the CIT Litigation at a time when Allied was insolvent.

iii. Causing Allied to pay, while insolvent, Ornstein \$250,000 for Consulting Services that were not provided under the terms of the Consulting Agreement, but rather were provided to Yucaipa.

iv. As to the JCT Negotiations, see *supra* pages: 205–10 – —.

Additionally, this Court, on summary judgment, finds that Yucaipa amended the FLCA despite knowing the proposed amendment was opposed to the original intent of the FLCA.³²⁰ This Court has already determined that Yucaipa's attempt to amend the FLCA was bad faith conduct.³²¹ The above allegations are sufficient to negate Yucaipa's claims that it dealt in good faith and inherent fairness. The Trustee has met her burden.

e. Summary

The Trustee has met her burden and produced admissible, undisputed evidence proving that (i) Yucaipa acted in bad faith *223 in purchasing first lien debt under an invalid Fourth Amendment and assuming Requisite Lender status thereunder; (ii) Yucaipa breached the Third Amendment to the FLCA by failing to provide a substantial capital contribution to Allied at a time that Allied was insolvent, in default of its loans, and needed the capital contribution, (iii) Yucaipa's inequitable conduct resulted in lawsuits and fees that Allied was required to pay at a time when Allied was insolvent, (iv) the conduct described in (i), (ii), and (iii) resulted in injury to Allied or creditors or resulted in the advantage of Yucaipa, and (v) Yucaipa did not conduct itself in good faith and inherent fairness in the above course of actions.

The Court grants, in part, the Trustee's motion for summary judgment on the following elements of Estate Claims 1–2 and Lender Claim 1: (i) Yucaipa is an insider and fiduciary; (ii) Yucaipa's conduct described in acts (i)–(iii), above, (a) constitute inequitable conduct and (b) injured Allied or Allied's lenders or advantaged Yucaipa; (iii) Yucaipa did not act in good faith in the instances of inequitable conduct described above; and (iv) the Court finds that the type of equitable subordination the Trustee is requesting (debt subordinated to debt) is consistent with the provisions of the Bankruptcy Code.³²²

The Court denies, in part, the Trustee's motion for summary judgment on the following triable issues of fact: (i) Yucaipa's conduct in the JCT Negotiations was unreasonable; (ii) Yucaipa caused Allied to commit events of default under the FLCA as there exists genuine issues of fact as to whether Yucaipa was able to prevent the defaults; (iii) if (i) and (ii) are inequitable acts, a triable issue of fact exists as to the degree of injury that Allied or Lenders suffered, or the advantage Yucaipa gained as a result; and (iv) the Court reserves for trial the exact extent to which Yucaipa's claims should be subordinated.

K. Estate Claim 3 – Recharacterization

The Trustee also seeks to recharacterize “Yucaipa's purported debt holdings under the First Lien Facility and Second Lien Facility.”³²³ Since the filing of the Estate Complaint, the Trustee now believes that the treatment of Yucaipa's debt holdings is best addressed through its equitable subordination claim (Estate Claims 1-2).³²⁴ However, as the Court is not granting the Trustee's Summary Judgment Motion on Estate Claims 1-2, the Court must turn to whether, as a matter of law, the Trustee may assert a claim for recharacterization.

Yucaipa asserts that Allied issued secured debt under the FLCA and SLCA as debt, not equity. Allied issued both the FLCA and the SLCA in connection with its Joint Plan,³²⁵ pursuant to which Allied exited its 2005 Bankruptcy. In response, *224 the Trustee argues that the Court should recharacterize Yucaipa's First Lien debt holdings in excess of the amount it was permitted to hold under the Third Amendment. The Third Amendment barred Yucaipa from acquiring more than \$50 million or 25% of the aggregate Term Loans.³²⁶ The Trustee claims that Yucaipa's void attempt to remove this restriction in the “lawless” Fourth Amendment, its acquisition of Term Loans far in excess of the cap, and its refusal to make the mandatory capital contributions required by the Third Amendment, so altered the nature of the First Lien Debt held by other Lenders as to warrant recharacterization to equity.³²⁷

[64] [65] [66] [67] [68] [69] “In a recharacterization action, someone challenges the assertion of a debt against the bankruptcy estate on the ground that the ‘loaned’ capital was actually an equity investment.”³²⁸ The Third Circuit has made clear that “the determinative inquiry in classifying advances as debt or equity is the intent of the parties as it

existed at the time of the transaction.”³²⁹ The Third Circuit decided that:

[The factors] devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt to discern whether the parties called an instrument one thing when in fact they intended it as something else. *That intent may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances.* Answers lie in facts that confer context case-by-case.

....

Which course a court discerns is typically a commonsense conclusion that the party infusing funds does so as a banker (the party expects to be repaid with interest no matter the borrower's fortunes; therefore the funds are debt) or as an investor (the funds infused are repaid based on the borrower's fortunes; hence, they are equity). Form is no doubt a factor, but in the end it is no more than an indicator of what the parties actually intended and acted on.³³⁰

“If recharacterization of an investment from debt to equity is warranted, the characterization occurs ‘*ab initio*,’ from the beginning of the investment.”³³¹

*225 [70] Although “[n]o mechanistic scorecard suffices,”³³² courts have considered the following factors in considering recharacterization:

- (1) the name given to the instrument;
- (2) the intent of the parties;
- (3) the presence or absence of a fixed maturity date;
- (4) the right to enforce payment of principal and interest;
- (5) the presence or absence of voting rights;
- (6) the status of the contribution in relation to regular corporate contributors; and
- (7) certainty of payment in the event of the corporation's insolvency or liquidation.³³³

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The Trustee cites to *In re Franklin* wherein the defendant argued that a loan may experience a “transformation” after acquisition – which the *Franklin* court acknowledged that the existing law was to review the “loan” as of the date it originated; however, the *Franklin* court acknowledged that the “transformation” argument was a strong, albeit ultimately unsuccessful, argument.³³⁴

[71] Here, the Trustee is urging the Court to consider that the Fourth Amendment so altered the nature of the First Lien Debtor held by other Lenders as to warrant recharacterization to equity. As intriguing as this argument is, it would be counter to Third Circuit binding precedent. The Court *must* look to the beginning of the investment to determine if such “loan” should be recharacterized, regardless of the now-voided steps that Yucaipa took in the Fourth Amendment. As a result, the Court will grant Yucaipa's Summary Judgment Motion as to Estate Claim 3 (recharacterization).

CONCLUSION

The Court will grant, in part, and deny, in part, the Trustee Summary Judgment Motion. In addition, the Court will grant, in part, and deny, in part, Yucaipa Summary Judgment Motion, consistent with the statements above and the chart attached hereto as *Appendix*. An order will be entered.

*226 Appendix

Summary Chart of Claims and Rulings

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Complaint Claim #/Description	Trustee Summary Judgment Motion (Adv. 13,58796, D.I. 793)	Yucaipa Summary Judgment Motion (Adv. 13,58796, D.I. 499)	Ruling
Estate Claims			
Estate Claim 1 – Equitable Subordination Pursuant to 11 U.S.C. § 510(c) against Yucaipa	Trustee moves for summary judgment		Grant, in part, deny, in part, Trustee Summary Judgment Motion as to Estate Claim 1.
Estate Claim 2 – Equitable Subordination Pursuant to 11 U.S.C. § 510(c) against Yucaipa for Harm to All First Lien and Second Lien Lenders	Trustee moves for summary judgment		Grant, in part, deny, in part, Trustee Summary Judgment Motion as to Estate Claim 2.
Estate Claim 3 – Recharacterization Pursuant to 11 U.S.C. § 541(a) of Yucaipa's Purported Debt Holdings Under the First and Second Lien Facilities against Yucaipa		Yucaipa moves for summary judgment	As a matter of law, the Trustee cannot establish a claim for recharacterization. Grant Yucaipa Summary Judgment Motion as there are no facts which would entitle the Trustee to judgment.
Estate Claim 4 – Specific Performance of Third Amendment to the First Lien Credit Agreement against Yucaipa (Contribution Provision)		Yucaipa moves for summary judgment	Trustee did not address in its briefs; however, since the confirmation of the 2016 Joint Plan, specific performance is moot. Grant Yucaipa Summary Judgment Motion as to Estate Claim 4.
Estate Claim 5 – Breach of Third Amendment to the First Lien Credit Agreement against Yucaipa (Contribution Provision)	Trustee moves for summary judgment	Yucaipa moves for summary judgment	Grant Trustee Summary Judgment Motion as to Estate Claim 5; Deny Yucaipa Summary Judgment Motion as to Estate Claim 5.
Estate Claim 6 – Specific Performance of Third Amendment to the First Lien Credit Agreement against Yucaipa (Divestiture of Debt)		Yucaipa moves for summary judgment	Grant Yucaipa Summary Judgment Motion as to Estate Claim 6 (See also Adv. D.I. 770 p. 17 Trustee specifically abandons Estate Claim 6)
Estate Claim 7 – Breach of Fiduciary Duty against Yucaipa		Yucaipa moves for summary judgment	Deny Yucaipa Summary Judgment Motion. Triable issues remain.
Estate Claim 8 – Breach of Fiduciary Duty against the Allied Directors			
Estate Claim 9 – Aiding and Abetting Breach of Fiduciary Duty against the Allied Directors and Yucaipa			
Estate Claim 10 – Avoidance and Recovery of Constructive Fraudulent Transfers against Yucaipa Pursuant to 11 U.S.C. §§ 548(a) and 550	Trustee moves for summary judgment	Yucaipa moves for summary judgment	Grant Trustee Summary Judgment Motion as to Estate Claim 10; Deny Yucaipa Summary Judgment Motion (partial) as to Estate Claim 10.

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Complaint Claim #/Description	Trustee Summary Judgment Motion (Adv. 13,58796, D.I. 793)	Yucaipa Summary Judgment Motion (Adv. 13,58796, D.I. 499)	Ruling
Estate Claim 11 – Avoidance and Recovery of Constructive Fraudulent Transfers and Conveyances against Yucaipa Pursuant to 11 U.S.C. §§ 544(b) and 550	Trustee moves for summary judgment	Yucaipa moves for summary judgment	Grant Trustee Summary Judgment Motion as to Estate Claim 11; Deny Yucaipa Summary Judgment Motion (partial) as to Estate Claim 11.
Estate Claim 12 – Preferential Transfers against Yucaipa Pursuant to 11 U.S.C. §§ 547 and 550			
Estate Claim 13 – Disallowance of Claim against Yucaipa	Trustee moves for summary judgment		Grant Trustee Summary Judgment Motion as to Estate Claim 13.
Lender Claims			
Lender Claim 1 – Subordination Pursuant to 11 U.S.C. § 510(c) against Yucaipa for Harm to All First Lien and Second Lien Lenders	Trustee moves for summary judgment		Grant, in part, deny, in part, Trustee Summary Judgment Motion as to Lender Claim 1.
Lender Claim 2 – Breach of Contract Against Yucaipa	Trustee moves for summary judgment	Yucaipa moves for summary judgment, and in the alternative for partial summary judgment on issue of damages	Grant Trustee Summary Judgment Motion as to Lender Claim 2; Deny Yucaipa Motion for Summary Judgment as to Lender Claim 2.
Lender Claim 3 – Breach of the Duty of Good Faith and Fair Dealing Against Yucaipa		Yucaipa moves for summary judgment, or, alternatively, for partial summary judgment on damages	Claim is not time barred by the statute of limitations; however, the Trustee has not established its prima facie case; triable issues remain. Claim should go forward to trial. As to the issue of damages, Deny Yucaipa (partial) Summary Judgment Motion, without prejudice, as to Lender Claim 3.
Lender Claim 4 – Tortious Interferences with Contract Against the Yucaipa Directors and Burke	Trustee moves for summary judgment		Deny Trustee Summary Judgment Motion as to Lender Claim 4. See Trustee's reply (Adv. D.I. 794 at n. 1) (“The Trustee's claims against Defendants Ron Burke and the Yucaipa Directors have been voluntarily dismissed (13-58796, D.I. 793; 14-59571, D.I. 333 and 334). The Trustee's motion seeking summary judgment on Direct Lender Claim 4 (Tortious Interference) is, therefore, no longer in the case”).

All Citations

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Footnotes

- ¹ This Opinion constitutes the Court's findings of fact and conclusions of law pursuant to [Federal Rule of Bankruptcy Procedure 7052](#).
- ² Capitalized terms not defined herein shall have the meaning ascribed to them *infra*.
- ³ Adv. Pro. 13-50530, Adv. D.I. 696; Adv. Pro. 14-50971, Adv. D.I. 453 (the “Yucaipa Summary Judgment Motion”). Although the Yucaipa Summary Judgment Motion and associated briefing were filed in both adversary actions, the Court will reference *only* docket numbers in Adv. Pro. 13-50530, unless otherwise indicated.
- ⁴ Adv. Pro. 13-50530, Adv. D.I. 705; Adv. Pro. 14-50971, Adv. D.I. 462 (pursued by the “Trustee” and referred to herein as “Trustee Summary Judgment Motion” and together with Yucaipa Summary Judgment Motion, the “Cross-Motions for Summary Judgment”). Although the Trustee Summary Judgment Motion and associated briefing were filed in both adversary actions, the Court will reference *only* docket numbers in Adv. Pro. 13-50530, unless otherwise indicated.
- ⁵ Declaration of Gila S. Singer in Support of Motion for Partial Summary Judgment (D.I. 710) (the “Singer Dec.”) Exh. 9 (Amended and Restated First Lien Secured Super-Priority Debtor in Possession and Exit Credit and Guaranty Agreement, dated Mar. 30, 2007).
- ⁶ Adv. No. 13-50530, D.I. 1, as amended D.I. 76 (The Official Committee of Unsecured Creditors' Complaint for (i) Equitable Subordination, (ii) Recharacterization, (iii) Breach of Contract, (iv) Specific Performance, (v) Breaches of Fiduciary Duties, (vi) Aiding and Abetting Breaches of Fiduciary Duties, (vii) Avoidance and Recovery of Avoidable Transfers, and (viii) Disallowance of Certain Claims) (the “Estate Complaint”). The Estate Complaint includes the following claims (each an “Estate Claim” and together, the “Estate Claims”): (i) Estate Claim 1: Equitable Subordination, (ii) Estate Claim 2: Equitable Subordination for Harm to All First Lien and Second Lien Lenders, (iii) Estate Claims 3: Recharacterization, (iv) Estate Claim 4: Specific Performance of Contribution Provision, (v) Estate Claim 5: Breach of Contract for Breach of Contribution Provision, (vi) Estate Claim 6: Specific Performance of Divestiture of Debt Provision, (vii) Estate Claim 7: Breach of Fiduciary Duty against Yucaipa, (viii) Estate Claim 8: Breach of Fiduciary Duty against Allied Directors, (ix) Estate Claim 9: Aiding and Abetting Breaches of Fiduciary Duties, (x) Estate Claim 10: Avoidance and Recovery of Fraudulent Transfers ([11 U.S.C. §§ 548\(a\), 550](#)), (xi) Estate Claim 11: Avoidance and Recovery of Fraudulent Transfers ([11 U.S.C. §§ 544\(b\), 550](#)), (xii) Estate Claim 12: Preferential Transfers, and (xiii) Estate Claim 13: Disallowance of Claims.
- ⁷ Del. Bankr. 14-50971 at D.I. 1 (Complaint for (i) Equitable Subordination, (ii) Breach of Contract, (iii) Breach of the Implied Duty of Good Faith and Fair Dealing, and (iv) Tortious Interference with Contract) (the “Lender Complaint”). The Lender Complaint includes the following claims (each a “Lender Claim” and together, the “Lender Claims”): (i) Lender Claim 1: Equitable Subordination, (ii) Lender Claim 2: Breach of Contract, (iii) Lender Claim 3: Breach of the Implied Duty of Good Faith and Fair Dealing, and (iv) Lender Claim 4: Tortious Interference with Contract.
- ⁸ 12-11564, D.I. 3360-1 (Debtors' Modified First Amended Joint Chapter 11 Plan of Reorganization Proposed by the Debtors, the Committee, and the First Lien Agents (the “Amended Plan”)). *See also* 12-11564, D.I. 3383 (Findings of Fact, Conclusions of Law, and Order Confirming the Plan) (the “Confirmation Order”). The Amended Plan became effective on December 20, 2016. *See* D.I. 3744 (Notice of Effective Date). Thereafter, the Trustee was substituted as plaintiff in both above-captioned adversary actions. Order Substituting

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Plaintiffs and Amending Captions in Above-Referenced Adversary Proceedings to Reflect Litigation Trustee as Plaintiff (Adv. Pro. 13-50530, D.I. 415; Adv. Pro. 14-050971, D.I. 214).

- 9 Amended Plan § 5.13. The Confirmation Order appointed Ms. Catherine E. Youngman as the Litigation Trustee (the “Trustee” for the “Trust”) and Plan Administrator in these cases. See Confirmation Order ¶¶ 20, 22.
- 10 See generally *Yucaipa Am. All. Fund I, L.P. v. Ehrlich*, 204 F. Supp. 3d 765 (D. Del. 2016), *aff’d sub nom. Yucaipa Am. All. Fund I, LP v. Ehrlich*, 716 F. App’x 73 (3d Cir. 2017) (RICO Action); *Yucaipa American Alliance Fund II, LP v. BDCM Opportunity Fund II, LP (In re Allied Sys. Holdings Inc.)*, 556 B.R. 581, 584 (D. Del. 2016), *aff’d sub nom. In re ASHINC Corp.*, 683 F. App’x 131 (3d Cir. 2017) (requisite lender litigation); *Gendregske v. Black Diamond Commercial Finance LLC (In re Ashing Corp.)*, 552 B.R. 80, 82 (D. Del. 2015) *Committee v. Yucaipa (In re Allied Sys. Holdings, Inc.)*, 524 B.R. 598, 601 (Bankr. D. Del. 2015) (Committee against former chief executive officer for breach of fiduciary duties), Del. Bankr. Case. No. 12-11564 (D.I. 1068) (Tr. of Hr’g Feb. 27, 2013); *BDCM Opportunity Fund II, L.P. v. Yucaipa American Alliance Fund L.L.P. (In re ASHInc. Corp.)*, Del. Bankr. 14-50971, D.I. 81; *Yucaipa Am. All. Fund I, LP v. SBDRE LLC, No. CIV.A. 9151-VCP, 2014 WL 5509787, at *10-15 (Del. Ch. Oct. 31, 2014)*.
- 11 **Yucaipa Summary Judgment Motion:** Motion for Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P. and Yucaipa American Alliance (Parallel) Fund I, L.P. (D.I. 696 and brief at D.I. 697, as amended D.I. 762); Declaration of Kahn Scolnick in Support of Motion For Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P., Yucaipa American Alliance (Parallel) Fund I, L.P., Ronald Burkle, Jos Opdeweegh, Derex Walker, Jeff Pelletier, and Ira Tochner (D.I. 700, the “Scolnick Dec.”); Declaration of Derex Walker in Support of Motion for Summary Judgment (D.I. 701); Declaration of Ira Tochner in Support of Motion for Summary Judgment (D.I. 702); Declaration of Jeff Pelletier in Support of Motion for Summary Judgment (D.I. 703); Declaration of Jos Opdeweegh in Support of Motion for Summary Judgment (D.I. 704); Objection/Litigation Trustee’s Opposition To The Motion For Summary Judgment By Defendants Yucaipa American Alliance Fund I, L.P., And Yucaipa American Alliance (Parallel) Fund I, L.P. (D.I. 770); Declaration Of Gila S. Singer In Support Of Litigation Trustee’s Oppositions To The Motion For Summary Judgment By Defendants Yucaipa American Alliance Fund I, L.P., And Yucaipa American Alliance (Parallel) Fund I, L.P., And The Motion For Summary Judgment By Ronald Burkle, Jos Opdeweegh, Derex Walker, Jeff Pelletier, And Ira Tochner (D.I. 772) (the “Supp. Singer Dec.”); Reply in Support of Motion for Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P., and Yucaipa American Alliance (Parallel) Fund I, L.P. (D.I. 803); and Declaration of Maurice M. Suh in Further Support of Yucaipa Defendants’ Motion for Summary Judgment (D.I. 804). **Trustee Summary Judgment Motion:** Litigation Trustee’s Motion for Partial Summary Judgment (D.I. 705, brief at D.I. 706); Declaration of Gila S. Singer in Support of Motion for Partial Summary Judgment (D.I. 710) (defined *supra* the “Singer Dec.”); Brief - Opposition to the Litigation Trustee’s Motion for Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P., Yucaipa American Alliance (Parallel) Fund I, L.P., Ronald Burkle, Ira Tochner, Derex Walker, Jos Opdeweegh, and Jeff Pelletier (D.I. 766); Declaration of Kahn Scolnick in Support of Yucaipa Defendants’ Opposition to the Litigation Trustee’s Motion for Summary Judgment (D.I. 767, the “Supp. Scolnick Dec.”); Litigation Trustees Reply Memorandum in Further Support of Motion for Summary Judgment (D.I. 794); Declaration of Gila S. Singer in Support of Litigation Trustees Reply Memorandum in Further Support of Motion for Partial Summary Judgment (D.I. 796); Declaration of Richard A. Ehrlich in Support of Litigation Trustees Reply Memorandum in Further Support of Motion for Partial Summary Judgment (D.I. 798); Declaration of Adam C. Harris in Support of Litigation Trustees Reply Memorandum in Further Support of Motion for Partial Summary Judgment (D.I. 800); and Declaration of Jeffrey A. Schaffer in Support of Litigation Trustee’s Reply Memorandum in Further Support of Motion for Partial Summary Judgment (D.I. 802).
- 12 Bankr. N.D. Ga., No. 05-12515 (CRM).

- [13](#) See Singer Dec. Exh. 5 (Bankr. N.D. Ga., No. 05-12515 (CRM) Second Amended Joint Plan of Reorganization of Allied Holdings, Inc. and Affiliated Debtors Proposed by the Debtors, Yucaipa and the Teamsters National Automobile Transportation Industry Negotiating Committee) (the “2005 Bankruptcy Joint Plan”).
- [14](#) Singer Dec. Exh. 10 (Second Lien Secured Super-Priority Debtor in Possession and Exit Credit and Guaranty Agreement, dated May 15, 2007).
- [15](#) Singer Dec. Exh. 20 (Amendment No. 3 to Credit Agreement and Consent (to the FLCA)).
- [16](#) Singer Dec. Exh. 22 (Amendment No. 3 to Credit Agreement and Consent (to the SLCA)). The FLCA, SLCA, and the Third Amendments are governed by New York law. FLCA at § 10.14; SLCA at § 10.14; Third Amendment (to the FLCA) at § 7.6, and Third Amendment to the SLCA at § 6.5.
- [17](#) *ASHINC Corp. v. AMMC VII, Ltd. (In re ASHINC Corp.)*, 683 F. App’x at 135 (“In April 2008, a majority of Lenders approved the Third Amendment to the Credit Agreement, which allowed Yucaipa to acquire a limited amount of Term Loans. Specifically, the Third Amendment made Yucaipa a ‘Restricted Sponsor Affiliate’ and amended the definition of ‘Eligible Assignee’ to provide that ‘no Restricted Sponsor Affiliate may be an Eligible Assignee with respect to a sale, assignment or transfer of Commitments, Revolving Loans or LC Deposits.’ Third Amendment § 2.1(c). Thus, Yucaipa was effectively prohibited from acquiring any First Lien Debt other than Term Loans.”).
- [18](#) Third Amendment at § 2.7(c), (e), adding language to § 10.6(c)(ii) to the FLCA.
- [19](#) Third Amendment at § 2.7(a), adding language to § 10.5(e)(i) of the FLCA.
- [20](#) Third Amendment at § 2.7(e), adding language to § 10.6(j)(iii) of the FLCA.
- [21](#) Third Amendment at § 2.7(e), adding language to § 10.6(j)(iv) of the FLCA; and § 2.7(f), adding language to § 10.6(k)(v) of the FLCA.
- [22](#) See Scolnick Dec. at Exh. 49 (Forbearance Agreement dated Sept. 24, 2008).
- [23](#) Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), at p. 1-2.
- [24](#) Singer Dec. Exh. 44 (Amendment No. 4 to Credit Agreement (to the FLCA)).
- [25](#) Singer Dec. Exh. 47 (Email from D. Walker to S. Bond re: Allied, dated Sept. 11, 2009 (attaching memorandum to Limited Partners from Yucaipa American Alliance Fund I, LP (Main and Parallel), dated Sept. 11, 2009)) at p. 3.
- [26](#) From late 2011 through spring 2012, Yucaipa demanded a premium price of \$1.15 for each dollar of its First Lien Debt, based on the premise that it was Requisite Lender. Yucaipa’s demand for a premium left less JCT money available for all other First Lien debtholders, so JCT lowered its offer other debtholders like BD/S to 70¢ on the dollar. See Singer Dec. Exh. 64 (Email from I. Tochner to D. Walker re: call me some time, dated Mar. 5, 2012 (stating that Yucaipa should “stay tight on demanding \$155 [million]” on account of its then \$135 million of First Lien Debt holdings)) and Singer Dec. Exh. 67 (Email from T. Ciupitu (JCT) to J. Schaffer, re: Revised Term Sheet with Black Diamond and Spectrum (May 10, 2012), dated May 10, 2012).
- [27](#) Singer Dec. Exh. 66 at p. 2 (Letter from A. Harris, counsel to BD/S, to Board of Directors of Allied, dated Mar. 22, 2012).

- [28](#)  [BDCM Opportunity Fund II, LP v. Yucaipa Am. Alliance Fund I, LP](#), No. 650150/2012, 2013 WL 1290394, at *4, *6 (N.Y. Sup. Ct. Mar. 8, 2013), *aff'd*, 112 A.D.3d 509, 978 N.Y.S.2d 10 (1st Dep't 2013), *leave to appeal denied*, 22 N.Y.3d 1171, 985 N.Y.S.2d 472, 8 N.E.3d 849 (2014).
- [29](#)  [Id.](#) at *5- 6.
- [30](#) [BDCM Opportunity Fund II, LP v. Yucaipa Am. Alliance Fund I, LP](#), 112 A.D.3d 509, 511–12, 978 N.Y.S.2d 10 (N.Y. App. Div. 2013).
- [31](#) See 13-50530, D.I. 297 (Tr. of Hr'g July 30, 2013) at 130:1-6.
- [32](#) *Id.* at 127:13-20.
- [33](#) *Id.* at 123:5-124:24.
- [34](#) [In re Allied Sys. Holdings Inc.](#), 556 B.R. at 608-09, *aff'd sub nom. In re ASHINC Corp.*, 683 F. App'x at 141-42.
- [35](#) See 12-11564, D.I. 1837 (Sale Order). BD/S as confirmed Requisite Lenders placed a successful credit bid for certain additional assets. (See 12-11564, D.I. 1868 (Order Authorizing and Approving Sale of Assets)).
- [36](#) See 12-11564, D.I. 2127 (Report of Sale of Debtors' Assets).
- [37](#) 12-11564, D.I. 3360 (the "Amended Plan").
- [38](#) Amended Plan § 5.13.
- [39](#) See *id.* §§ 5.11(b), 5.14. Yucaipa is an exception to this recovery waterfall. (12-11564, D.I. 3383 at ¶¶MM, 1).
- [40](#) Further procedural history is set forth in the parties' joint submission at 13-50530, D.I. 599 ("Joint Procedural History").
- [41](#)  [Celotex Corp. v. Catrett](#), 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).
- [42](#)  [J. Aron & Co. v. SemCrude, L.P. \(In re SemCrude, L.P.\)](#), 504 B.R. 39, 51 (Bankr. D. Del. 2013) (*citing*  [Celotex](#), 477 U.S. at 322, 106 S.Ct. 2548).
- [43](#) [Liquidation Tr. v. Huffman \(In re U.S. Wireless Corp.\)](#), 386 B.R. 556, 560 (Bankr. D. Del. 2008) (citations omitted).
- [44](#) [Id.](#)
- [45](#) [Id.](#) (*quoting*  [Celotex](#), 477 U.S. at 325, 106 S.Ct. 2548).
- [46](#) [In re W.R. Grace & Co.](#), 403 B.R. 317, 319 (Bankr. D. Del. 2009).
- [47](#)  [Matsushita Elec. Indus. Co. v. Zenith Radio Corp.](#), 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).
- [48](#) [Giuliano v. World Fuel Servs., Inc. \(In re Evergreen Int'l Aviation\)](#), 2018 WL 4042662, at *2 (Bankr. D. Del. Aug. 22, 2018) (citations omitted).

- 49 [Huffman](#), 386 B.R. at 560 (quoting [Mack v. Great Atl. & Pac. Tea Co.](#), 871 F.2d 179, 181 (1st Cir. 1989)).
- 50 [Argus Mgmt. Grp. v. GAB Robins, Inc. \(In re CVEO Corp.\)](#), 327 B.R. 210, 214 (Bankr. D. Del. 2005) (quoting [Anderson v. Liberty Lobby, Inc.](#) 477 U.S. 242, 249, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (citations omitted)).
- 51 [Saldana v. Kmart](#), 260 F.3d 228, 231-32 (3d Cir. 2001).
- 52 [Whitlock v. Pepsi Ams.](#), No. C 08-24742 SI, 2009 WL 3415783, at *7 (N.D. Cal Oct. 21, 2009) (citations omitted).
- 53 [O'Connor v. Boeing N. Am., Inc.](#), 311 F.3d 1139, 1150 (9th Cir. 2002) (quoting [Munger v. City of Glasgow Police Dep't](#), 227 F.3d 1082, 1087 (9th Cir. 2000)).
- 54 [Id.](#)
- 55 [Auto-Owners Ins. Co. v. Stevens & Ricci Inc.](#), 835 F.3d 388, 402 (3d Cir. 2016) (citations omitted).
- 56 [Huffman](#), 386 B.R. at 560-61 (quoting [WorldCom, Inc. v. GE Global Asset Mgmt. Servs. \(In re WorldCom, Inc.\)](#), 339 B.R. 56, 62 (Bankr. S.D.N.Y. 2006)).
- 57 As discussed below, Yucaipa also asserts a statute of limitations defense against Lender Claim 2. The Court will discuss the merits of the breach of contract claims in this section. The Court will then discuss whether the Lender's breach of contract claim (Lender Claim 2) is barred by the statute of limitations.
- 58 Third Amendment, § 2.7(e), adding language to § 10.6(j)(iii) to the FLCA, among other relevant additions to the FLCA noted *infra*.
- 59 [Second Source Funding, LLC v. Yellowstone Cap., LLC](#), 144 A.D.3d 445, 445–46, 40 N.Y.S.3d 410 (2016) (citing [Nevco Contracting Inc. v. R.P. Brennan Gen. Contractors & Builders, Inc.](#), 139 A.D.3d 515, 33 N.Y.S.3d 166 (2016) (citation omitted) (holding that a claim for breach of contracts includes the following: “existence of the parties' agreement, its performance thereunder, and defendant general contractor's failure to perform, resulting in harm to plaintiff”) and [Harris v. Seward Park Hous. Corp.](#), 79 A.D.3d 425, 426, 913 N.Y.S.2d 161 (2010) (further citation omitted) (holding that “elements of such a [breach of contract] claim include the existence of a contract, the plaintiff's performance thereunder, the defendant's breach thereof, and resulting damages.”)). See also [Morris v. 702 E. Fifth St. HDFC](#), 46 A.D.3d 478, 479, 850 N.Y.S.2d 6, 7 (2007) (setting forth “the existence of a valid contract, plaintiff's performance of his obligations thereunder, defendant's breach by its refusal to schedule a sound test, and resulting damages in the form of lost profits”).
- 60 See 13-50530, D.I. 297 (Tr. of Hr'g July 30, 2013) at 127:13- 15 (holding that “[u]pon acquiring the debt, Yucaipa subjected itself to the first lien credit agreement and all of the amendments, including the third amendment.”).
- 61 Adding the definition of “Eligible Assignee” and “Term Loan Exposure” to section 1.2 of the FLCA, as well as other language modifications.
- 62 Adding language to section 10.6(c) of the FLCA.
- 63 Adding language to section 10.6(j) of the FLCA.

- [64](#) See Singer Dec. Exh. 45 (Assignment and Assumption Agreement between ComVest and Yucaipa).
- [65](#) Third Amendment, Recitals, p. 1.
- [66](#)  [Law Debenture Tr. Co. of New York v. Maverick Tube Corp.](#), 595 F.3d 458, 467 (2d Cir. 2010) (“Where the parties dispute the meaning of particular contract clauses, the task of the court ‘is to determine whether such clauses are ambiguous when read in the context of the entire agreement,’ ” (quoting  [Sayers v. Rochester Telephone Corp. Supplemental Management Pension Plan](#), 7 F.3d 1091, 1095 (2d Cir.1993) (quoting [W.W.W. Associates v. Giancontieri](#), 77 N.Y.2d 157, 163, 565 N.Y.S.2d 440, 443, 566 N.E.2d 639 (1990))))); *ASHINC Corp. v. AMMC VII, Ltd. (In re ASHINC Corp.)*, 683 F. App’x at 140 (“However, ‘contractual language must be read in context.’) (citing  [LightSquared LP v. SP Special Opportunities LLC \(In re LightSquared Inc.\)](#), 511 B.R. 253, 335 (Bankr. S.D.N.Y. 2014) (applying New York law).
- [67](#) Third Amendment, § 2.7(f), modifying section 10.6 of the FLCA by adding subsection (k). Furthermore, the Third Amendment address the mechanics of the extinguishment and cancellation of the debt (had Yucaipa contributed Term Loans): (i) Yucaipa was to “promptly provide all information and data reasonably requested by Administrative Agent in connection with such capital contribution” of Term Loans. *Id.* at § 2.7(f)(ii). (ii) Upon Yucaipa’s contribution of Term Loans to Allied: (a) “all rights and obligations as a Lender related thereto” were “deemed to be irrevocably prepaid, terminated, extinguished, cancelled,” (b) Allied was not to obtain “any rights as a Lender hereunder or under the other Credit Documents,” and (c) the Company was to “deliver to Administrative Agent a written acknowledgment and agreement executed by an Authorized Officer” acknowledging its relinquishment of any rights as a Lender. *Id.* at § 2.7(f)(iii). (iii) “As soon as practicable after [Allied’s] acquisition of Term Loans from [Yucaipa],” Allied was to “take all actions necessary to cause such Term Loans to be extinguished or otherwise canceled in its books and record in accordance with GAAP.” *Id.* at § 2.7(f)(iv).
- [68](#) The Capital Contribution Provision explicitly states that within 10 days after acquiring Term Loans, Yucaipa “shall make a capital contribution to [Allied] of no less than 50% of the aggregate principal amount of such Term Loans in accordance with Section 10.6(k).” Third Amendment, § 2.7(e), adding FLCA § 10.6(j)(iii). Section 10.6(k), in turn, is titled, “Contribution of Term Loans to Borrowers; Cancellation of Debt.” It states that Yucaipa “may at any time make a capital contribution of its Term Loans to Borrowers in exchange for Equity Interests of [Allied.]” Third Amendment, § 2.7(f) adding FLCA § 10.6(k)(ii). Thus, the plain language of the Third Amendment makes clear that a “capital contribution” to Allied would not have to be made in the form of cash, but rather that Yucaipa could make “a capital contribution of its Term Loans” in exchange for equity in Allied. However, had Yucaipa forgiven debt in exchange for equity, Allied would have had less debt, resulting in fewer claims, further resulting in a higher payout to the other First Lien Lenders. There is no dispute, that Yucaipa neither contributed cash nor gave the Capital Contribution by way of its Term Loans.
- [69](#) See Singer Dec. Exh. 103 (Expert Witness Report of Jeffrey M. Risius, CPA/ABV, CFA, ASA, dated Sept. 27, 2019 (the “Risius Report”)) at ¶ 88 (“If Yucaipa had made this \$57.4 million contribution, the Estate would have been better off by \$57.4 million. This holds true notwithstanding whether the required contribution would have involved the receipt of \$57.4 million in cash or the forgiveness of \$57.4 million in debt. Yucaipa never made the required capital contribution, resulting in damages to the Estate of \$57.4 million.” (footnote excluded)).
- [70](#)  [Simon v. Electrospace Corp.](#), 28 N.Y.2d 136, 145, 320 N.Y.S.2d 225, 269 N.E.2d 21 (1971) (“The proper measure of damages for breach of contract is determined by the loss sustained or gain prevented at the time and place of breach.”);  [Boyce v. Soundview Technology Group, Inc.](#), 464 F.3d 376, 384 (2d Cir. 2006) (“[I]n a breach of contract case, damages are calculated at the time of the breach.”).

[71](#) Singer Dec. at Exh. 102 (Expert Report of Daniel R. Fischel, dated Sept. 27, 2019 (the “Fischel Report”)) at ¶¶ 17-20.

[72](#) See Singer Dec. Exh. 103 (Risius Report) at ¶ 88 n. 130.

[73](#)  [Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc.](#), 487 F.3d 89, 110-11 (2d Cir. 2007).

[74](#)  [Tractebel Energy Mktg.](#), 487 F.3d at 110.

[75](#) [Queens Ballpark Co. v. Vysk Commc'ns](#), 226 F. Supp. 3d 254, 259 (S.D.N.Y. 2016) (citations omitted).

 [Tractebel Energy Mktg.](#), 487 F.3d at 110 (“For ‘when it is certain that damages have been caused by a breach of contract, and the only uncertainty is as to their amount, there can rarely be good reason for refusing, on account of such uncertainty, any damages whatever for the breach. A person violating his contract should not be permitted entirely to escape liability because the amount of the damage which he has caused is uncertain.’” (footnote omitted; quoting  [Wakeman v. Wheeler & Wilson Mfg. Co.](#), 101 N.Y. 205, 209, 4 N.E. 264, 266 (1886))). See also [Entis v. Atl. Wire & Cable Corp.](#), 335 F.2d 759, 763 (2d Cir. 1964) (“Such an estimate [of damages] necessarily requires some improvisation, and the party who has caused the loss may not insist on theoretical perfection.” (citations omitted)).

[76](#) Scolnick Dec. Exh. 13 (Risius Dep.) 97:13-15.

[77](#) See, e.g., Singer Dec. at Exh. 102 (Fischel Report) at ¶¶ 40-42.

[78](#) As Mr. Risius testified:

My damages analysis is essentially reliable and kind of middle of the road I don't assume that the \$57.4 million would have been used to benefit the first lien lenders by getting their interest payments over that period, from 2009 to 2010, 2011. I don't assume that those dollars would have been used to – essentially for capital investment in the company to improve the prospects above and beyond what actually happened in the actual world.

...

So I don't assume kind of that rose-colored glass viewpoint that the 5.4 million would have improved the ultimate outcome at the end of the day. I also don't assume, as Mr. Fischel has in his report, that the 57.4 million would essentially be burned through and all lost. ... I didn't assume rose-colored glass view, and I didn't assume doom-and-gloom view. I just took, hey, I'm not going to speculate on what would have happened with that cash because there's too many variables.

Scolnick Dec. Exh. 13 (Risius Dep.) 97:13-99:16.

[79](#)  [Polk Lending 33, LLC v. THL Corporate Finance, Inc. \(In re Aerogroup Int'l, Inc.\)](#), 601 B.R. 571, 598 and n. 191 (Bankr. D. Del. 2019) (citations omitted), *motion to certify appeal denied*, No. BR 17-11962, 2020 WL 757892 (D. Del. Feb. 14, 2020), and *aff'd*, 620 B.R. 517 (D. Del. 2020).

[80](#) See [Roan/Meyers Assocs., L.P. v. CT Holdings, Inc.](#), 26 A.D.3d 295, 296, 810 N.Y.S.2d 67 (2006) (prejudgment interest properly awarded on plaintiff's successful summary judgment motion on breach of contract claim); [City of Binghamton v. Serafini](#), 8 A.D.3d 835, 838, 778 N.Y.S.2d 547 (3d Dep't 2004) (plaintiff properly recovered prejudgment interest at statutory rate of 9% running from the date of default). See also Singer Dec. Exh. 103 (Risius Report) at ¶¶ 89-90, 121-122, 132-133, exhs. A-1 and B-1.

- [81](#) The Court and the Delaware Chancery Court have construed the covenant not to sue in section 2.7(e) of the Third Amendment against Yucaipa. *See, e.g.*, Del. Bankr. Case. No. 12-11564 (D.I. 1068) (Tr. of Hr'g Feb. 27, 2013 at 105:4-6 (“One is simply under its plain meaning, you can't sue. I don't think there's any question as to the plain meaning of the covenant and I think it's very clear.”)); *BDCM Opportunity Fund II, L.P. v. Yucaipa American Alliance Fund L.L.P. (In re ASHINC Corp.)*, Del. Bankr. 14-50971, D.I. 81 at pp. 30-37; *Yucaipa Am. All. Fund I, LP v. SBDRE LLC*, 2014 WL 5509787 at *10-15 (allowing for a narrow exception to the Covenant Not to Sue). However, the covenant not to sue in section 2.7(e) differs from the Covenant Not to Sue in section 2.7(f) (that is the subject of this Opinion). Although many of the words or the same – there is a considerable distinction. Section 2.7(e) applies to *any* claims or causes of action arising out of the Third Amendment or any other Credit Document; whereas the Covenant Not to Sue in section 2.7(f) applies to any claims or causes of action arising out of *any capital contribution*. The Covenant Not to Sue in section 2.7(f) is wholly related to the Capital Contributions and not all claims and causes of action related to the Third Amendment or the other Credit Documents. There is a vast difference between a full relationship waiver of causes of action and the specific, nuanced waiver that the Court is examining herein. To compare the breadth of the waiver in section 2.7(e) to the narrowness of the waiver in section 2.7(f) would be a mistake.
- [82](#) There has been argument that Yucaipa's use of this affirmative defense has been waived by Yucaipa's failure to raise the Covenant Not to Sue until the summary judgment phase of this litigation. As set forth in detail herein, the Court finds that the Covenant Not to Sue is not applicable on the merits and, therefore, does not need to address the issue of waiver.
- [83](#) Third Amendment, § 2.7(f); adding new subsection (k)(v) to FLCA § 10.6) (emphasis added).
- [84](#) FLCA § 1.1 (p. 16). *See also id.* at FLCA § 1.1 (p. 6) and Preamble (definition of “Borrower”) and FLCA § 1.1 (p. 23) (definition of “Guarantor”). The Third Amendment also includes a covenant not to sue in favor of other Lenders against Yucaipa (Third Amendment, § 2.7(e)).
- [85](#) *See Lipscomb v. Clairvest Equity Partners Ltd. P'ship (In re LMI Legacy Holdings, Inc.)*, 553 B.R. 235, 246 (Bankr. D. Del. 2016) (“[T]he Trustee is asserting ... claims inherited from the Debtors; as a result, ‘the [T]rustee stands in the shoes of the debtor.’”) (quoting  *Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149, 1154 (3d Cir. 1989));  *Medtronic AVE, Inc. v. Advanced Cardiovascular Sys., Inc.*, 247 F.3d 44 (3d Cir. 2001) (recognizing that “[w]hen [the assignee] stepped into [assignor's] shoes, it had to adhere to the covenant not to sue on [assigned] claims.”).
- [86](#) *Bank of Am. Nat. Tr. & Sav. Ass'n v. Gillaizeau*, 766 F.2d 709, 715 (2d Cir. 1985) (apply New York law).
- [87](#)  *Golden Pac. Bancorp v. F.D.I.C.*, 273 F.3d 509, 514–15 (2d Cir. 2001) (citations and internal quotations marks omitted).
- [88](#) *Joao v. Cenuco, Inc.*, 376 F. Supp. 2d 380, 382 (S.D.N.Y. 2005) (citing *Kamfar v. New World Restaurant Group, Inc.*, 347 F.Supp.2d 38, 50 (S.D.N.Y. 2004) (further citations omitted)).
- [89](#) *Joao*, 376 F. Supp. 2d at 382–83 (citations omitted; emphasis added). *See also*  *Golden Pac. Bancorp*, 273 F.3d at 515; *Bank of Am. Nat. Tr. & Sav. Ass'n v. Gillaizeau*, 766 F.2d at 713.
- [90](#) *Vill. of Hamburg v. Am. Ref-Fuel Co. of Niagara, L.P.*, 284 A.D.2d 85, 89, 727 N.Y.S.2d 843, 845 (2001) (quoting *Reda v. Eastman Kodak Co.*, 233 A.D.2d 914, 915, 649 N.Y.S.2d 555, 557 (1996) (emphasis added; further citation omitted)).
- [91](#) *Reda v. Eastman Kodak Co.*, 649 N.Y.S.2d at 557 (citations omitted).

[92](#) Third Amendment, § 2.7(e) (adding § 10.6(j) to the FLCA) (emphasis supplied).

[93](#) FLCA, § 1.1.

[94](#) Third Amendment, § 2.7(f)(v).

[95](#)  [Greenfield v. Philles Records, Inc.](#), 98 N.Y.2d 562, 569, 750 N.Y.S.2d 565, 780 N.E.2d 166 (2002) (further citation omitted). [Slamow v. Del Col](#), 79 N.Y.2d 1016, 1018, 594 N.E.2d 918, 584 N.Y.S.2d 424 (1992) (holding that “the best evidence of what parties to a written agreement intend is what they say in their writing”).

[96](#) See, *supra*, n. 67 listing some of the Third Amendment mechanics for contributing Term Loans (instead of cash). The Court is aware that the contribution of debt is a complicated process wherein many things could be omitted inadvertently.

[97](#) [Joao](#), 376 F. Supp. 2d at 382 (citations omitted);  [Golden Pac. Bancorp.](#), 273 F.3d at 515 (citations omitted).

[98](#) Del. Bankr. Case. No. 12-11564 (D.I. 1068) (Tr. of Hr'g Feb. 27, 2013 at 108:1-17 (hearing on the motion to dismiss Yucaipa's cross-claims)). The Court held:

The Delaware statute of limitations is applicable here based on the fact that this case was brought in Delaware, breach of contract claims brought in federal court setting [sic] in Delaware, so the Delaware statute applies. In the alternative, the borrowing statute applies which would use the shorter three year statute of limitations. Other than a bald choice of law provision there's nothing in this contract or deal that is so involved in New York to provide that the New York statute of limitations would have to apply. First of all, the contract doesn't say that. It was mentioned that the case survived the transfer of venue motion but not to New York, to Georgia, I believe. ... So the [three] year statute [of limitations] applications that that statute run at the latest in November of 2012, so the cause of action, the cross claim is barred by the running of the statute of limitations.

Id. at 108:1-17.

[99](#) The Lender Complaint makes the following allegations: Yucaipa breached the FLCA by (i) acquiring more first lien debt from ComVest in August 2009 than permitted under the Third Amendment (Lender Compl. ¶¶ 117–120; 123(a)); (ii) declaring itself to be the Requisite Lender as a result of an impermissible acquisition of First Lien Debt (*id.* ¶ 121; See also *id.* ¶ 123(b)); (iii) breaching the Third Amendment's provisions related to voting rights “by improperly acting as Requisite Lender” (*id.* ¶ 122); (iv) using its status as Requisite Lender “to neutralize the First Lien Lenders, giving the debtors a ‘free pass’ to ignore” the FLCA's provisions, and to protect its equity investment by precluding a restructuring of Allied (*id.* ¶ 123(c)–(d)); and (v) violating the Third Amendment's Capital Contribution Provision by not making a capital contribution of at least 50% of the aggregate principal of the Term Loans that Yucaipa acquired from ComVest on August 21, 2009, within 10 days of acquiring that debt (*id.* ¶¶ 54 (second bullet), 101). For the purposes of this Opinion, although many factual allegations overlap various counts in the Lender Complaint, the Trustee's breach of contract claim is distinct from the Trustee's breach of fiduciary duty claim.

[100](#) [10 Del. Code § 8106](#). Delaware's borrowing statute provides that “[w]here a cause of action arises outside of this State, an action cannot be brought in a court of this State to enforce such cause of action after the expiration of whichever is shorter, the time limited by the law of this State, or the time limited by the law of the state ... where the cause of action arose, for bringing an action upon such cause of action.” [10 Del. Code § 8121](#). See  [End of the Road Trust v. Terex Corp. \(In re Fruehauf Trailer Corp.\)](#), 250 B.R. 168, 184 (D. Del. 2000) (breach of contract); [Williams v. Chrysler Corp.](#), 991 F. Supp. 383, 390 (D. Del. 1998) (state law

action for breach of the implied covenant of good faith and fair dealing, the applicable limitations period is also three years).

- 101  [Burger v. Level End Dairy Investors \(In re Burger\)](#), 125 B.R. 894, 901–02 (Bankr. D. Del. 1991) (citation omitted).
- 102 See  [Burger](#), 125 B.R. at 901–02 (citing  [Oliver B. Cannon & Son, Inc. v. Fid. & Cas. Co. of New York](#), 484 F. Supp. 1375, 1390 (D. Del. 1980) (recognizing continuing contracts and continuing breach in Delaware)); [Guerrieri v. Cajun Cove Condo. Council](#), C.A. No. 04C-08-022, 2007 WL 1520039, at *6 (Del. Super. Ct. Apr. 25, 2007) (holding that whether a contract is continuous is a question of fact); [Smith v. Mattia](#), C.A. No. 4498-VCN, 2010 WL 412030, at *4 (Del. Ch. Feb. 1, 2010) (same; citations omitted).
- 103 [Mattia](#), 2010 WL 412030, at *4 (quoting [Kaplan v. Jackson](#), No. C.A. 90-C-JN-6, 1994 WL 45429, at *3 (Del. Super. Ct. Jan. 20, 1994)). See also [Palisades Collection, LLC v. Unifund CCR Partners](#), No. C.A. No. N14C-08-036 EMD CCLD, 2015 WL 6693962, at *5 (Del. Super. Ct. Nov. 3, 2015) (“If the Court finds a contract continuous in nature, Delaware’s statute of limitations does not typically begin to run until the termination of the entire contract. If the Court finds the contract severable in nature, the statute of limitations generally begins to run on each severable portion when a party breaches that portion of the contract. The Court determines the continuous or severable nature of a contract by analyzing the intent of the parties. The Court must ascertain this intent through the terms and subject matter of the contract, taken together with pertinent facts and circumstances surrounding the contract.” (footnotes and citations omitted)).
- 104 See generally FLCA at § 2.
- 105 FLCA at §§ 5.6, 5.7.
- 106 FLCA at §§ 9.8, 10.5(a).
- 107 Third Amendment at § 2.7(e).
- 108 Third Amendment at § 2.7(e).
- 109 Third Amendment at § 2.7(e).
- 110 Singer Dec. at Exh. 58 (Email from D. Walker to I. Tochner, May 29, 2011 re: Meeting with Gores).
- 111 See Singer Dec. Exh. 103 (Risius Report) at ¶¶ 110–144 (discussion of damages as a result of Yucaipa’s contractual breaches as of December 27, 2013).
- 112  [C.A. No. 8481-VCN](#), 2015 WL 4710321, at *7 (Del. Ch. July 31, 2015).
- 113  [Id.](#) at *2.
- 114  [Id.](#) at *7.
- 115  [Burger](#), 125 B.R. at 898.
- 116  [Id.](#) at 898.
- 117  [Id.](#)

[118](#)  [Id.](#)

[119](#)  [Id. at 901.](#)

[120](#)  [Id. at 902.](#)

[121](#)  [Id.](#)

[122](#) As the Trustee has prevailed on the breach of contract claim such victory subsumes the Lender Claims. The Trustee's expert Mr. Risius, directly addressed this point in his report, explaining that these claims "are mutually exclusive and cannot be added together."¹²² Singer Dec. Exh. 103 (Risius Report) at ¶109 ("The Lender Damages Claims and the Estate Damages Claims are generally factually consistent. However, because the Lender Damage Claims are only available to the First Lien Debt lenders, as opposed to the Estate, the method of calculating damages would be different. As such, the factual basis and framework described below does not include the same commentary that was provided in the Estate Damage Claims section of this report as it would be duplicative. It should also be noted that the Estate Damage Claims and Lender Damages Claims are *mutually exclusive* and *cannot* be added together." (emphasis added)). As a result, the Trustee could have only prevailed once on its damages as it relates to the breach of contract claim against Yucaipa.

[123](#)  [Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 648 \(3d Cir. 1991\).](#)

[124](#) The Contested Payments include the "Kasowitz Legal Payments," the "Latham Legal Payments," the "Ornstein Payment," the "Yucaipa Payment," and the "ComVest Payment," each as summarized on the below chart by date of the transfer and amount.

[125](#) Scolnick Dec. Exh. 51 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc. Dec. 10, 2008) at p. 3.

[126](#) Scolnick Dec. Exh. 1 (Tomczak Deposition p. 100–102, 191–93).

[127](#) Scolnick Dec. Exh. 31 (Email from M. Riggs to M. Hughes, re: Allied Holdings Deal Updates from Riggs 1-28-09; dated Jan. 28, 2009) p. 1-2.

[128](#) Scolnick Decl. Exh. 62 (Email from R. Ehrlich to J. Schaffer, re: ComVest, dated July 29, 2009).

[129](#) Scolnick Dec. Exh. 63 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Mar. 6, 2009) p. 1-2. Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep.) 70:24-71:24; 72:23-73:5) ("ComVest's strategy was "to move forward and work on a restructuring to get the business properly capitalized.").

[130](#) Yucaipa's expert concedes that Allied was insolvent by early 2008. *Infra* n. 156.

[131](#) Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), at p. 1.

[132](#) See Singer Dec. Exh. 43 (Loan Purchase Agreement (the "LPA"), dated Aug. 21, 2009), at §§ 1.5(a)(ii), (b) (ii), 1, S-1; Compare LPA with Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009). Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), at p. 1.

- [133](#) LPA at § 1.5.
- [134](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) 135:20–136:3) (“I just know that part of the deal with Yucaipa is that they ... would reimburse us for our expenses ... we didn't care if it came from Allied or Yucaipa.”).
- [135](#) See LPA at § 1.5.
- [136](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) 135:20–136:3) (“I just know that part of the deal with Yucaipa is that they ... would reimburse us for our expenses ... we didn't care if it came from Allied or Yucaipa.”).
- [137](#) Fourth Amendment §§ 1.1, 2.1(b), 2.4, 2.7(e), 10.5, and 10.6(c).
- [138](#) Supp. Scolnick Dec. Exh. 47 (Email from J. Bulter to J. Schaffer, re: DRAFT Allied_Audit_Memo_12-31-2009, dated Jan 13, 2010). The deposition witness clarified that Spectrum distinguished between Yucaipa's efforts to add value to Allied and Yucaipa's efforts to restructure Allied and improve operations. Scolnick Dec. Exh. 2 (Shaffer Dep. 361:12-16).
- [139](#) Supp. Scolnick Dec. Exh. 29 (Email from J. Butler to J. Schaffer, re: AHI Valuation Memo, dated May 28, 2010) at p. 5.
- [140](#) Supp. Scolnick Dec. Exh. 32 (Email from S. Deckoff to R. Burkle, dated Feb. 2, 2011).
- [141](#) See Burkle emailed a ComVest principal that “we gave [Ornstein] 250k a few months ago.” Singer Dec. Exh. 55 (Email from R. Burkle to R. Priddy re: Jonathan [Ornstein], dated Mar. 26, 2010) (“I know you guys have been talking ...just an fyi ... we gave him 250k a few months ago”).
- [142](#) See *id.*
- [143](#) *Id.*
- [144](#) Scolnick Dec. Exh. 7 (Walker/Yucaipa 30(b)(6) Dep.) at 712.
- [145](#) Supp. Scolnick Dec. Exh. 6 (Ornstein Dep.) at 46.
- [146](#) *Id.* at p. 78-79.
- [147](#) See, e.g., Singer Dec. Exh. 26 (Email from D. Walker to M. Gendregske attaching an invoice from Latham to Yucaipa and asking “Could you guys review and handle payment?”); Singer Dec. Exh. 51 (Email from D. Walker to S. Macaulay and J. Blount of Allied attaching an invoice from Kasowitz to Yucaipa and asking “Could you please pay directly to Kasowitz?”). See also, e.g., Singer Dec. Exh. 97 (Gendregske Dep.) 148:14-16 (Latham was Yucaipa's counsel), 278: 21-23 (same); Singer Dec. Exh. 98 (Walker Dep.) 350:20-22 (Latham represented Yucaipa), 619:4-13 (Yucaipa was represented by Kasowitz).
- [148](#) Singer Dec. Exh. 49 at ¶¶56–57.
- [149](#) Singer Dec. Exh. 52 at p. 35 of 39.
- [150](#) Scolnick Dec. Exh. 94 (Settlement Agreement and Mutual Limited Releases between Allied, Yucaipa and CIT, dated Dec. 5, 2011).
- [151](#) Scolnick Dec. Exh. 30 (Dec. of Derex Walker in Support of Yucaipa's Opposition to the Petition Creditors' Motion for Summary Judgment Regarding the Determination of Requisite Lenders Under the First Lien Credit Agreement) at 16–17 (¶ 45); See Scolnick Dec. Exh. 18 (Aliberto/CIT 30(b)(6) Dep.) at 605–06; Scolnick Dec. Exh. 94 (Settlement Agreement and Mutual Limited Releases between Allied, Yucaipa and CIT, dated

Dec. 5, 2011) at 12–13 (§ 11(a); Supp. Scolnick Dec. Exh. 2 (CIT 30(b)(6) Dep.) at 253; Supp. Scolnick Dec. Exh. 28 (Email from M. Aliberto to A. O'Shea, re: Allied request to release US titles for transfer to Canada, dated Feb. 1, 2012).

¹⁵²  [*Pension Transfer Corp. v. Beneficiaries Under the Third Amendment of Fruehauf Trailer Corp. Retirement Plan No. 003 \(In re Fruehauf Trailer Corp.\)*, 444 F.3d 203, 213 \(3d Cir. 2006\). *Contra Riley v. Countrywide Home Loans, Inc. \(In re Duplication Mgmt., Inc.\)*, 501 B.R. 462, 483 \(Bankr. D. Mass. 2013\) \(“To make out the elements of a fraudulent conveyance claim, a plaintiff must prove that a debtor did not receive direct benefits reasonably equivalent to the value which it gave up. If the plaintiff meets that burden, the burden is then on defendants to produce \(if they can\) evidence that the debtors indirectly received sufficient, concrete value.”\) \(citations omitted\).](#)

¹⁵³  [11 U.S.C. § 548\(a\)\(1\) \(2020\).](#)

¹⁵⁴ The UFCA, UFTA, and UVTA generally track the legal elements of  [11 U.S.C. § 548\(a\)\(1\)\(B\)](#) but allow the avoidance of transactions occurring within a four (UVTA and UFTA) or six-year (NY-UFCA) lookback period rather than  [section 548](#)'s two-year lookback period. *See, e.g., Moody v. Sec. Pac. Bus. Credit, Inc.*, 971 F.2d 1056, 1062, n.5 (3d Cir. 1992) (agreeing that district court correctly disposed of UFCA claims and  [section 548](#) claims together); *Charys Holding Co., Inc. v. Growth Mgmt., LLC (In re Charys Holding Co., Inc.)*, Adv. No. 10-50204, 2010 WL 2774852, at *6 (Bankr. D. Del. July 14, 2010) (“Plaintiffs here have alternatively pled claims under the fraudulent conveyance laws of Georgia, New York, and Delaware. These laws do not meaningfully vary from the requirements of  [Bankruptcy Code section 548\(a\)\(1\)\(B\)](#) for present purposes.”). The four or six-year distinction is irrelevant as the Trustee only alleges fraudulent transfers within a four-year lookback period. *See* D.I. 307 p. 33–36.

At the time of the transfers, Arizona, California, Delaware, Florida, and Georgia all operated under the UFTA and New York operated under the Uniform Fraudulent Conveyance Act (the “UFCA”). [ARIZ. REV. STAT. ANN. §§ 44-1001](#) to –1010 (1990); [CAL. CIV. CODE §§ 3439](#) to 3439.14 (West 2016) (replaced UFTA with UVTA effective January 1, 2016); [DEL. CODE ANN. tit. 6 § 1301](#)— [1312](#) (1996); [FLA. STAT. ANN. § 726.101](#)—112 (West 1987); [GA. CODE ANN. §§ 18-2-70](#) to -85 (UFTA—2002; UVTA 2015); and [N.Y. DEBT. & CRED. LAW §§ 273–278 \(McKinney 2021\)](#) (UVTA—April 4, 2020 and UFCA—1925). California, Georgia, and New York have, since adopted the Uniform Voidable Transactions Act (the “UVTA”). *See, e.g.,* 2015 Cal. Legis. Serv. Ch. 44 (S.B. 161) (West); [GA. CODE ANN. § 18-2-70](#); 2019 N.Y. Laws 580.

¹⁵⁵ [Argus Mgmt. Group v. Chanin Capital Partners, LLC \(In re CVEO Corp.\)](#), 320 B.R. 258, 260 (Bankr. D. Del. 2005).

¹⁵⁶ *Compare* Singer Dec. at Exh. 102 (Fischel Report) at ¶ 18 (“[O]ne direct piece of evidence of whether a firm is solvent or insolvent—especially in this context where Allied’s common shares were not publicly traded—is the price at which a company’s debt is traded in arm’s-length transaction. Deeply discounted debt implies the company is insolvent.”) *with id.* at Exh. 81 (Dec. of Derex Walker in Support of Yucaipa’s Opposition to the Petitioning Creditors’ Motion for Summary Judgment Regarding the Determination of Requisite Lenders Under the First Lien Credit Agreement) at ¶ 7 (“Thus, shortly after Allied exited bankruptcy, its financial condition began to deteriorate. As a consequence, in early 2008 the Allied first and second lien debt was trading at a significant discount to par, and a number of lenders expressed interest in potentially selling their debt positions to Yucaipa.”) *and* Singer Dec. at Exh. 102 (Fischel Report) at ¶ 19 (“At the outset, I note that Plaintiffs themselves acknowledge that Allied was insolvent in early 2008.”).

- [157](#) D.I. 706 at p. 31-36. Singer Dec. Exh. 88 (The Yucaipa Defendants' First Supplemental Responses and Objections to the Official Committee of Unsecured Creditors' First Set of Requests for Admission).
- [158](#) Compare [11 U.S.C. § 541\(a\)\(1\)](#) (defining debtor's property interests broadly as “all legal or equitable interests of the debtor in property as of the commencement of the case.”) with [11 U.S.C. § 548\(a\)](#) (“The trustee may avoid any transfer ... of an interest of the debtor in property ...”); and [Begier v. I.R.S., 496 U.S. 53, 54, 110 S.Ct. 2258, 110 L.Ed.2d 46 \(1990\)](#) (defining same term in 547(b) as “property that would have been part of the estate had it not been transferred.”). Allied's payments were made from corporate assets, the transfer of which diminished the fund from which creditors could be paid. Compare, e.g., [Sierra Steel, Inc. v. S&S Steel Fabrication \(In re Sierra Steel, Inc.\), 96 B.R. 271, 273 \(B.A.P. 9th Cir. 1989\)](#) (finding 547(b) transfer “must involve property of the debtor such that the transfer diminishes the fund from which similarly situated creditors may be paid.”) with Singer Dec. Exh. 104 (Expert Report of Jonathan R. Macey (“Macey Report”)) at ¶¶105–106 and Singer Dec. Exh. 103 (Risius Report) at ¶ 82.
- [159](#) [Mellon Bank, N.A. v. Off. Committee of Unsecured Creditors of R.M.L., Inc. \(In re R.M.L., Inc.\), 92 F.3d 139, 149 \(3d Cir. 1996\)](#) (“The bankruptcy court, therefore, conflated two inquiries that should remain separate and distinct: before determining whether the value was “reasonably equivalent” to what the debtor gave up, the court must make an express factual determination as to whether the debtor received any value at all.”).
- [160](#) [In re R.M.L., Inc., 92 F.3d at 150](#) (citations and internal quotation marks omitted) (emphasis in original).
- [161](#) [Id.](#)
- [162](#) [Id.](#)
- [163](#) [Leonard v. Norman Vinitsky Residuary Trust \(In re Jolly's Inc.\), 188 B.R. 832, 842 \(Bankr. D. Minn. 1995\)](#) (“Transfers made solely for the benefit of a third party do not furnish reasonably equivalent value.” (quotations marks and citations omitted)). See e.g., [Klein v. Tabatchnick, 610 F.2d 1043, 1047 \(2d Cir. 1979\)](#) (“[T]ransfers solely for the benefit of third parties do not furnish fair consideration under section 67(d)(2)(a).”).
- [164](#) [Pummill v. Greensfelder, Hemker & Gale \(In re Richards & Conover Steel, Co.\), 267 B.R. 602, 613-14 \(B.A.P. 8th Cir. 2001\)](#). [Klein v. Tabatchnick, 610 F.2d at 1047](#) (“Benefit to a debtor need not be direct; it may come indirectly through benefit to a third person.”) (citations omitted).
- [165](#) [In re R.M.L., Inc., 92 F.3d at 152](#).
- [166](#) [Id.](#) (emphasis in original) (citations omitted).
- [167](#) [Id.](#)
- [168](#) [In re Richards & Conover Steel, Co., 267 B.R. at 613-14](#) (citation omitted).
- [169](#) [In re Richards & Conover Steel, Co., 267 B.R. at 613-14](#) (citation omitted).
- [170](#) [FBI Wind Down Inc. Liquidating Trust v. All American Policy Corp. \(In re FBI Wind Down, Inc.\), 581 B.R. 116, 147-48 \(Bankr. D. Del. 2018\)](#).

- [171](#) [Wallace v. McFarland \(In re McFarland\)](#), Nos. 11-10218, 11-01021, 2013 WL 5442406, *14 (Bankr. S.D. Ga. Sep. 30, 2013) (“If the Trustee makes a *prima facie* showing that the alleged “value” given to the Debtor provided no direct value to the Debtor, the burden shifts to the defendants to show that tangible and concrete indirect value was provided and to quantify that value.” (citations omitted); *See also* [Cooper v. Centar Invest. \(Asia\) Ltd. \(In re TriGem America Corp.\)](#), 431 B.R. 855, 868 (Bankr. C.D. Cal. 2010) (“Once the plaintiff makes a *prima facie* showing that no sufficient direct benefit was received in the transaction, it is the defendants’ burden to prove sufficient indirect benefit that is tangible and concrete.”).
- [172](#) [FBI Wind Down Inc. Liquidating Trust](#), 581 B.R. at 149 (“Regardless, the Defendant’s argument falters as it makes no attempt to actually compare the value given, the Transfers, to the value received, the alleged increase in the borrowing base.”); [Metro Communications, Inc.](#), 945 F.2d at 646–47 (“These indirect economic benefits must be measured and then compared to the obligations that the bankrupt incurred.”); [In re Richards & Conover Steel, Co.](#), 267 B.R. at 614.
- [173](#) *See supra* n. 171-172.
- [174](#) Scolnick Dec. Exh. 32 (Monitoring and Management Services Agreement).
- [175](#) Bankr. L.R. 7007–2(b)(ii).
- [176](#) [FBI Wind Down Inc. Liquidating Trust](#), 581 B.R. at 149 (Bankr. D. Del. 2018).
- [177](#) FLCA § 10.2.
- [178](#) D.I. 762 at p. 47.
- [179](#) FLCA § 10.2.
- [180](#) [ASHINC Corp. v. AMMC VII, Ltd.](#), 683 Fed. Appx. at 139 (“The Credit Agreement defined “Lender “as each financial institution listed on the signature pages hereto as a Lender, and any other Person that becomes a party hereto pursuant to an Assignment Agreement. Based on this definition, Yucaipa could not be a Lender because it was not an original signatory. Further, Yucaipa could not become a party to the Credit Agreement pursuant to an Assignment Agreement because it was not an Eligible Assignee. For an Assignment Agreement to become effective, the assignee was required to represent and warrant as of the Closing Date or as of the Assignment Effective Date that (i) it is an Eligible Assignee. The Credit Agreement further stated that an assignee becomes a Lender ‘subject to the terms and conditions of this Section 10.6.’ *Id.* § 10.6(f). Yucaipa could not represent and warrant that it was an Eligible Assignee.”) (quoting [BDCM Opportunity Fund II v. Yucaipa American Alliance Fund I, LP](#), 2013 WL 1290394, at *3-4).
- [181](#) Supp. Scolnick Dec. Exh. 25 (Expert Report of J. Scott Victor) at 31–32 ¶¶93.
- [182](#) *Compare* Singer Dec. Exh. 43 (Loan Purchase Agreement, dated Aug. 21, 2009) *with* Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), p. 2; Scolnick Dec. Exh. 57 (Email from J. Tomczak to P. Bartles, re: Allied Systems Holdings Amendment 4 and Purchase Offer, dated Feb. 4, 2009) *and* Singer Dec. Exh. 37 (Letter from M. Kasowitz to R. Priddy re: Allied Systems Holdings, Inc. and Allied Systems, Ltd., dated Mar. 13, 2009). There is evidence that the Allied Board considered earlier versions of the Fourth Amendment. The only evidence that the final version of the Fourth Amendment was considered by the Allied Board derives from an email describing a 10-minute phone call that took place *after* the Fourth Amendment was executed. *See* Supp. Singer Dec. Exh. 150 (Email from M. Gendregske to B. Cullen re: Emergency Call, dated Aug. 19, 1009), Supp. Singer Dec. Exh. 151 (Email

- from J. Blount to R. O'Shea re Signature Pages Needed, dated Aug. 19, 2009); Supp. Scolnick Dec. Exh. 3 (Troutman 30(b)(6) Dep.) 346:5-350:19; Scolnick Dec. Exh. 10 (Cullen Dep.) at 229:3-8.
- [183](#) Singer Dec. Exh. 104 (Macey Report) at ¶56.
- [184](#) Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), at 1. [ASHINC Corp. v. AMMC VII, Ltd., 683 Fed. Appx. at 140](#) (“It would be inequitable to allow Yucaipa to achieve an ‘end run’ around the substance of the Eligible Assignee restrictions in the Credit Agreement and undercut what Yucaipa certainly knew the restrictions were designed to prevent.”) (citations and quotations marks omitted).
- [185](#) See also *infra* section H(vi)(b) (in addition to the fees being unreasonable, there was no “work out”).
- [186](#) Scolnick Dec. Exh. 32 (MMSA) § 6.
- [187](#)  [BDCM Opportunity Fund II v. Yucaipa American Alliance Fund I, LP, 2013 WL 1290394, at *5](#). See [Murray v. Nat'l Broad. Co., Inc., 178 A.D.2d 157, 576 N.Y.S.2d 578, 580 \(1991\)](#) (ruling on summary judgment constitutes final determination).
- [188](#)  [BDCM Opportunity Fund II v. Yucaipa American Alliance Fund I, LP, 2013 WL 1290394, at *5](#).
- [189](#) [ASHINC Corp. v. AMMC VII, Ltd., 683 Fed. Appx. at 142](#).
- [190](#) [Id. at 140](#) (emphasis added; citations and internal quotation marks omitted).
- [191](#)  [LightSquared LP, 511 B.R. at 333](#) (applying New York law and ruling on summary judgment).
- [192](#) See, e.g., [ASHINC Corp. v. AMMC VII, Ltd., 683 Fed. Appx. at 140](#) (“It would be inequitable to allow Yucaipa to achieve an ‘end run’ around the substance of the Eligible Assignee restrictions in the Credit Agreement and undercut what Yucaipa certainly knew the restrictions were designed to prevent.”).
- [193](#)  [LightSquared LP, 511 B.R. at 333](#) (applying New York law and finding that the “[Defendant] violated, at a minimum, the covenant of good faith and fair dealing automatically implied by law in the credit agreement” and that “[s]uch an end-run, if not a downright sham” was not permissible as it did away with the ‘fruits’ of the contract.”) (quoting  [Empresas Cablevision, S.A.B. de C.V. v. JPMorgan Chase Bank, N.A., 680 F. Supp. 2d 625, 632 \(S.D.N.Y.\), aff'd and remanded, 381 F. App'x 117 \(2d Cir. 2010\)](#)). See also  [Nemec v. Shrader, 991 A.2d 1120, 1126 \(Del. 2010\)](#) (“We will only imply contract terms when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected.” (applying Delaware law; footnotes and citations omitted); [Lightway Litigation Services, LLC v. Yung \(In re Tropicana Ent., LLC\), 520 B.R. 455, 474 \(Bankr. D. Del. 2014\)](#) (reviewing allegations that “entities unreasonably failed to manage the Debtors in accordance with the Debtors' best interests, thus denying them the fruits of the contract and resulting in damages.” (applying Delaware law, citations omitted)).
- [194](#)  [In re R.M.L., Inc., 92 F.3d at 153](#) (“Since we review the transaction at the time the transfer was made ...”) (citing to  [In re Chomakos, 69 F.3d 769, 770–71 \(6th Cir. 1995\)](#) (“The point in time as of which we must determine whether [Debtor] received property of reasonably equivalent value in exchange for the money they wagered at the casino is the point at which their bets were placed.”));  [Id. at 152](#) (“The best

solution, therefore, is to determine, based on the circumstances that existed at the time the investment was contemplated, whether there was any chance that the investment would generate a positive return.”).

[195](#)  [In re R.M.L., Inc., 92 F.3d at 150.](#)

[196](#) Scolnick Dec. Exh. 7 (Walker/Yucaipa 30(b)(6) Dep.) at 712.

[197](#) Supp. Scolnick Dec. Exh. 6 (Ornstein Dep.) at 46.

[198](#) *Id.* at p. 78-79.

[199](#) Supp. Scolnick Dec. Exh. 47 (Email from J. Bulter to J. Schaffer, re: DRAFT Allied_Audit_Memo_12-31-2009, dated Jan 13, 2010) (Spectrum, after forming a steering committee to protect its “rights in the event that the Sponsor does not operate in good faith to restructure the company and improve operations and add value” believed, as of 12/31/2009, that Yucaipa was “operating in good faith to add value to the company.”). *See also* Supp. Scolnick Dec. Exh. 29 (Email from J. Butler to J. Schaffer, re: AHI Valuation Memo, dated May 28, 2010) at p. 5 (A May 31, 2010 Spectrum internal memorandum stated: “It is our belief that Yucaipa will be able to extract value from the first lien in order to protect this investment and we will benefit from that.”). Supp. Scolnick Dec. Exh. 32 (Email from S. Deckoff to R. Burkle, dated Feb. 2, 2011) (BDCM's Steve Deckhoff emailed Ron Burkle on February 02, 2011 stating: “On Allied, the strategy you outlined seemed right and you have our support.”).

Scolnick Dec. Exh. 93 (Verified Complaint in Allied Systems Holdings, Inc. v. The CIT Group/Business Credit, Inc.) at 19–20 ¶¶65–66.

[200](#) Scolnick Dec. Exh. 93 (Verified Complaint in Allied Systems Holdings, Inc. v. The CIT Group/Business Credit, Inc.) at 28.

[201](#) *See* Scolnick Dec. Exh. 7 (Walker Dep.) at 707–11 *and* Singer Dec. Exh. 26 at 91990–91, 91994–003.

[202](#) Scolnick Dec. Exh. 2 (JCT 30(b)(6) Dep.) at 104.

[203](#) Scolnick Dec. Exh. 30 (Dec. of Derex Walker in Support of Yucaipa's Opposition to the Petition Creditors' Motion for Summary Judgment Regarding the Determination of Requisite Lenders Under the First Lien Credit Agreement) at p. 5 ¶12.

[204](#) 13-50530 D.I. 297 (Tr. of Hr'g. 126:11-15); Scolnick Dec. Exh. 6 (Ornstein Dep.) at 381:21-383:23 (Third Amendment to the FLCA was never used and was too onerous to be used).

[205](#) [11 U.S.C. § 550\(a\)\(1\).](#)

[206](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep. 135:20–136:3) (“I just know that part of the deal with Yucaipa is that they ... would reimburse us for our expenses ... we didn't care if it came from Allied or Yucaipa.”).

[207](#) The Trustee is no longer pursuing this claim based on two allegations. (i) The first relates to the MMSA that Yucaipa entered with Allied on May 29, 2009 (*see* Scolnick Dec. Exh. 32 (MMSA)). The understanding at the time the Committee filed the Estate Complaint was that Yucaipa had the Company pay it \$1.5 million annually pursuant to the MMSA notwithstanding its various acts of misconduct. Yucaipa's 30(b)(6) witness testified it was never paid pursuant to the MMSA and, therefore, the Trustee is no longer pursuing this allegation. (ii) Additionally, the Trustee is also not pursuing allegations in connection with the breach of fiduciary claim as it relates to Yucaipa's purchases of Second Lien Debt. *See Litigation Trustee's Opposition to the Motion for*

Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P., and Yucaipa American Alliance (Parallel) Fund I, L.P. (Adv D.I. 770) at p. 32-33, n. 34.

- [208](#) See Singer Dec. Exh. 103 (Risius Report) at ¶¶68-71 (“Relying on the March 8, 2012 ‘final’ term sheet with JCT, Yucaipa pled in a counterclaim against BD/S in these proceedings – as well as RICO actions filed in New York and Delaware – that JCT was offering a deal of \$305 million for all of Allied’s debt. Yucaipa claimed that, but for the filing of the 2012 bankruptcy, a JCT sale would have been consummated at \$170 million more than the ultimate figure of approximately \$135 million.” *Id.* at ¶ 71 (footnote excluded).).
- [209](#)  [Kahn v. Lynch Commc'n Sys., Inc.](#), 638 A.2d 1110, 1113 (Del. 1994) (quoting  [Ivanhoe Partners v. Newmont Min. Corp.](#), 535 A.2d 1334, 1344 (Del. 1987) (further citation omitted) (“ ‘a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation.’ ”)).
- [210](#)  [Schuss v. Penfield Partners, L.P.](#), No. CIV.A. 3132-VCP, 2008 WL 2433842, at *10 (Del. Ch. June 13, 2008) (footnotes and citations omitted).
- [211](#)  [Gale v. Bershad](#), No. CIV. A. 15714, 1998 WL 118022 (Del. Ch. Mar. 4, 1998).
- [212](#)  *Id.* at *5.
- [213](#)  *Id.*
- [214](#)  *Id.*
- [215](#)  *Id.*
- [216](#)  [Nemec](#), 991 A.2d at 1129 (Del. 2010) (citing  [Schuss v. Penfield Partners, L.P.](#), 2008 WL 2433842, at *10).
- [217](#)  [Schuss v. Penfield Partners, L.P.](#), 2008 WL 2433842, at *10.
- [218](#) See Singer Dec. Exh. 104 (Macey Report) at ¶¶114, 116-17 (Yucaipa’s decision to purchase ComVest debt and cause Allied to enter into the Fourth Amendment “represent[ed] an egregious attempt by Yucaipa to use its position of control over Allied’s corporate governance to benefit itself at the expense of non-Yucaipa shareholders.”).
- [219](#) See  [Schuss v. Penfield Partners, L.P.](#), 2008 WL 2433842, at *10. See, e.g., [Kulick v. Gamma Real Est. LLC](#), No. 1:20-CV-03582-MKV, 2021 WL 918555, at *8 (S.D.N.Y. Mar. 10, 2021) (finding that the breach of contract claim was distinct from the breach of fiduciary duty claim because the breach of contract claim is “that Defendants underpaid him for his outstanding shares in the company. Meanwhile, [plaintiff’s] fiduciary duty claim concerns different conduct (purported self-dealing transactions and interference with [plaintiff’s] role as Administrative Member of SLP), different harm (breach of the duty of loyalty rather than only underpayment), and a different time period (the harms occurred largely before [plaintiff] departed SLP, whereas the contract breach occurred contemporaneous with and after his departure) ...”).
- [220](#) Yucaipa Summary Judgment Motion at p. 42.

- [221](#)  [Jedwab v. MGM Grand Hotels, Inc.](#), 509 A.2d 584, 598 (Del. Ch. 1986);  [Odyssey Partners, L.P. v. Fleming Cos.](#), 735 A.2d 386, 411 (Del. Ch. 1999) (controlling shareholder had not breached duty to the corporation merely by acting in self-interest and failing to search for capital for the corporation).
- [222](#)  [Jedwab](#), 509 A.2d at 598-99.
- [223](#) Del. Ch., C.A. No., Allen, C., 1993 WL 443406, *7, mem. op. at 14 (Oct. 29, 1993). See also  [Odyssey Partners, L.P. v. Fleming Companies, Inc.](#), 735 A.2d at 411.
- [224](#) Singer Dec. Exh. 93 (Riggs Dep.) at 97:17-98:15, 271:5-13.
- [225](#) Scolnick Dec. Exh. 7 (Walker Dep.) at 668:19-669:11.
- [226](#) Supp. Singer Dec. Exh. 121 (Email from M. Riggs to D. Walker, re: confidential – from Mike Riggs, dated Sept. 6, 2008) (stating “given the recent financial trends at Allied, and also given Zuckerman's recent ‘grievance’ regarding the 15% pay cut, I can envision a way to bring those investors into play if Y [Yucaipa] would consider divesting its stock in Allied Holdings. ... To be clear, if Yucaipa would have any interest in selling off its stake in Allied Holdings, then I am confident I could get funding at an appropriate price to purchase your shares. I would intend to implement a similar margin turnaround strategy at Allied, and I am fully aware of all of the risks.”).
- [227](#) Supp. Singer Dec. Exh. 123 (General Concept Presentation for Jason New IEP Innovative Equity Partners, LLC, dated Dec. 20, 2008). There was no role for Yucaipa in this strategy (it had earlier rebuffed an approach from Riggs for its equity). See also Scolnick Dec. at Exh. 17 (ComVest 30(b)(6) Dep.) 182:22-24 (“Based on [ComVest's] valuation ... our expectation was that everything below the first lien would be flushed.”).
- [228](#) Supp. Singer Dec. Exh. 24 (Email from M. Hughes to D. Walker, dated Feb. 24, 2009).
- [229](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep) 197:3-198:20.

Q: And you testified earlier that ComVest wasn't being given access to information, is this right?

...

A: Yes.

Id. at 198:17-20. Yucaipa points out that Mr. Hughes testified that he was not “concerned about Ron's involvement[.]” *Id.* at 198:6-15. However, in full, Mr. Hughes testified:

A. My recollection is we were concerned that we weren't getting access to information, and that it got escalated to Ron [Burkle], but I don't think I was concerned about Ron's involvement, per se, I was just – I think we were more concerned about getting the information.

Id. Yucaipa argues that the Trustee implies that Yucaipa breached its fiduciary duty by directing ComVest to proceed in a specific manner (i.e. contacting Mr. Burkle) to obtain information about the borrower. See Yucaipa Reply (Adv. D.I. 803) p. 27. However, the Court believes that the Trustee is pointing to the lack of information and process and not ComVest speaking to Mr. Burkle. Again, this is again why the Court is finding a dispute of material fact – Why was this escalating to Mr. Burkle? Why was Yucaipa directing information traffic? Why was ComVest not receiving the information? Questions that may need to be answered before the Court can make a determination.

- [230](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep) 70:24-71:24.
- [231](#) Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep.) 72:23-73:5. Mr. Hughes also testified that if Yucaipa had offered ComVest the right price for its debt at that meeting, ComVest would have sold to Yucaipa. (Scolnick Dec. Exh. 17 (ComVest 30(b)(6) Dep.) at 103:3-14). Mr. Hughes also testified that from the time Riggs approached ComVest about buying Allied's debt, ComVest "thought there was a chance that Yucaipa ... could come in, because [they] thought it still had potential if they could weather the storm. So we thought there was an opportunity that—that [Yucaipa] would potentially buy out our position." (*Id.* at 31:7–32:4.) Mr. Hughes confirmed that ComVest favored selling its debt to Yucaipa over a bankruptcy, the only "restructuring strategy" ComVest ever considered. (*Id.* at 99:8–100:25.).
- [232](#) Singer Dec. Exh. 35 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc. Mar. 6, 2009).
- [233](#) Supp. Singer Dec. at Exh. 146 (Priddy Dep) 87:15-24 and 97:14-98:7.
- [234](#) Supp. Singer Dec. Exh. 125 (Email from M. Riggs to D. Walker, dated June 27, 2009, re: Equity Offer for Jack Cooper-Active Transportation – confidential) ("My relationships with various financing partners could help affect a buyout of Yucaipa's position in Allied Holdings if you are ever interested in pursuing that alternative."). Yucaipa claims that all of JCT's terms sheets were subject to numerous contingencies and as such the Trustee has not proved that a deal with JCT could be reached. Yucaipa Reply, Adv. D.I. 802 at 30. However, the Trustee did not move for summary judgment and has not had the time to establish its affirmative case on the breach of fiduciary duty claim. Here, the Court is determining whether there are any disputes of material facts as to preclude Yucaipa's motion for summary judgment, and the Court finds that there are.
- [235](#) Scolnick Dec. Exh. 19 (Riggs Dep.) 171:9-172:18.
- [236](#) Scolnick Dec. Exh. 19 (Riggs Dep.) 171:9-172:18.
- [237](#) Yucaipa asserts that there is "no evidence or reasonable inference" that Yucaipa prevented restructuring discussions between ComVest and Allied. *See* Yucaipa Reply (Adv. D.I. 803 at p. 27). This is where a trial would be helpful in flushing out some of these issues of material fact – and again, the Court is not considering the Trustee's affirmative case in this Opinion, rather, assuming *arguendo* that the Trustee makes its affirmative case would any of Yucaipa's defenses prevent a ruling in the Trustee's favor? Be that as it may, Yucaipa does not dispute that it owed fiduciary duties to Allied – so while Yucaipa did not prevent, it is clear from the present record before the Court that Yucaipa did nothing to facilitate discussions between ComVest and Allied nor is there evidence before the Court that Yucaipa even brought the ComVest discussions to Allied's attention. So, while Yucaipa is correct that there is no evidence that Yucaipa prevented discussions, that argument also cuts the other way to show that Yucaipa's inaction also caused harm to Allied. As a result, the Court finds that there are disputes of material fact regarding these issues.
- [238](#) Supp. Singer Dec. Exh. 135 (Email from M. Riggs to D. Walker and M. Gendregske, dated July 20, 2010, re: CONFIDENTIAL – Letter of Intent from Jack Cooper for the Acquisition of Allied Systems Holdings, Inc. 7-21-10, attaching Allied LOI from Jack Cooper 7.20.10).
- [239](#) *Id.*
- [240](#) Scolnick Dec. Exh. 119 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc. July 29, 2010).
- [241](#) *Id.* Yucaipa notes that "(1) a copy of the LOI was provided to all Board members; (2) Allied's CFO (who was indisputably independent from Yucaipa) conducted a financial analysis of the LOI and concluded that it was

43% short of a conservative liquidation value for Allied; (3) the entire Board received that financial analysis, and the CFO walked the Board through it; and (4) Allied's CEO weighed in on the value of the offer and found it unfavorable. (*See id.*) Only after this discussion and evaluation did Mr. Walker comment on the offer." Yucaipa Reply, Adv. D.I. 803, at p. 27. Again, the Court finds there to be a dispute of material fact because the minutes continue:

Mr. Walker stated that he found the offer flawed on several levels: first, a release of all claims as a condition to negotiations is clearly unacceptable. Second, *as the Company's largest lender, Mr. Walker stated that Yucaipa would **never** accept such as offer* and rather believes that the Company is worth very significantly more on [sic] liquidation.

Id. (emphasis added). It was only **after** Mr. Walker's statement that a "thorough discussion of the Letter of Intent was undertaken after which Mr. Walker made a motion to allow the Letter of Intent to lapse without any response from the Company." *Id.* (emphasis added).

[242](#) Singer Dec. Exh. 103 (Risius Report) at ¶ 68. Yucaipa asserts that "although the Trustee proclaims 'JCT was willing to pay approximately \$244.2 million to own Allied in spring 2012, she ignores that it would have gone to Allied's debtholders, including BD/S, not Allied.'" Yucaipa Reply, Adv. D.I. 803 at p. 29. Yucaipa does not address that ultimately Allied only received \$135 million of its assets – a decline in value to Allied and its Lenders of approximately \$109 million – a significant sum.

[243](#) Del. Bankr. Case No. 12-11564, D.I. 1837.

[244](#) See Yucaipa's Summary Judgment Motion at pp. 43-44.

[245](#) [Fed.R.Civ.P. 8\(a\)\(2\)](#).

[246](#)  [Swierkiewicz v. Sorema N.A., 534 U.S. 506, 512, 122 S.Ct. 992, 152 L.Ed.2d 1 \(2002\)](#) ("Before discovery has unearthed relevant facts and evidence, it may be difficult to define the precise formulation of the required prima facie case in a particular case. Given that the prima facie case operates as a flexible evidentiary standard ..."); *See also Romdhani v. Exxon Mobil Corp., Civ. Action No. 07-715-LPS, 2010 WL 4682414, at *5 (D. Del. Nov. 10, 2010)* (plaintiff is "not required to plead every factual allegation supporting their claims.").

[247](#) [Romdhani v. Exxon Mobil Corp., 2010 WL 4682414, at *5](#).

[248](#) In its brief Yucaipa cites to the following cases, which are distinguishable as the "new facts" raise new and distinct claims:  [McMahon v. Salmond, 573 F. App'x 128, 135 \(3d Cir. 2014\)](#) (unpublished) (new facts plaintiff raised on summary judgment formed a separate and distinct claim unpled in his complaint); [Wilson v. City of Wilmington, Civ. No. 13-1390-LPS, 2015 WL 4571554, at *7 \(D. Del. July 29, 2015\)](#) (plaintiff "first raised the issue of a hostile work environment in his opposition to Defendants' motion for summary judgment."). *See also*   [Krouse v. American Sterilizer Co., 984 F. Supp. 891, 914 \(W.D.Pa.1996\)](#) (citing numerous reasons for striking affidavit, including that it "inappropriately raises new allegations"), *aff'd*,  [126 F.3d 494 \(3d Cir. 1997\)](#).

[249](#) [Romdhani v. Exxon Mobil Corp., 2010 WL 4682414, at *5](#).

[250](#) Scolnick Dec. Exh. 19 (Riggs Dep.) 233:17-236:15 ("whether ... a purchase of the debt or a[n] M&A deal," the "end game" was "own[ing] the company and combin[ing] the entities, same as it has always been."). *See also* Supp. Singer Dec. Exh. 144 (Email from M. Riggs to BD/S on December 18, 2011 stating that Yucaipa is "simply not interested in exploring a typical M&A type transaction...").

[251](#) Scolnick Dec. Exh. 9 (Trustee 30(b)(6) Dep.) 44:14-45:22.

[252](#) Scolnick Dec. Exh. 20 (JCT 30(b)(6) Dep.) 37:10-21. *See also* Singer Dec. Exh. 93 (Riggs Dep.) 234:8-236:9 (“I was not in the debt investing business, I was in the business of running companies, so this whole thing was to try to get a package together.”).

[253](#)  [Dweck v. Nasser, No. CIV.A. 1353-VCL, 2012 WL 161590, at *12 \(Del. Ch. Jan. 18, 2012\)](#) (“The doctrine of corporate opportunity represents ... one species of the broad fiduciary duties assumed by a corporate director or officer. The doctrine holds that a corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation.” (citations and internal citations omitted)). *See* Scolnick Dec. Exh. 13 (Risius Dep.) 158:8-160:11 (Q. Do you have any separate opinion about whether or not a deal with JCT was, in fact, a corporate opportunity that belonged to Allied? A. I think it requires a legal conclusion. Q. So I'm just asking you if you have an opinion, yes or no. A. I'm not here to give legal opinions. “corporate opportunity” is a legal term.); Singer Dec. Exh. 106 (Responsive Expert Report of Jonathan R. Macey) at ¶ 50 (“There is no dispute that Allied was in the car hauling business. It was not in the business of acquiring control of other firms, or of itself.”).

[254](#) FLCA § 10.2(h) (emphasis added).

[255](#) Matthew W. Kavanaugh, Randy B. Soref, *What is a workout?*, Business Workouts Manual § 1:1 (2020):

The term “workout” describes a process rather than an event or a technique. The successful result of this process is a business entity that has realigned its financial structure. Essential to that realignment is an adjustment in the reasonable expectations of creditors, shareholders, labor, management, suppliers, and other parties that have an economic interest in the continued viability of the financially troubled business.

A workout is needed when the condition of the debtor's business has changed radically. The original expectations of parties in interest at the time of their first involvement with the business no longer are attainable. The workout requires reevaluation by everyone. It is traumatic and, of necessity, involves conflict.

See also In re Art Van Furniture, LLC, 617 B.R. 509, 516 (Bankr. D. Del. 2020) (“the term ‘loan workout,’ it is ordinarily defined as ‘a mutual agreement between a lender and borrower to renegotiate the terms on a loan that is in default.’” (citations omitted)); Black's Law Dictionary defines a “workout” as “[t]he act of restructuring or refinancing overdue loans.” Black's Law Dictionary (11th ed. 2019).

[256](#) Yucaipa Reply (Adv. D.I. 803) at p. 33 (The Fourth Amendment “memorialized a renegotiation between Allied and ComVest of the terms of the FLCA, at a time when Allied was in default.”).

[257](#) Singer Dec. Exh. 40 (Minutes of Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 3, 2009), at p. 1.

[258](#) Singer Dec. Exh. 103 (Risius Report) at ¶ 57 (“Yucaipa and ComVest also agreed that, as a closing condition to the transaction, Allied would reimburse ComVest in the amount of \$1,850,000 for its legal fees and expenses in connection with the sale of its debt to Yucaipa, and that Allied would reimburse Yucaipa for its fees and expenses in the amount of \$831,325.83. Allied was not a party to the Loan Purchase Agreement.” (footnotes omitted)) and Exh. E1.

[259](#) However, the parties had entered into a forbearance agreement regarding (some of the) prior existing defaults. See Scolnick Dec. at Exh. 49 (Forbearance Agreement dated Sept. 24, 2008).

[260](#) Scolnick Dec. Exh. 32 (MMSA) at § 6 (a) and (b).

[261](#) Scolnick Dec. Exh. 32 (MMSA) at § 6 (a) (“... provided, that this clause (ii) shall not apply if it is finally judicially determined by a court of competent jurisdiction that such Losses arose solely out of the gross negligence or bad faith of such Indemnified Party.”) and (b) (“... provided, however, that in the event it is finally judicially determined by a court of competent jurisdiction that the Losses of such Indemnified Party arose solely out of the gross negligence or bad faith of such Indemnified Party, such Indemnified Party will promptly remit tot the Company any amounts reimbursed or advanced under this paragraph.”).

[262](#)  [BDCM Opportunity Fund II, LP v. Yucaipa American Alliance Fund I, LP](#), 2013 WL 1290394, at *5 (emphasis added).

[263](#) [ASHINC Corp. v. AMMC VII, Ltd.](#), 683 F. App'x at 140 (emphasis added; citations and internal quotation marks omitted).

[264](#)  [Brehm v. Eisner \(In re Walt Disney Co. Derivative Litig.\)](#), 906 A.2d 27, 67 (Del. 2006) (emphasis added, quoting  [In re Walt Disney Co. Derivative Litig.](#), 907 A.2d 693, 755 (Del. Ch. 2005) (footnotes and further citations omitted), *aff'd*,  906 A.2d 27 (Del. 2006)). See also Singer Dec. Exh. 104 (Macey Report) at ¶¶50-54. The duty to act in good faith is described as:

The duty to act in good faith, meanwhile, is a subsidiary element of the duty of loyalty. The behavior that must be shown to prove a violation of the duty to act in good faith requires conduct that is qualitatively different from, and more culpable than, the conduct giving rise to a violation of the fiduciary duty of care (i.e., gross negligence). The Delaware Supreme Court has identified three examples of conduct that may establish a failure to act in good faith. First, it has held that such a failure may be shown where a director intentionally acts with a purpose other than that of advancing the best interests of the corporation. Second, it has held that a failure may be proven where a director acts with the intent to violate applicable positive law. Third, it has held that a failure may be shown where the director intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. The court noted, however, that this list of examples is not necessarily exclusive. More specifically, it said there may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.

 [Official Comm. of Unsecured Creditors v. Goldman Sachs Credit Partners L.P. \(In re Fedders N. Am., Inc.\)](#), 405 B.R. 527, 540 (Bankr. D. Del. 2009) (internal quotation marks omitted; citing  [Stone v. Ritter](#), 911 A.2d 362, 370 (Del. 2006) and  [In re Walt Disney Co. Derivative Litig.](#), 907 A.2d at 755.

[265](#) [ASHINC Corp. v. AMMC VII, Ltd.](#), 683 F. App'x at 140.

[266](#) See *Litigation Trustee's Reply Memorandum in Further Support of Motion for Partial Summary Judgment*, Adv. D.I. 794 at p. 1 n. 1 (“The Trustee’s claims against Defendants Ron Burkle and the Yucaipa Directors have been voluntarily dismissed (13-50530, D.I. 793; 14-50971, D.I. 533 and 534). The Trustee’s motion seeking summary judgment on Lender Claim 4 (Tortious Interference) is, therefore, no longer in the case.”).

[267](#) The Trustee and Lenders have standing to bring the claims. See [Picard v. J. Ezra Merkin \(In re Bernard L. Madoff Inv. Sec. LLC\)](#), 515 B.R. 117, 159 (Bankr. S.D.N.Y. 2014) (“[W]here the inequitable conduct injures the estate as a whole, the trustee is the person with the standing to assert it.”); *id.* (A creditor may bring

an equitable subordination claim only if he can allege a particularized injury resulting from the defendant's inequitable conduct ... [or] that [Yucaipa's] inequitable conduct ... allowed [Yucaipa] to achieve an unfair advantage.”). *See also supra* p. 165 (allowed under the Litigation Trust Agreement).

- 268 Yucaipa's citation to this proposition is misleading at best. Yucaipa's brief states (with all but the relevant internal citations and quotations omitted):

Equitable subordination is an extraordinary remedy which is applied sparingly. Because the claim requires a fact-intensive inquiry, it “is rarely amenable to resolution at summary judgment,” particularly on behalf of a plaintiff. *In re Mid-Am. Waste Sys., Inc.*, 284 B.R. at 126; *In re J. Silver Clothing, Inc.*, 453 B.R. 518, 533 (Bankr. D. Del. 2011)

Miller v. U.S. (In re Miller), 284 B.R. 121, 126 (N.D. Ca. 2002) reveals no such quote. *In re Mid-Am. Waste Sys., Inc.*, 284 B.R. 53 (Bankr. D. Del. 2002) also contains no such quote. *Burtch v. Connecticut Comm. Bank (In re J. Silver Clothing, Inc.)*, 453 B.R. 518, 533 also does not contain this quote.

Instead, the quote is found in *YA Global Invest., L.P. v. Global Outreach, S.A. (In re Glob. Outreach, S.A.)*, Civ. Act N. 11-620, 2011 WL 2294168, at *8 (D.N.J. June 6, 2011) and does not stand for the proposition cited. Instead, *Glob. Outreach* states: “[T]his language ... does not conclusively establish an *actual intent* to hinder, delay, or defraud the Debtor's creditors when divorced from the context and circumstances surrounding the transaction. The issue of intent **with respect to a fraudulent transfer** is rarely amenable to resolution at summary judgment.” (emphasis added). The issue of intent as to a fraudulent transfer is not at issue here.

- 269 Yucaipa's argument is irrelevant as to the Estate Claims 1 and 2 because any injury to the Estate occurred independent of when certain lenders held claims. This argument fails as to Lender Claim 1 because equitable subordination claims have only been barred where they are purchased **after the intervention of bankruptcy**.

Indeed, § 510(c) subordinates claims to other claims—not claims to specific claimants. *See, also*, *Consol. Pet Foods v. Millard Refrigerated Services, Inc. (In re S & D Foods, Inc.)*, 110 B.R. 34, 37 (Bankr. D. Colo. 1990) (no subordination for claims purchased “after the alleged misconduct of other creditors *and after the intervention of bankruptcy* and at distressed prices”); *In re W. T. Grant Co.*, 4 B.R. 53, 78 (Bankr. S.D.N.Y. 1980) (debt acquired “after the alleged misconduct of the [defendants], *the intervention of bankruptcy* and at distressed prices”), *appeal aff'd*, 699 F.2d 599 (2d Cir. 1983).

- 270 11 U.S.C. § 510(c).

- 271 *United States v. Noland*, 517 U.S. 535, 539, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996) (citations and quotations omitted).

- 272 *Id.* *See also* *Schubert v. Lucent Tech. Inc. (In re Winstar Commc'ns, Inc.)*, 554 F.3d 382, 411 (3d Cir. 2009) (quoting *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 700 (5th Cir. 1977)); *In re Mid-Am. Waste Sys., Inc.*, 284 B.R. at 71 (“Under the second prong of the traditional equitable subordination analysis, the Court must determine whether the claimant's inequitable conduct either (i) created some unfair advantage for the claimant or (ii) harmed the debtor or its creditors.”).

- 273 *Noland*, 517 U.S. at 539, 116 S.Ct. 1524.

- 274 *Id.*

- [275](#)  [Id. at 543, 116 S.Ct. 1524.](#)
- [276](#)  [Id. at 540, 116 S.Ct. 1524.](#)
- [277](#) See, e.g.,  [Merrimac Paper Co. v. Harrison \(In re Merrimac Paper Co.\), 420 F.3d 53, 61 \(1st Cir. 2005\).](#)
- [278](#)  [Id. at 61](#) (emphasis in original).
- [279](#) See generally,  [id.](#)
- [280](#)  [Id. at 63.](#)
- [281](#)  [In re Mid-Am. Waste Sys., Inc., 284 B.R. at 73.](#)
- [282](#)  [In re Winstar Commc'ns, Inc., 554 F.3d at 412](#) (citations and internal quotation marks omitted).
- [283](#)  [Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims, 323 F.3d 228, 234 \(3d Cir. 2003\);](#)  [In re Winstar Commc'ns, Inc., 554 F.3d at 412.](#)
- [284](#)  [Pepper v. Litton, 308 U.S. 295, 306, 60 S.Ct. 238, 84 L.Ed. 281 \(1939\);](#) See, e.g.,  [In re Winstar Commc'ns, Inc., 554 F.3d at 412.](#)
- [285](#) See, e.g.,  [Noland, 517 U.S. at 540, 116 S.Ct. 1524](#) (stating that the “principles of equitable subordination permits a court to make exceptions to a general rule when justified by particular facts”). (citations and quotations omitted).
- [286](#)  [In re Mid-Am. Waste Sys., Inc., 284 B.R. at 70.](#)
- [287](#)  [Miller v. Greenwich Capital Fin. Products, Inc. \(In re Am. Bus. Fin. Servs., Inc.\), 362 B.R. 149, 164-65 \(Bankr. D. Del. 2007\)](#) (finding that the Trustee made a claim for equitable subordination by alleging inequitable conduct such as breach of contract, but also finding that the relief sought could not be granted under a claim for equitable subordination.).
- [288](#)  [In re Mid-Am. Waste Sys., Inc., 284 B.R. at 70;](#)  [Pepper v. Litton, 308 U.S. at 310, 60 S.Ct. 238.](#)
- [289](#) See [Comstock v. Grp. of Institutional Inv'rs, 335 U.S. 211, 229, 68 S.Ct. 1454, 92 L.Ed. 1911 \(1948\).](#)
- [290](#) See generally [id.](#)
- [291](#)  [Gannett Co. v. Larry, 221 F.2d 269, 275 \(2d Cir. 1955\).](#)
- [292](#)  [In re Mid-Am. Waste Sys., Inc., 284 B.R. at 69.](#)
- [293](#)  [Anstine v. Carl Zeiss Meditec AG \(In re U.S. Med., Inc.\), 531 F.3d 1272, 1279 \(10th Cir. 2008\).](#)
- [294](#) Singer Dec. Exh. 47 (Email from D. Walker to R. Burkle, re: Allied, dated Sept. 11, 2009) at p. 2 (“Our purchase of the first lien debt is also notable because it puts us in the position of controlling every tranche

of the Company's capital structure. In addition to holding 56% of the first lien debt, we also hold 67% of the second lien debt as well as 71% of the fully-diluted equity.”).

[295](#) 13-50530 D.I. 297 at p. 129 (Tr. of Hr'g. 129:11-22) (“Yucaipa was involved in the negotiation and the establishment of the first lien credit agreement as part of the earlier bankruptcy. And at all other times, has controlled the equity and the board of directors. And has been intimately involved in every aspect of the debtor's business, and the credit agreement issues since 2007. To allow Yucaipa to be involved this heavily in negotiating agreements with -- including those with expressed limits on Yucaipa's rights, and won't allow them to buy the debt, the seller cannot sell to them in the first place, and to (indiscernible) **would be inequitable**, you know, to the (indiscernible) degree in my mind” (emphasis added)).

[296](#)  [Kahn v. Lynch Commc'n Sys., Inc.](#), 638 A.2d 1110, 1113 (Del. 1994) (quoting  [Ivanhoe Partners v. Newmont Min. Corp.](#), 535 A.2d 1334, 1344 (Del. 1987) (further citation omitted) (“ ‘a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation.’ ”).

[297](#) 11 Moore's Federal Practice – Civil § 56.40 (2021).

[298](#) 11 Moore's Federal Practice – Civil § 56.40 (2021).

[299](#)  [BDCM Opportunity Fund II v. Yucaipa American Alliance Fund I, LP](#), 2013 WL 1290394, at *5. See [Murray v. Nat'l Broad. Co., Inc.](#), 178 A.D.2d 157, 576 N.Y.S.2d 578, 580 (1991) (“[Yucaipa] seiz[ed] control of the Lenders' rights and remedies under the Credit Facility.”) (ruling on summary judgment constitutes final determination). See *supra* Sections D and E (granting Trustee's Lender Claims 2 and 3 for breach of contract and breach of duty of good faith and fair dealing); *id.* p. 41–42 (listing the contractual injuries Lenders assert they sustained).

[300](#) See *e.g.*, *supra* pp. 189–90 – — and accompanying notes.

[301](#) Allied was under no contractual obligation to make the payments related to the ComVest transaction. See Singer Dec. Exh. 43 (Loan Purchase Agreement, dated Aug. 21, 2009), at p. 2 (§ 1.4).

[302](#) Singer Dec. Exh. 103 (Risius Report) at ¶¶ 120-122.

[303](#) *Id.* at Exhs. B.2 through B.6. See also *supra* p. 186 (asserting damages related to the JCT Negotiations).

[304](#) Singer Dec. Exh. 43 (Loan Purchase Agreement, dated Aug. 21, 2009), at p. 2 (§ 1.4).

[305](#) Yucaipa knew it was imposing an end-run around creditors' contractual rights. See *supra* n. 34. In response to Yucaipa's February 2009 tender that included an Amendment to the FLCA that allowed Yucaipa to become Requisite Lender, CIT's counsel stated:

[C]ertain provisions of the Proposed Fourth Amendment cannot be entered into without the consent of Administrative Agent or Collateral Agent [also CIT], or both ... [T]he Proposed Fourth Amendment may not be consummated on its present terms without the consent of each Agent. On behalf of CIT, we can confirm that CIT will not grant its consent, whether in its capacity as a Lender or as an Agent, to the Proposed Fourth Amendment.

Singer Dec. Exh. 32 (Letter from E. Kimball to H. Dempster re: Amended and Restates First Lien Secured Super-Priority Debtor in Possession and Exit Credit and Guaranty Agreement ..., dated Feb. 12, 2009) at p. 2 (emphasis in original).

- [306](#) See *supra* p. 196 (finding § 2(b) of the MMSA to have been improperly raised); p. 196-98 (determining § 10.2 of the FLCA to not obligate Allied to make the payments); p. 197-996 (finding § 6 of the MMSA did not preclude Allied from suing).
- [307](#) Singer Dec. Exh. 55 (Email from R. Burkle to R. Priddy re: Jonathan [Ornstein], dated Mar. 26, 2010) (“I know you guys have been talking ...just an fyi ... we gave him 250k a few months ago”).
- [308](#) See *supra* pp. 191–92 – — (containing relevant facts).
- [309](#) See *supra* pp. 191–92 – — (containing facts as to Ornstein Payment).
- [310](#)  [Pepper v. Litton, 308 U.S. at 306–08, 60 S.Ct. 238.](#)
- [311](#)  [Id.](#)
- [312](#) Singer Dec. Exh. 32 (Letter from E. Kimball to H. Dempster re: Amended and Restates First Lien Secured Super-Priority Debtor in Possession and Exit Credit and Guaranty Agreement ..., dated Feb. 12, 2009) at p. 2 (“may not be consummated on its present terms without the consent of each Agent ... we can confirm that [we] will not grant [our] consent”) (emphasis in original)). Singer Dec. Exh. 42 (Resolutions for Meeting of the Board of Directors of Allied Systems Holdings, Inc., Aug. 19, 2009) (Yucaipa employee and Allied Board Member Walker moved to approve Fourth Amendment and Allied's Board passed it).
- [313](#) Scolnick Dec. Exh. 76 (Letter from Troutman Sanders to The CIT Group/Business Credit, Inc., dated Aug. 20, 2009) at p. 10 of 70.
- [314](#) See generally, Scolnick Dec. Exh. 76 (Letter from Troutman Sanders to The CIT Group/Business Credit, Inc., dated Aug. 20, 2009).
- [315](#) See LPA § 2.6.
- [316](#) Singer Dec. Exh. 46 (E-mail from S. Bond to D. Walker, re: Restructuring Plan.pdf, dated Aug. 23, 2009) at p. 2.
- [317](#) See *supra* p. 170–71.
- [318](#) Singer Dec. Exh. 52 (Verified Answer and Counterclaims of Defendant The CIT Group Business Credit, Inc. in Allied Systems Holdings, Inc. v. The CIT Group/Business Credit, Inc.) at p. 35 of 39.
- [319](#) Singer Dec. Exh. 88 (The Yucaipa Defendants' First Supplemental Responses and Objections to the Official Committee of Unsecured Creditors' First Set of Requests for Admissions).
- [320](#) [ASHINC v. AMMC VII, Ltd., 683 Fed. Appx. at 140](#) (finding the amendment to the FLCA to be invalid and finding that Yucaipa knew the amendments were prohibited).
- [321](#) See *supra* pp. 198–99 – —.
- [322](#)  [United States v. State St. Bank & Tr. Co., 520 B.R. 29, 85 \(Bankr. D. Del. 2014\)](#) (determining that where a court subordinates a claim based on the facts before it without attempting to categorically reorder statutory priorities, the subordination is likely to be consistent with the Bankruptcy Code).
- [323](#) Estate Compl. § 148.

- [324](#) If the Court were to grant the claims for equitable subordination, the claim for recharacterization would be moot. *See Litigation Trustee's Opposition to the Motion for Summary Judgment by Defendants Yucaipa American Alliance Fund I, L.P., and Yucaipa American Alliance (Parallel) Fund I, L.P.* (Adv D.I. 770) at p. 48.
- [325](#) The debt was initially issued as DIP financing in the 2005 Bankruptcy and then converted into exit financing. The DIP Financing document expressly called it debt. (*See* Scolnick Dec. Exh. 123 (Secured Super-Priority Debtor in Possession and Exit Credit and Guaranty Agreement, dated Mar. 30, 2007)).
- [326](#) Third Amendment § 2.7(e) (amending and inserting § 10.6(j) into the FLCA).
- [327](#) *See, e.g., In re Franklin Equip. Co.*, 416 B.R. 483, 519 (Bankr. E.D. Va. 2009) (recharacterization may be warranted where “the purchasing insiders effect such radical modification of the terms and conditions of the transaction after acquisition so as to remove its original character”);  *Cohen v. KB Mezzanine Fund II, LP (In re Submicron Systems Corp.)*, 432 F.3d 448, 456 (3d Cir. 2006) (courts consider “the economic reality of the surrounding circumstances” to determine whether recharacterization is warranted).
- [328](#) *In re Insilco Techs., Inc.*, 480 F.3d 212, 217 (3d Cir. 2007) (citing  *Bayer Corp. v. MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 749 (6th Cir. 2001) (further citation omitted)).
- [329](#)  *In re SubMicron Sys. Corp.*, 432 F.3d at 457; accord  *United States v. State Street Bank & Tr. Co.*, 520 B.R. at 74–75 (placing “particular emphasis on the parties' intent at the initial funding”).
- [330](#)  *United States v. State St. Bank & Tr. Co.*, 520 B.R. at 74 (emphasis supplied by  *State St. Bank & Tr. Co.* court; quoting  *In re SubMicron Sys. Corp.*, 432 F.3d at 456). *See also Drake v. Franklin Equip. Co. (In re Franklin Equip. Co.)*, 416 B.R. 483, 509 (Bankr. E.D. Va. 2009) (citations and internal quotation marks omitted) (holding “reclassification is substantially different from subordination in that subordination focuses on the creditor's behavior; whereas, reclassification rests on the substance of the transaction giving rise to the claim.”).
- [331](#) *Official Comm. Of Unsec. Creditors of HH Liquidation, LLC v. ComVest Group Holdings, LLC (In re HH Liquidation, LLC)*, 590 B.R. 211, 290 (Bankr. D. Del. 2018) (quoting  *United States v. State St. Bank & Tr. Co.*, 520 B.R. at 74).
- [332](#)  *In re SubMicron Sys. Corp.*, 432 F.3d at 456.
- [333](#) *Cohen v. KB Mezzanine Fund II, LP (In re SubMicron Sys. Corp.)*, 291 B.R. 314, 323 (D. Del. 2003), *aff'd*,  432 F.3d 448 (3d Cir. 2006) (citations omitted). *See also*  *Friedman's Liquidating Trust v. Goldman Sachs Credit Partners, L.P. (In re Friedman's Inc.)*, 452 B.R. 512, 525 (Bankr. D. Del. 2011).
- [334](#) *In re Franklin Equip. Co.*, 416 B.R. at 519. The Court stated in full (as it is important to help distinguish the Trustee's argument here):

Remembering decisions teach that a court considering recharacterization must center its focus on the time at the time of origination of a challenged transaction, ... a strong argument may be waged that a transaction originated as a loan may not change its fundamental character, unless perhaps the **purchasing insiders effect such radical modification of the terms and conditions of the transaction after acquisition so as to remove its original character**. The Trustee has presented nothing to suggest that existing law or the existence of a good faith argument for the reversal or a modification of existing law support of this component of her argument. Nevertheless, and assuming arguendo that for recharacterization purposes a

In re Ashinc Corporation, 629 B.R. 154 (2021)

loan may experience “transformation” after acquisition, the Court will analyze the loan represented by the Replacement Note at the time of its purchase by the Drakes.

Id. (emphasis added, citations omitted). Although the *Franklin Equipment* court assumed *arguendo* that a loan could be “transformed,” the Court held that the note in question never became a capital contribution after reviewing all the recharacterization factors. *Id.* at 521.

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KeyCite Blue Flag – Appeal Notification

Appeal Filed by [In re: Ashinc Corporation, et al.](#), 3rd Cir., August 12, 2022

2022 WL 2666888

Only the Westlaw citation is currently available.
United States District Court, D. Delaware.

IN RE: ASHINC CORPORATION, et al., Debtors.
Catherine E. Youngman, Litigation Trustee for
ASHINC Corporation, et al., as Successor to the
Official Committee of Unsecured Creditors of ASHINC
Corporation, and Its Affiliated Debtors, Plaintiff,
BDCM Opportunity Fund II, LP, Black
Diamond CLO 2005-1 Ltd., and [Spectrum
Investment Partners, L.P.](#), Intervenor,

v.

Yucaipa American Alliance Fund L.P., and Yucaipa
American Alliance (Parallel) Fund I, L.P., Defendants.

Catherine E. Youngman, Litigation Trustee
for ASHINC Corporation, et al., as Successor
to BDCM Opportunity Fund II, LP, Black
Diamond Commercial Finance, L.L.C., as co-
administrative agent, and Spectrum Commercial
Finance LLC, as co-administrative agent, Plaintiff,

v.

Yucaipa American Alliance Fund I, L.P., and Yucaipa
American Alliance (Parallel) Fund I, L.P., Defendants.

Bankr. No. 12-11564-CSS (Jointly Administered)

|

Adv. No. 13-50530-CSS, Adv. No. 14-50971-CSS

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Civ. No. 21-1060-CFC

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Filed 07/11/2022

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Chapter 11

[CONNOLLY](#), CHIEF JUDGE

MEMORANDUM OPINION

*1 On May 4, 2021, the Bankruptcy Court issued a 115-
page Opinion (Adv. D.I. 563)¹ and Order (Adv. D.I. 564)
with respect to cross-motions for summary judgment that
disposed of some but not all claims asserted in two adversary
proceedings: the so-called “Estate Action” (Adv. Proc. No.
13-50530-CSS) and the so-called “Lender Action” (Adv.
Proc. No. 14-50971-CSS). The Order directed the parties
to submit a proposed judgment reflecting the Bankruptcy
Court’s rulings. On June 23, 2021, following briefing by
the parties, the Bankruptcy Court entered a \$130 million
judgment (Adv. D.I. 579) (“Judgment”) on certain claims
in favor of plaintiff Catherine Youngman, as Litigation
Trustee for ASHINC Corporation and its affiliated Debtors
(“Trustee”), and against defendants Yucaipa American
Alliance Fund I, L.P., and Yucaipa American Alliance
(Parallel) Fund I, L.P. (“Yucaipa”).

Currently before the Court are the Bankruptcy Court’s
proposed findings of fact and conclusions of law (“FFCL”)
pursuant to [Federal Rule of Bankruptcy Procedure 7052](#)
and [9033](#)² as they were issued solely with respect to the
Bankruptcy Court’s granting of summary judgment in favor
of the Trustee and against Yucaipa in the Lender Action with
respect to the Trustee’s non-core breach of contract claim
referred to in these proceedings as “Lender Claim 2.”

For the reasons set forth herein, the Court sustains in part
Yucaipa’s Objections to the Opinion and Order and adopts
the remaining proposed FFCL submitted by the Bankruptcy
Court with respect to Lender Claim 2.

II. RELEVANT BACKGROUND³

This dispute arose in the Chapter 11 cases of Allied Systems
Holdings, Inc., which sought bankruptcy protection on

May 17, 2012. Over the past 8^{1/2} years, the Honorable Christopher S. Sontchi has presided over the Chapter 11 cases, including the long and contentious history of litigation in two adversary proceedings brought against Yucaipa concerning the First Lien Credit Agreement (“FLCA”) and multiple amendments thereto.

The Estate Action, filed on February 1, 2013 by the Official Committee of Unsecured Creditors (the “Committee”), asserts claims for (i) equitable subordination, (ii) recharacterization, (iii) breach of contract, (iv) specific performance, and recovery of avoidable transfers, and (v) disallowance of certain claims.

*2 The Lender Action, filed on November 19, 2014, by BDCM Opportunity Fund II, LP, Black Diamond CLO 2005-1 Ltd. (collectively, “Black Diamond”), and Spectrum Investment Partners, L.P. (“Spectrum,” and together with Black Diamond, “BD/S”), asserts claims for (i) equitable subordination, (ii) breach of contract, (iii) breach of the implied duty of good faith and fair dealing, and (iv) tortious interference with contract. With respect to the breach of contract claim at issue here—Lender Claim 2—the complaint in the Lender Action alleges that Yucaipa breached the FLCA by (i) acquiring more first lien debt from ComVest in August 2009 than permitted under the Third Amendment (Adv. D.I. 1 ¶¶ 117–120; 123(a)); (ii) declaring itself to be the Requisite Lender as a result of an impermissible acquisition of First Lien Debt (*id.* ¶ 121; *see also id.* ¶ 123(b)); (iii) breaching the Third Amendment’s provisions related to voting rights “by improperly acting as Requisite Lender” (*id.* ¶ 122); (iv) using its status as Requisite Lender “to neutralize the First Lien Lenders, giving the debtors a ‘free pass’ to ignore” the FLCA’s provisions, and to protect its equity investment by precluding a restructuring of Allied (*id.* ¶ 123(c)–(d)); and (v) violating the Third Amendment’s Capital Contribution Provision by not making a capital contribution of at least 50% of the aggregate principal of the Term Loans that Yucaipa acquired from ComVest on August 21, 2009, within 10 days of acquiring that debt (*id.* ¶¶ 54 (second bullet), 101).

In 2020, the Trustee and Yucaipa each moved for summary judgment on certain of the Trustee’s claims. On May 4, 2020, the Bankruptcy Court issued the Opinion and Order. As both parties had moved the Bankruptcy Court for affirmative relief, the Order included language indicating that the claims at issue constituted a “‘core proceeding’ pursuant to  28 U.S.C. § 157(b)” and that the Bankruptcy Court had “judicial power

to enter a final order.” With respect to Lender Claim 2, the Bankruptcy Court rejected Yucaipa’s argument that this claim was barred by Delaware’s 3-year statute of limitations and further determined that the Trustee had carried her burden of establishing the absence of a genuine issue of material fact regarding the elements of breach of contract under New York law.⁴ The Order directed the parties to submit a proposed judgment reflecting the various rulings in the Opinion and Order.

Prior to submission of the proposed judgment, however, Yucaipa filed its [Rule 9033](#) Objection (D.I. 1-2) (“9033 Objection”) along with an objection to the entry of judgment (Estate Action, Adv. D.I. 830) (“Proposed Judgment Objections”) asserting, *inter alia*, that the Bankruptcy Court lacked authority to enter a final judgment on non-core claims in both the Estate Action and Lender Action – specifically, Lender Claim 2 and Estate Claim 5.⁵ The Bankruptcy Court subsequently advanced questions to the Trustee regarding: (i) whether Yucaipa consented to the Court exercising jurisdiction to issue final orders and judgments on non-core claims through its conduct, and (ii) whether the Bankruptcy Court can provide findings of fact on summary judgment where the Court ruled *as a matter of law*, in whole or in part, in favor of the Trustee on certain claims including Lender Claim 2. On June 22, 2021, the Trustee filed her responses to the Objections (D.I. 1-3) (“9033 Response”), which also responded to specific questions that the Bankruptcy Court posed regarding its ability to enter a final order with respect to the non-core Estate Claim 5 based on Yucaipa’s waiver, along with an amended proposed form of Judgment (Adv. D.I. 575-1). The Trustee conceded in her 9033 Response that Lender Claim 2 was a non-core claim, as previously determined by the Bankruptcy Court (*see* Adv. D.I. 70), and that Yucaipa had not consented to entry of a final order by the Bankruptcy Court on that claim. (*See* Response, D.I. 1-3 at 5). The Trustee requested that the Bankruptcy Court issue clarifications that: (i) “the rulings on [Lender Claim 2] are entered as proposed findings of fact and conclusions of law,” and similarly (ii) “if it is later determined that this Court somehow lacked jurisdiction to enter final orders and judgments on Estate Claim 5, that the Opinion should be construed as proposed findings and conclusions.” (*Id.* at 2-3 & 5 n.8).⁶

*3 On June 22, 2021, Yucaipa filed its reply (D.I. 1-4) (“9033 Reply”), in which it also responded to the specific questions posed by the Bankruptcy Court and took the position that it had properly contested the Bankruptcy Court’s

authority to enter a final order with respect to both Lender Claim 2 and Estate Claim 5. (D.I. 1-4 at 4). On June 23, 2021, the Bankruptcy Court entered the Judgment on various claims, including Estate Claim 5, but it did not enter Judgment on Lender Claim 2 or issue any clarifications.

On July 23, 2021, Yucaipa filed a Notice of Completion of Briefing, indicating that briefing on its 9033 Objections was complete and “request[ing] transmittal to the District Court” for *de novo* review solely with respect to “*that portion of the Order* contained in the first Paragraph 2 thereof granting summary judgment in favor of the Plaintiff [Trustee] and against Defendants [Yucaipa] ... *on the non-core ‘Lender Claim 2 (Breach of Contract).’*” (D.I. 1-6) (emphasis added). Yucaipa has appealed other determinations made in the Opinion, Order, and Judgment, which appeals are pending before the Court in separate proceedings. *See* Civ. No. 21-994-CFC, 21-995-CFC.

III. JURISDICTION AND STANDARDS OF REVIEW

The Court has jurisdiction over this matter under [28 U.S.C. § 1334](#). Solely before the Court is the Bankruptcy Court’s grant of summary judgment in favor of the Trustee on the breach of contract claim asserted in Lender Claim 2, which is a final order. With respect to a matter that is not a core proceeding under [28 U.S.C. § 157\(b\)\(2\)](#) but is nonetheless related to a case under title 11, the bankruptcy court shall submit proposed findings of fact and conclusions of law to the district court. *See* [28 U.S.C. § 157\(c\)\(1\)](#). Here, the Bankruptcy Court noted that the Opinion “constitutes the Court’s findings of fact and conclusions of law pursuant to [Federal Rule of Bankruptcy Procedure 7052](#).” (Opinion at 2 n.1). Following submission, “any final order or judgment shall be entered by the district court judge after considering the bankruptcy judge’s proposed findings and conclusions and after reviewing *de novo* those matters to which any party has timely and specifically objected.” [28 U.S.C. § 157\(c\)\(1\)](#). With respect to the standard of review, the Federal Rules of Bankruptcy Procedure further instruct:

The district judge shall make a *de novo* review upon the record or, after additional evidence, of any portion of the bankruptcy judge’s findings of fact or conclusions of law to which specific written objection has been made in accordance with this rule. The district judge may accept, reject, or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit

the matter to the bankruptcy judge with instructions that “[t]he district judge may accept, reject or modify the proposed findings of fact or conclusions of law, receive further evidence, or recommit the matter to the bankruptcy judge with instructions.

[FED. R. BANKR. P. 9033\(d\)](#). “In conducting a *de novo* review, the Court must consider all of the Bankruptcy Court’s findings and conclusions and afford them no presumption of validity.” [In re Montgomery Ward & Co., 2004 WL 323095, at *1 \(D. Del. Feb. 13, 2004\)](#), *rev’d on other grounds*, 428 F.3d 154 (3d Cir. 2005).

Pursuant to Rule 56, a court “shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” [FED. R. CIV. P. 56](#); [Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 \(1986\)](#) (“Under [Rule 56\(c\)](#), summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.”). If the moving party has carried its burden, the nonmovant must then “come forward with specific facts showing that there is a genuine issue for trial.” [Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 \(1986\)](#) (internal quotation marks omitted).

*4 To defeat a motion for summary judgment, the nonmoving party must “do more than simply show that there is some metaphysical doubt as to the material facts.” [Matsushita, 475 U.S. at 586-87](#); *see also* [Podohnik v. U.S. Postal Service, 409 F.3d 584, 594 \(3d Cir. 2005\)](#) (stating party opposing summary judgment “must present more than just bare assertions, conclusory allegations or suspicions to show existence of a genuine issue”) (internal quotation marks omitted). Although the “mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment,” a factual dispute is genuine where “the evidence is such that a reasonable jury could return a verdict for the nonmoving party.” [Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 \(1986\)](#). Finally, under the summary judgment standard, the Bankruptcy Court was required to “draw all reasonable inferences in favor of the nonmoving party, and it may not make credibility determinations or weigh

the evidence.” [!\[\]\(919a2cb85b99741a73c0c31a427236a8_img.jpg\) *Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 150 \(2000\).](#)

IV. ANALYSIS

Yucaipa identifies five specific objections to the Bankruptcy Court's Opinion and Order (“Objections A-E”). (See D.I. 1-2 at 9-14). As Yucaipa explains, “[t]he focus of these objections is on the Bankruptcy Court's resolution of the non-core claims for breach of contract; Yucaipa will present its grounds for reversal as to the other claims in its appeal from the judgment, once entered.” (*Id.* at 9). The Court reviews *de novo* each of the specific objections below.

A. **Objection A:** Opinion at 6

Yucaipa objects to the discussion of jurisdiction at page 6 of the Opinion, which states: “This Court has jurisdiction over this matter, pursuant to [!\[\]\(e3f8612927870f2e0f9f5989e6dd3064_img.jpg\) 28 U.S.C. § 1334](#). This is a core proceeding, pursuant to [!\[\]\(a86c7d1c9cb81c81614634a31267440d_img.jpg\) 28 U.S.C. § 157\(b\)](#).” (Opinion at 6). Yucaipa argues that Lender Claim 2 is a quintessentially non-core claim as to which the Bankruptcy Court lacked jurisdiction to enter a final order. (D.I. 1-2 at 9).

It is not disputed that Lender Claim 2 is a non-core claim. The Bankruptcy Court has previously determined as much, and the Trustee concedes. I therefore agree with Yucaipa that it is appropriate at this juncture to review *de novo* any findings of fact and conclusions of law supporting the Bankruptcy Court's grant of summary judgment in favor of the Trustee on the breach of contract claim asserted in Lender Claim 2.

B. **Objection B:** Opinion at 6-22

1. **Objection to factual history**

Yucaipa objects to the Bankruptcy Court's factual findings in the Opinion, including the “Factual History” set forth in pages 6-22. (D.I. 1-2 at 10-12). Yucaipa argues that the Bankruptcy Court made findings of fact in “violat[ion of] the fundamental standards that are supposed to guide courts’ resolution of summary judgment motions.” (*Id.* at 10). According to Yucaipa, the Bankruptcy Court “resolved genuine issues of material fact, ignored or mischaracterized evidence, failed to construe the evidence in a light most favorable to the non-moving party (Yucaipa), drew inferences against the non-moving party (Yucaipa), and in some instances allowed the Trustee to rely on noting more than speculation.” (*Id.*)

The Bankruptcy Court expressed its disagreement with this argument during the hearing on Yucaipa's motion for stay pending appeal held on July 6, 2021. (See Estate Action, Adv. D.I. 864 (“7/6/21 Hearing Tr.”) at 31:21-32:3 (“[T]here was no fact finding. There's no violation of the summary judgment rules. Every fact that is the underpinning of the judgment was undisputed or, to the extent there was a dispute as to what it might have meant if you had applied parol[e] evidence, it was irrelevant because it was based solely on the plain meaning of the documents. Plain meaning of documents is not a fact-finding exercised by the Court that could somehow be disputed.”).

*5 The Bankruptcy Court recommended that this Court enter summary judgment in the Trustee's favor on Lender Claim 2 under [Rule 56](#). [Rule 56](#) requires that “[t]he court should state on the record the reasons for granting or denying the motion.” [Fed. R. Civ. P. 56\(a\)](#). The Trustee argues, under [Federal Rule of Civil Procedure 52\(a\)\(3\)](#) — made applicable to adversary proceedings under Bankruptcy [Rule 7052](#) — the Bankruptcy Court “is not required to state findings or conclusions when ruling a motion under [Rule 12](#) or [56](#).” [Fed. R. Civ. P. 52\(a\)\(3\)](#). The Trustee argues that [Rule 52\(a\)\(3\)](#) is stated permissively, leaving it “totally within the discretion of bankruptcy judges as to whether they wish to make any specific findings of fact and/or conclusions of law” in connection with deciding a motion for summary judgment. [Barone v. Strouse, Greenberg Mortg. Co.](#), 71 B.R. 521, 524 (Bankr. E.D. Pa. 1987).⁷

Assuming that is true with respect to entry of summary judgment on a core matter, it is undisputed that the breach of contract claim at issue here—Lender Claim 2—is a non-core claim, and therefore, under [!\[\]\(95b425611cbd2b8716a140cf67c81822_img.jpg\) 28 U.S.C. § 157\(c\)\(1\)](#), any final judgment on that claim required not only a statement of “reasons for granting or denying the [Trustee's summary judgment] motion” under [Rule 56](#), but also submission of “proposed findings of fact and conclusions of law” sufficient to support its holding — *i.e.*, in the summary judgment context, the undisputed facts that warrant judgment as a matter of law in favor of the moving party.

Notwithstanding Yucaipa's objection, the Bankruptcy Court's careful Opinion meets these requirements. (See Opinion at 2 n.1 (stating “This Opinion constitutes the Court's findings of fact and conclusions of law pursuant to [Federal Rule of Bankruptcy Procedure 7052](#).”)) As discussed below, having reviewed *de novo* the matters raised in Yucaipa's 9033 Objections with respect to Lender Claim 2, I find that the

Bankruptcy Court correctly applied the summary judgment standard, relying on undisputed facts or the plain meaning of documents, in finding that the Trustee carried her initial burden in “establishing the absence of a genuine issue of material fact” regarding the elements of breach of contract under New York law,  *Celotex*, 477 U.S. at 322, and that Yucaipa failed to produce “evidence in the record creating a genuine issue of material fact” as to those same elements. ⁸

2. Objections to specific factual findings

In its 9033 Objections, Yucaipa cites three examples of the Bankruptcy Court's purported misapplication of the summary judgment standard (D.I. 1-2 at 10-12). ⁹

*6 First, Yucaipa objects to the finding contained in the Opinion that “[f]rom late 2011 through Spring 2012, Yucaipa demanded a *premium* price of \$1.15 for each dollar of its First Lien Debt, based on the premise that it was Requisite Lender.” (Opinion at 19 n.26) (emphasis added). Yucaipa contends that the question of whether Yucaipa demanded a “premium” in those negotiations was “heavily disputed.” (D.I. 1-2 at 10-11). Yucaipa argues that its summary judgment opposition brief demonstrated, with supporting evidence, that “Yucaipa agreed to ratable treatment, but then BD/S walked away from the deal and filed the involuntary bankruptcy instead.” (*Id.* at 10-11). Yucaipa cites pages 24-25 of its summary judgment opposition brief (Adv. D.I. 510 (“Yucaipa Opp. Br.”)) and the declaration in support (Adv. D.I. 511) in its entirety.

The communications cited by Yucaipa did not preclude the entry of summary judgment. Yucaipa cites an email dated May 16, 2012—the day before BD/S filed an involuntary petition against the Debtors—in which counsel for BD/S memorialized the prior day's “discussions” between BD/S and Yucaipa concerning ratable treatment. (*See* Yucaipa Opp. Br. at 24-25 (citing Adv. D.I. 464 (“Singer Decl.”) at Exhs. 68, 70 at 3-4 (¶¶ 4,6) (filed under seal)). Yucaipa claims that a draft agreement circulated by BD/S's counsel in the May 16, 2012 email memorialized an earlier agreement to accept equal and ratable treatment. (*Id.* at 24 (citing Ex. 70)). As set forth to in the accompanying declarations, however, there was no such “agreement [] reached on these issues, in principle or otherwise.” (*See* Adv. D.I. 801 (“Harris Decl.”) ¶ 5). As the Trustee correctly points out, the documents identified by Yucaipa in support of its contention that it agreed to ratable

treatment consist only of attorney discussions and do not demonstrate a genuine issue as to the fact that Yucaipa had demanded a premium. *See In re Revstone Indus., LLC*, 2019 WL 2929328, at *4 (D. Del. 2019) *aff'd* 834 F. App'x 695 (3d Cir. 2020) (denying objection because Bankruptcy Court “did not weigh any evidence or determine the truth of any matter,” rather it “determined that Defendant failed to present anything in rebuttal to the Motions other than conclusory, self-serving, and hedged statements unsupported by any evidence”). Yucaipa failed to put forth concrete evidence that it offered ratable treatment to the Lenders, thus the Trustee's evidence to the contrary stands undisputed.

Second, Yucaipa objects to the finding at page 30 of the Opinion that, in August 2009, Yucaipa had the option, entirely in its own discretion, to make a Capital Contribution either in the form of \$57 million in cash or “as an exchange [of Yucaipa's newly acquired Term Loans] for equity interests” in Allied, but that Yucaipa did neither, which constituted a breach of contract. (*See* Opinion at 30). Yucaipa asserts that the Bankruptcy Court then made the “logical” leap—without citing any evidence—that in August 2009, Yucaipa indisputably would have elected to contribute cash. The Bankruptcy Court found “It is illogical to think that Yucaipa would exchange its Term Loans in favor of worthless equity in Allied.” (*Id.*) According to Yucaipa, “[t]his factual conclusion is not only unsupported, it is itself illogical” and “ignored Yucaipa's argument that it would have been absurd for it to have agreed in August 2009 to pay \$43 million to ComVest to acquire \$145.1 million (principal face value) of debt, and then ten days later pay a massive premium of an *additional* \$57.4 million to Allied in cash, instead of simply converting half of the discounted debt to Allied equity.” (D.I. 1-2 at 11) (citing Yucaipa Opp. Br. at 5). In other words, Yucaipa argues, “the Bankruptcy Court erroneously concluded that the only “logical” course for Yucaipa in August 2009 would have been to pay *more than double* what ComVest had paid for the same debt six months earlier, even when Allied's outlook continued to decline in the interim.” (*Id.*)

*7 With respect to the finding that Yucaipa had the option to contribute cash or debt in August 2009, the Trustee says this line of argument misses the point, and I agree. Whether it would have made more sense for Yucaipa to contribute Term Loans or equity to Allied on August 31, 2009, has no bearing on the undisputed fact that “Allied received neither.” (Opinion at 30). The Bankruptcy Court measured the Estate's damages not by deciding that it was logical for Yucaipa to elect a cash contribution in August 2009, but by observing that Yucaipa

can no longer contribute its Term Loans. (Opinion at 32-33). Yucaipa failed to contest this dispositive finding.

With respect to the effect of Yucaipa's failure to make a Capital Contribution to Allied, Yucaipa argues that the Bankruptcy Court engaged in "speculation about what would have happened in [a] counterfactual scenario" in which Yucaipa made its Capital Contribution (D.I. 1-2 at 11-12) and objects to the Bankruptcy Court's finding (Opinion at 31) that "Allied was insolvent at the time of the breach" in August 2009. On the next page of the Opinion, the Bankruptcy Court concluded that Yucaipa's failure to contribute \$57.4 million to Allied in August 2009 "ensured" Allied's second bankruptcy nearly three years later. According to Yucaipa, "[t]here is zero evidence to support the Bankruptcy Court's speculation about what would have happened in that counterfactual scenario." (D.I. 1-2 at 11). According to Yucaipa, the evidence cited by Bankruptcy Court in support of this finding—the deposition testimony of the Trustee's damages expert—"directly contradicts the Bankruptcy Court's finding." (*Id.*) The expert testified: "I'm not going to speculate on what would have happened with that cash because there's too many ... variables." (Opinion at 32 n.78).

As the Trustee correctly points out, however, the Opinion reflects that the Bankruptcy Court did not engage in speculation but did the exact opposite — it rejected Yucaipa's expert's speculation that "Allied would have 'burned through' all the money and it would add no value to Allied," had Yucaipa made the Capital Contribution. (Opinion at 31-32). Refusing to engage in such speculation, the Bankruptcy Court made the uncontroversial point that if Allied was already headed toward a second bankruptcy, Yucaipa's failure to make a Capital Contribution did not help Allied avoid that fate. (*Id.* at 32). In any event, the Bankruptcy Court's statement was in the context of discussing the damages to the Estate as a result of Yucaipa's breach of the Capital Contribution Provision. Yucaipa fails to challenge the Bankruptcy Court's key holding that, under settled New York law, the full cash value of the Capital Contribution as a result of Yucaipa's breach is a stable foundation to award damages given that Yucaipa admitted that it breached the FLCA. (*See* B.D.I. 4144 ("2/4/21 Hearing Tr.") at 59:25-60:15 (Yucaipa's Counsel: "[I]n hindsight we know the fourth amendment was *void ab initio*, so when Yucaipa acquired more than the third amendment allowed, that was a breach of the contract. The second breach is what we call the capital contribution provision ... [T]en days after acquiring term loans [Yucaipa] needs to make a capital contribution; undisputed Yucaipa didn't do that. And

again ... in hindsight we know that that was required and it was a breach of the contract in failing to make the capital contribution within ten days."))

Objection C: Opinion at 26-38

Yucaipa objects to several of the Bankruptcy Court's conclusions addressing the breach of contract claim asserted in Lender Claim 2. First, Yucaipa asserts that the Bankruptcy Court erred in concluding that the Litigation Trustee had established as a matter of law and undisputed fact that the Estate and Lenders suffered damages resulting from Yucaipa's breach of the Capital Contribution Provision, and that the appropriate measure of damages was the full amount of the Capital Contribution. (*See* D.I. 1-2 at 12-13). According to Yucaipa, its summary judgment papers demonstrated that the Trustee had no evidence of damages resulting from the alleged breach, and at the very least there was a genuine dispute concerning the fact and amount of any damages, which precludes summary judgment. (*See id.* (citing Adv. D.I. 454 ("Yucaipa Opening Br.") at 27-30; Yucaipa Opp. Br. at 3-11; Adv. D.I. 544 ("Yucaipa Reply Br.") at 17-18)).

*8 Conversely, the Trustee argues there was no "genuine dispute" concerning the fact and amount of damages for Yucaipa's breach of the Capital Contribution Provision. (*See* 9033 Objection at 12). I agree. The Bankruptcy Court correctly applied New York law on this issue, which places the "burden of uncertainty" as to the amount of damages on the wrongdoer. (Opinion at 31). The Bankruptcy Court rejected Yucaipa's expert's "speculative" opinion that Allied "would have 'burned through' all the money" and accepted the reasonable estimate put forth by the Trustee's expert that damages are best measured by the full cash value of the Capital Contribution. (*Id.* at 30-31). Because Yucaipa fails to challenge the Court's application of New York law, its objection must fail. *See In re Green Field Energy Servs., Inc.*, 610 B.R. 760, 771-72 (D. Del. 2019) (denying objection to proposed findings of fact because defendants "ignore [the bankruptcy court's] critical holding and have not objected to it"), *aff'd*, 834 F. App'x 695 (3d Cir. 2020).

Second, Yucaipa asserts that the Bankruptcy Court erred in awarding prejudgment interest on the contract claims. (D.I. 1-2 at 12-13). Yucaipa argues that the Bankruptcy Court determined that prejudgment interest shall accrue "from the date of the breach" of the Capital Contribution provision in August 2009. (Opinion at 33). In analyzing the timeliness of Lender Claim 2, Yucaipa asserts, the Bankruptcy Court erroneously agreed with the Trustee that "Yucaipa

continuously breached” the FLCA through 2013, such that it would be improper to “isolate” the August 2009 breach, and it was therefore “impossible to determine the extent of the breach” or the damages resulting from it until the JCT 363 sale in December 2013. (D.I. 1-2 at 12 (citing Opinion at 42-45)). According to Yucaipa, it cannot simultaneously be true that (a) there was an actionable breach causing the Lenders harm in August 2009 such that prejudgment interest started accruing immediately at that time and (b) the August 2009 breach was not independently actionable because it was part of one “continuous” breach that did not become actionable until December 2013. (*Id.* at 12-13).

As the Trustee correctly points out, however, Yucaipa's argument conflates the Estate's and the Lenders' breach of contract claims as well as the continuous breach doctrine. The Estate's breach of contract claim is based *solely* on Yucaipa's failure to make the Capital Contribution and was actionable when Yucaipa's contribution was due — *i.e.*, August 31, 2009. (Opinion at 32). In contrast, the Court held that the Lenders' breach of contract claim is based on Yucaipa's continuous breaches, which only became actionable upon the JCT 363 sale in December 2013. (*Id.* at 45).

Third, Yucaipa objects to the Bankruptcy Court's conclusion that the Third Amendment's covenant-not-to-sue did not bar Estate Claim 5. (D.I. 1-2 at 13 (citing Opinion at 37-38)). The grant of summary judgment on Estate Claim 5, however, is not before the Court in this proceeding. Rather, the Bankruptcy Court has entered a final Order and Judgment on Estate Claim 5, which is currently on appeal. (*See* D.I. 1-6).¹⁰

Objection D: Opinion at 38-46

*9 [Delaware Code Title 10, Section 8106](#) specifies a three-year limitations period for the Contract-Based Claims:

No action based on a statute, and no action to recover damages caused by an injury unaccompanied with force or resulting indirectly from the act of the defendant shall be brought after the expiration of 3 years from the accruing of the cause of such action.

¹⁰ [Del Code § 8106](#). Yucaipa objects to the Bankruptcy Court's conclusions that Lender Claim 2 was not time-barred.

(*See* Opinion at 38-46). According to Yucaipa, it is undisputed that “Delaware's three-year statute of limitations applies, that Yucaipa's alleged breach of the Capital Contribution happened in August 2009, and that the Lender Complaint was not filed until November 2014.” (*See* D.I. 1-2 at 13 (citing Adv. D.I. 1 ¶ 135)).

In the proceedings below, the Trustee accused Yucaipa of isolating just one of its breaches—its purchase of ComVest's debt and declaration that it was Requisite Lender on August 21, 2009—to bar claims arising from all of its breaches. Based on the “continuous contract” and “continuous breach” doctrines, which are recognized under Delaware law, the Trustee argued that the FLCA granted the Lender reoccurring and continuous rights, that Yucaipa continuously breached the FLCA for 4 years on the pretext that it was Requisite Lender, and that the statute of limitations did not accrue until full damages were ascertainable. According to the Trustee, it was not until the JCT 363 Sale was consummated on December 27, 2013 that the cumulative effect of Yucaipa's breaches could be determined.

As the Bankruptcy Court correctly noted (*see* Opinion at 40-41), while a cause of action for breach of contract generally accrues at the time of breach, Delaware law recognizes exceptions for a “continuous contract” or a “continuous breach.” Under both exceptions, “the statute begins to run only when full damages can be ascertained and recovered.” *See* [In re Burger](#), 125 B.R. 894, 901-02 (Bankr. D. Del. 1991); [Guerrieri v. Cajun Cove Condo. Council](#), 2007 WL 1520039, at *6 (Del. Super. Ct. Apr. 25, 2007) (statute of limitations did not accrue until damages could be ascertained where contract created an ongoing and continuous duty); [Smith v. Mattia](#), 2010 WL 412030, at *4 (Del. Ch. Feb. 1, 2010) (same). Determining the application of these exceptions requires an analysis of “[w]hether the obligations under a contract are continuous or severable” which “turns on the parties’ intent, which may be ascertained through the contract's terms and subject matter, taken together with the pertinent facts and circumstances surrounding its formation.” [Smith](#), 2010 WL 412030, at *4; [Kaplan v. Jackson](#), 1994 WL 45429, at *3 (Del. Super. Ct. Jan. 20, 1994) (same).

Applying this framework, the Bankruptcy Court determined that the FLCA and the Third Amendment was a continuing contract. Specifically, in return for providing hundreds of millions of dollars in loans, the non-Yucaipa Lenders were entitled over time to, among other things:

recurring principal and interest payments; (ii) recurring financial information from the Company and reasonable access to its management; (iii) the right to direct the Agent — through the Requisite Lenders — to exercise certain remedies in the case of an Event of Default; (iv) Capital Contributions in the amount of 50% of Term Loans acquired by Yucaipa; (v) Yucaipa never serving or acting as Requisite Lender; and (vi) Yucaipa never asserting any claims against them, or the Agent, in any way relating to the Credit Agreement or related documents.

***10** (Opinion at 42 (footnotes omitted)). Looking to “contract’s terms and subject matter, taken together with the pertinent facts and circumstances surrounding its formation” to determine the parties’ intent, these contractual rights were designed to ensure the First Lien Lenders were repaid the principal amount of their loans (with the applicable interest) over the duration of the Credit Agreement. Thus it is a “continuous contract,” and the Delaware courts hold that the statute of limitations for breach of a continuous contract does not accrue until “full damages can be ascertained and recovered.” *Bridgestone/Firestone, Inc. v. Cap Gemini America, Inc.*, 2002 WL 1042089, at *7 (Del. Super. Ct. 2002). Here, the extent of monetary damages caused by Yucaipa’s continuous breaches of the FLCA was not ascertainable until December 27, 2013, when JCT purchased substantially all of Allied’s assets for \$135 million — generating only \$53.8 million to Allied’s First Lien Lenders, who held about \$244 million of loans.

Yucaipa asserts that the Bankruptcy Court erred in applying the “continuous breach” doctrine, as the Third Circuit has held that the doctrine is a narrow exception to the statute of limitations and does not apply where, as here, the complaint alleges a discrete breach of a specific provision of a contract that was actionable at the moment of the breach. (D.I. 1-2, at 14). Yucaipa argues that the Bankruptcy Court departed from binding case law in Delaware and the Third Circuit, misconstrued the contract, and ignored the Trustee’s specific theory of breach. (See *id.* (citing Yucaipa Opening Br. at

19-26; Yucaipa Reply Br. at 2-17; Estate Action, Adv. D.I. 819; Adv. D.I. 558 (Yucaipa’s supplemental post-hearing letter brief)). Yucaipa cites [Norman v. Elkin](#), 961 F.3d 275, 286 (3d Cir. 2020), which, according to Yucaipa, explains that the “continuous breach” doctrine is a “narrow” exception to the statute of limitations that applies “only in unusual circumstances.” [Id.](#) at 286.

In *Norman*, majority shareholder Elkin and minority shareholder Norman founded a company (“USM”) for the purpose of acquiring certain FCC licenses. Elkin later caused USM to enter into a Shareholder Loan Agreement (“SLA”) pursuant to which “USM agreed to treat any amount Elkin contributed above his capital requirement as a loan.” [Id.](#) at 279. Elkin neither informed Norman about the SLA nor sought his approval for it, and purportedly lent USM in excess of \$600,000. *Id.* Thereafter, Elkin caused USM to sell certain licenses, and in a series of distributions effectuated by Elkin from 2000 to 2002, USM paid Elkin \$615,026 from the proceeds of the license sales. Norman received nothing and eventually brought an action against Elkin. Following years of litigation, Norman’s continuous breach argument was rejected.

On appeal, the Third Circuit noted that, under Delaware law, the continuing breach doctrine is narrow and typically is applied only in “unusual situations.” *Id.* at 286. Norman’s breach of contract claim did not present such an “unusual situation,” as each individual distribution Elkin made to himself constituted, at least in theory, a discrete and readily determinable violation of Norman’s rights as a 25% equity-holder. *Id.* at 286. The Court rejected Norman’s contention that he had asserted an overarching and continuous breach because his damages from each individual distribution were “inherent[ly] contingen[t]” on the SLA being invalidated and could not be calculated until that time. The Court found that the SLA’s validity and Elkin’s purported failure to make proper distributions were adjudicated simultaneously, as the question of the SLA’s validity arose in connection with Elkin’s defense to Norman’s breach of contract claim—not as a condition precedent to the claim. The Court therefore rejected what it described as “Norman’s unsupported attempt to dramatically expand the ‘narrow’ continuous breach doctrine such that it reaches defenses to claims rather than true contingencies.” *Id.* at 286.

***11** In my view, the facts of *Norman*—distributions under a contested loan agreement—differ significantly from those

at issue here. While there was a discrete and readily determinable breach here, that breach led to an unforeseeable chain of events and with serious consequences for the Debtor and damages that could not have been known (or sought) at the time of the breach, and, which in my view, constitute unusual circumstances under *Norman*. The initial breach—the purchase of ComVest's debt in 2009—was just an initial trigger which enabled Yucaipa to continuously breach the FLCA in various ways, including by (i) causing Allied to cease making principal or interest payments from that point onward; (ii) blocking Lenders from the Company's financial information and access to management; (iii) preventing any restructuring dialogue among the Lenders; (iv) preventing Lenders from exercising remedies for the Company's ongoing Events of Defaults; (v) routinely asserting claims against the Agent and Lenders in contravention of the express covenant not to sue; and (vi) demanding JCT pay Yucaipa, and no other Lender, a premium of \$1.15 for each dollar of its First Lien Debt.

As the Trustee points out, none of these later, continuous breaches was committed by Yucaipa when it executed the void Fourth Amendment or proclaimed that it was the Requisite Lender in 2009. None was an effect caused by execution of the Fourth Amendment or assumption of Requisite Lender status. As purported Requisite Lender, Yucaipa could still have (1) allowed Allied to make principal and interest payments, (2) granted Lenders access to the Company's financial information and management, (3) permitted restructuring dialogue among the Lenders, (4) allowed Lenders to exercise remedies for Allied's ongoing Events of Defaults, (5) not asserted claims against the Agent and Lenders in contravention of Yucaipa's express covenant not to sue, and (6) not demanded JCT pay Yucaipa, and no other Lender, a premium of \$1.15 for each dollar of its debt. But under these circumstances, where continuous and additional breaches were committed, Lenders were not required to bring piecemeal litigation and it would have been inefficient to have done so. Rather, the “continuous contract” and “continuous breach” exceptions should apply, and the statute of limitations does not begin to run until their full damages could be ascertained and recovered. Here, the extent of monetary damages caused by Yucaipa's continuous breaches of the First Lien Credit Agreement was not ascertainable until December 27, 2013, when JCT purchased substantially all of Allied's assets for \$135 million—generating only \$53.8 million to the Company's First Lien Lenders, who held about \$244 million of loans

The Bankruptcy Court was persuaded by  [*Branin v Stein Roe Investment Counsel LLC*, 2015 WL 4710321, at *7 \(Del. Ch. July 31, 2015\)](#). In that case, the Chancery Court held the defendant-employer was in continuous breach of an operating agreement by declining (at least 5 times) to indemnify the plaintiff-employee.  [*Id.* at *2](#). The *Branin* court ruled that the statute of limitations was “appropriately suspended for the period during which [plaintiff's] liabilities grew,” and it observed that requiring plaintiff “to sue continually to enforce his indemnification right would have been inefficient.”  [*Id.* at *7](#).

The Bankruptcy Court was also persuaded by  [*In re Burger*, 125 B.R. 894 \(Bankr. D. Del. 1991\)](#). In that case, the parties entered into a service contract where Burger would purchase a herd of cattle with the investor's money, manage, maintain and expand the herd as well as improve the quality of the herd.  [*Id.* at 898](#). The investor agreed to pay all feed and upkeep expenses while Burger would pay over all milk revenues and any sale proceeds from bulls or cull cows. *Id.* The investor and Burger also executed a seven-year lease agreement, wherein the investor would pay monthly rent for keeping the herd at Burger's ranch. *Id.* At the end of the seven-year period, the investor and Burger would liquidate the herd. *Id.* In *Burger*, the court held that the statute of limitations for the investor's claims against a farm manager's breach of contract did not accrue when he first allegedly breached the contract (in 1981).  [*Id.* at 901](#). The court further held that there was a continuous contract for a “fixed seven-year period where full and complete damages could not be determined by either party until the end of that time.”  [*Id.* at 902](#). The *Burger* court stated:

*12 Moreover, any claim by the Investors for damages necessarily relies on the liquidation of the herd which, under the terms of the contract, was scheduled to take place on or about September 1, 1988. Furthermore, this contract was continuously acknowledged by both parties throughout the seven-year period by the various payments made between the parties. These payments

toll the statute because a new promise to pay is implied therefrom.

Id. In reaching its conclusion, the Bankruptcy Court considered the facts at issue here and those in *Burger* to be remarkably similar:

Here, the Lenders invested in Allied, pursuant to the FLCA, just as the cattle-investor paid for the initial herd of cattle. As part of that transaction, the Lenders expected to receive financial information, interest and principal payments, among other things. If BD/S had to run into court at each and every breach – it would have been impossible to adjudicate let alone assess damages. Here, the Court agrees that the failure to pay the Capital Contribution is just one of the breaches of the FLCA and the Third Amendment made by Yucaipa and that the parties had a continuous contract that Yucaipa continuously breached. Furthermore, the Court finds that it would have been impossible to determine the extent of the breach until such time as the JCT 363 Sale, which determined the bulk of the damages. In other words, like in *Burger*, the full and complete damages could not be determined until the JCT 363 Sale.

(Opinion at 45). I agree with the Bankruptcy Court's analysis and that the breach considered by the *Burger* court more closely matches this case than that considered in *Norman*.

The Bankruptcy Court properly considered (i) the continuing nature of the Lenders' rights under the FLCA; (ii) an admission by Derex Walker (of Yucaipa) that there had been multiple breaches of the FLCA dating back to August 2009; (iii) the fact that the Lenders' damages were not ascertainable until December 27, 2013; and (iv) relevant case law supporting the Trustee's argument. (See Opinion at 41-45). The Court therefore adopts the Court's well-reasoned finding that the continuous breach doctrine applies here as a matter of law.

Objection E: Order at 2

Yucaipa objects to the Bankruptcy Court's finding that “this is a core proceeding, pursuant to [28 U.S.C. § 157\(b\)](#)” and “this Court has the judicial power to enter a final order.” (D.I. 1-2 at 14). As explained above, the Court agrees and has accordingly undertaken this *de novo* review of the proposed FFCL relating to the Bankruptcy Court's grant of summary judgment to the Trustee on Lender Claim 2.

IV. CONCLUSION

Based on the Bankruptcy Court's own prior determination, and the parties' apparent agreement, I do not adopt any holding in the Opinion or Order that (i) Lender Claim 2 “is a core proceeding, pursuant to [28 U.S.C. § 157\(b\)](#)” or that Lender Claim 2 is a claim for which “this [Bankruptcy] Court has the judicial power to enter a final order.” I overrule Yucaipa's remaining Objections and adopt the remaining proposed FFCL solely with respect to Lender Claim 2.

The Court will issue a separate Order consistent with this Memorandum Opinion.

All Citations

Slip Copy, 2022 WL 2666888

Footnotes

- 1 Unless otherwise noted, “Adv. D.I. —” shall refer to the docket of the Lender Action, Adv. Proc. No. 14-50971-CSS. The docket of the Chapter 11 cases is cited as “B.D.I.—.” Capitalized terms not otherwise defined shall have the meanings ascribed to them in the Opinion.

- 2 The Opinion and Order constituted the Bankruptcy Court’s findings of fact and conclusions of law as required by Bankruptcy [Rule 7052](#). Bankruptcy [Rule 9033](#) provides that, in any proceeding in which the Bankruptcy Court has issued proposed findings of fact and conclusions of law, this Court shall review *de novo* “any portion of the bankruptcy judge’s findings of fact or conclusions of law to which specific written objection has been made ...” [FED. R. BANKR. P. 9033](#).

- 3 As it is written primarily for the parties, this Memorandum Opinion sets forth only the procedural background relevant to this proceeding.

- 4 The Bankruptcy Court previously held that the Delaware statute of limitations applies as it related to the FLCA and its various amendments. (See B.D.I. 1068 (“2/27/13 Hearing Tr.”) at 108:1-17 (hearing on the motion to dismiss Yucaipa’s cross-claims)).

- 5 Yucaipa’s Objections do not contest the Court’s jurisdiction to enter final orders or judgment where summary judgment was granted *in its favor*.

- 6 Because this Court’s standard of review is *de novo*, any error in this regard is harmless. See Exec.  [Benefits Ins. Agency v. Arkinson](#), 573 U.S. 25, 39-40 (2014) (District Court’s *de novo* review of the Bankruptcy Court’s order granting summary judgment and entry of its own judgment cured any error in the Bankruptcy Court’s earlier entry of judgment).

- 7 See also [Leibowitz v. Kalamata Capital Grp. LLC](#), 625 B.R. 390, 398 n.5 (N.D. Ill. 2021) (“[T]he court is not stating findings of fact or conclusions of law because Civil [Rule 52\(a\)\(3\)](#), made applicable by Bankruptcy [Rule 7052](#), does not so require when ruling on a motion for summary judgment ... [T]his Memorandum Decision constitutes the court’s statement on the record for granting or denying the Motions.”); [Devices Liquidation Tr. v. KMT Wireless, LLC](#), 588 B.R. 661, 662 (Bankr. E.D.N.Y. 2018) (“The Court is not stating findings of facts and conclusions of law as [Bankruptcy [Rule](#)] 7052 ... does not so require in ruling on a motion for summary judgment.”);  [Sheet Metal Workers Nat’l Pension Fund v. Kern](#), 542 B.R. 87, 90 (Bankr. E.D.N.Y. 2017) (same).

- 8 Because review of the proposed FFCL is *de novo*, I need not address whether Yucaipa otherwise consented to the Bankruptcy Court’s authority to enter a final order on Lender Claim 2. (See D.I. 1-2 at 3-4).

- 9 Yucaipa contends these examples “are merely illustrative, not exhaustive” and Yucaipa purports to “reserve its rights to challenge every erroneous factual and/or evidentiary ruling in the Opinion.” (D.I. 1-2 at 10). The docket reflects that Yucaipa has caused the proposed FOFCOL and its 9033 Objections to be transmitted to this Court for *de novo* review, and Yucaipa had the burden of submitting “timely and specific[]” objections for the Court’s review. See  [28 U.S.C. § 157\(c\)\(1\)](#). The Court therefore considers only the specific objections asserted by Yucaipa in its 9033 Objections.

- 10 Assuming, arguendo, however, that the Bankruptcy Court’s conclusion has any bearing on Lender Claim 2, the Court finds no error. Yucaipa argues that its summary judgment papers demonstrated that the covenant-not-to-sue expressly bars Allied (and thus the Litigation Trustee, who now stands in Allied’s shoes as to Estate Claim 5) from asserting claims against Yucaipa premised on any “omission” with respect to the Capital Contribution, and the only potentially relevant omission in connection with the Capital Contribution was Yucaipa’s failure to make it. (D.I. 1-2 at 13 (citing Yucaipa Opening Br. at 31-35; Yucaipa Reply Br. at 18-2).

Yucaipa contends that the Bankruptcy Court improperly referred to other hypothetical “omissions” that could apply to the covenant-not-to-sue at issue in order to reject Yucaipa's interpretation of the provision. (See D.I. 1-2 at 13 (citing Opinion at 37-38 & n.96)). As the Trustee correctly points out, however, the Bankruptcy Court's holding was that the covenant-not-to-sue clearly and unambiguously bars Allied from suing over an “omission” by Yucaipa “*only* ... when Yucaipa *makes* a Capital Contribution of its Term Loans, which Yucaipa did not do.” (Opinion at 38 (emphasis in original)). Yucaipa does not challenge the Bankruptcy Court's understanding of the plain meaning of this provision, on which its conclusions rely, and the Court finds no reason to disturb the Bankruptcy Court's conclusion. See [*In re Green Field Energy Servs., Inc.*, 610 B.R. at 771-72.](#)

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Richmond Division

In re Toys “R” Us, Inc., et al.¹
Debtors.

Case No. 17-34665-KLP
Chapter 11
Jointly Administered

TRU Creditor Litigation Trust,
Plaintiff,

v.

Adv. Pro. No. 20-03038-KLP

David A. Brandon, Paul E. Raether,
Nathaniel H. Taylor, Joseph Macnow,
Wendy A. Silverstein, Richard Goodman,
Michael Short, Richard Barry, David A. Brandon,
Joshua Bekenstein, and Matthew S. Levin,
Defendants.

MEMORANDUM OPINION

Before the Court is the Defendants’ Motion for Summary Judgment² (the “Motion”). Plaintiff, TRU Creditor Litigation Trust (the “Trust”), commenced this suit against Defendants, former directors and officers of Toys “R” Us, alleging various breaches of fiduciary duty, fraudulent misrepresentation and concealment, negligent misrepresentation and concealment, and negligence. In the Motion, the Defendants contend that the suit is barred by the law of the case, estoppel principles, contractual mandates, and insufficient evidence. In response, the Trust asserts that the Defendants are not entitled to summary judgment because they have failed to apply the appropriate standard of review,

¹ The Debtors in these cases, along with the last four digits of each Debtor’s tax identification number, are set forth in the Order (I) Directing Joint Administration of Chapter 11 Cases and (II) Granting Related Relief. ECF 78. All references to “ECF” are to docket entries in the lead case unless otherwise noted. References to the docket in this adversary proceeding are prefaced by “AP ECF.”

²At the inception of this adversary proceeding, the Defendants filed a motion to dismiss the complaint. AP ECF 2. The Court deferred ruling on that motion, stating that it would consider the motion to be a motion for summary judgment that would be considered at the appropriate time. After the initial motion for dismissal was filed, the Trust amended the Complaint, and thereafter the Defendants filed the instant Motion, which the Court considers to be an expanded restatement of the original motion to dismiss. Thus, because this Memorandum Opinion resolves issues raised in the motion to dismiss as well and because the original Complaint was amended twice after the motion to dismiss was filed, the Court finds the motion to dismiss to be moot. *See Pettaway v. Nat’l Recovery Sys.*, 955 F.3d 299, 303-04 (2d. Cir. 2020).

failed to apply the correct legal principles, failed to properly address the Trust's theories of recovery, and failed to acknowledge the Trust's evidence.

After considering the applicable statutory and procedural authority, the case law, the pleadings, and the arguments of counsel, the Court has determined that the Motion should be granted in part and denied in part. This Memorandum Opinion sets forth the Court's findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.³

Background

On September 18 and 19, 2017, Toys “R” Us, Inc. and twenty-four affiliated entities (collectively, “TRU” or “the Debtors”) filed voluntary Chapter 11 petitions for relief in the United States Bankruptcy Court for the Eastern District of Virginia (the “Court” or “Bankruptcy Court”). The cases were jointly administered pursuant to Bankruptcy Rule 1015(b), Fed. R. Bankr. P. 1015(b), the lead case being *In re: Toys R Us, Inc., et al.*, Case No. 17-34665-KLP.⁴ At the time of the bankruptcy filing, the Debtors and other related non-filing entities conducted the business of selling toys, childcare items, and related products on a global basis.

On March 22, 2018, the Court entered an Order authorizing TRU to wind down U.S. operations, authorizing U.S. store closings, establishing administrative claims procedures, and granting related relief.⁵ On July 17, 2018, in connection with its wind-down, TRU filed with the Court a settlement agreement (the “Settlement Agreement”) by and among multiple parties. The Settlement Agreement resolved numerous issues relating to the

³ Findings of fact shall be construed as conclusions of law and conclusions of law shall be construed as findings of fact when appropriate. *See* Fed. R. Bankr. P. 7052. *See also infra* note 16.

⁴ ECF 78.

⁵ ECF 2344.

liquidation of TRU's U.S. businesses.⁶ The parties to the Settlement Agreement agreed to release all claims against each other. Further, the Settlement Agreement provided that a Non-Released Claims Trust (the "Trust") would be established for the purpose of administering all remaining non-released claims, including claims held by TRU and its creditors against TRU's directors and officers. The Court entered an order approving the Settlement Agreement on August 8, 2018.⁷

On December 17, 2018, the Bankruptcy Court confirmed the Third Amended Chapter 11 Plan of TRU (the "Plan").⁸ On April 30, 2019, the Debtors filed the Non-Released Claims Trust Agreement.⁹ Section 2.3(a) of that agreement provides in part that:

The TRU Creditor Litigation Trust shall be the successor-in-interest to the Debtors with respect to any Non-Released Claims that were or could have been commenced or asserted by, or on behalf of, any of the Debtors or their estates prior to the applicable Effective Date, shall be deemed substituted for each such Debtor as the party in any such litigation and shall have the right to proceed in the name, right and stead of the Debtors with respect to all such Non-Released Claims.

In furtherance of its duty to pursue the non-released claims, the Trust initiated this litigation against the Defendants. It originally filed its complaint (the "Complaint") in the Supreme Court of the State of New York, County of New York.¹⁰ The case was subsequently removed to the U.S. District Court for the Southern District of New York and then transferred, upon Defendants' motion, to the District Court for the Eastern District of

⁶ ECF 3814.

⁷ ECF 4083.

⁸ The Court entered two confirmation orders, one for the so-called Toys Delaware and Geoffrey Debtors and one for the so-called Taj and TRU, Inc. Debtors. An order entered on November 21, 2018 [Docket No. 5746] confirmed the Fourth Amended Chapter 11 Plan of the Toys Delaware and Geoffrey Debtors and an order entered on December 17, 2018 [Docket No. 5979] confirmed the Third Amended Chapter 11 Plan of the Taj and TRU, Inc. Debtors.

⁹ ECF 6925.

¹⁰ See AP ECF 10.

Virginia (the “District Court”). The District Court then referred the case to this Court by Order dated May 5, 2020.¹¹

The Complaint, as amended on April 30, 2021,¹² asserts breach of fiduciary duty claims on behalf of TRU and direct claims on behalf of TRU’s trade vendors against Defendants. Specifically, the Trust alleges that Defendants breached their fiduciary duties to TRU by (i) taking on DIP financing at the start of the Bankruptcy Proceeding¹³ (Complaint ¶¶ 169-201, 226-232); (ii) authorizing pre-petition retention payments to 114 company executives before the commencement of the Bankruptcy Proceeding (*Id.* ¶¶ 56-89, 213-217); and (iii) authorizing the payment of advisory fees to TRU’s private equity shareholders from the fourth quarter of 2014 through the first quarter of 2017. (*Id.* ¶¶ 45-55, 207-225). These claims (the “Fiduciary Breach Claims”) comprise Counts 1-4 of the Complaint.

The Trust further alleges that to induce trade vendors to ship goods and provide services to TRU on credit after the commencement of the bankruptcy cases, the Defendants misrepresented facts concerning TRU’s ability to make payments for those goods and services. The Trust alleges that because of these misrepresentations, goods and services ordered by TRU on credit from trade vendors were delivered to TRU but were not paid for during the period from December 2017 through March 14, 2018. The Trust claims that the total amount due to vendors for those goods exceeds \$600 million (*Id.* ¶¶ 90-135). It also alleges that TRU continued its misrepresentations to trade vendors, both fraudulently and negligently concealing and omitting material facts concerning TRU’s ability to pay for goods

¹¹ Case No. 3:20-cv-00311-DJN, ECF 15. *See also* AP ECF 1.

¹² AP ECF 146.

and services ordered on credit, upon which misrepresentations the trade vendors reasonably relied. (*Id.* ¶¶ 136-168, 233-265). These claims are referred to as the “Vendor Claims.”

On December 13, 2021, the Defendants filed the Motion,¹⁴ to which the Trust filed a lengthy opposition. The matter has been extensively briefed and oral arguments were held on February 23, 2022.

Jurisdiction

The Court has subject matter jurisdiction over this Adversary Proceeding pursuant to 28 U.S.C. §§ 157(a) and 1334 and the General Order of Reference from the United States District Court for the Eastern District of Virginia dated August 15, 1984. The District Court has determined that none of the counts set forth in the Complaint constitute core proceedings under 28 U.S.C. § 157(b)(2) and that the Trust is entitled to a jury trial on all counts; however, the District Court has not withdrawn the reference pursuant to 28 U.S.C. § 157(d), pending the parties’ decision on whether to jointly consent to having the trial conducted by the Bankruptcy Court.^{15,16} Venue is appropriate in this Court pursuant to 28 U.S.C. § 1408.

Standard of Review

Rule 56 of the Federal Rules of Civil Procedure, Fed. R. Civ. P. 56, made applicable by Rule 7056 of the Federal Rules of Bankruptcy Procedure, Fed. R. Bankr. P. 7056, governs summary judgment in an adversary proceeding. Summary judgment is proper under Rule 56(c), “if the pleadings, depositions, answers to interrogatories, and admissions on file,

¹⁴AP ECF 315.

¹⁵ The District Court has scheduled a status conference on July 8, 2022, at which “the Court will discuss the parties’ positions on whether they each consent to Bankruptcy Court jurisdiction for the trial of any claims that survive summary judgment or if a party instead will move to withdraw the reference to the Bankruptcy Court.” Case No. 3:20-cv-00311-DJN, ECF 63.

¹⁶ Should the reference be withdrawn before entry of this Memorandum Opinion and accompanying Order, or should it otherwise be determined that this Court does not have the authority to issue a final order in this proceeding, this Memorandum Opinion shall constitute proposed findings of fact and conclusions of law pursuant to 28 U.S.C. §157(e)(1).

together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). A moving party, in this case the Defendants, has the burden of showing that there is no genuine issue of material fact. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986). In addition, “reasonable inferences should be drawn in favor of the nonmoving party” and the “court must view the evidence in the light most favorable to the opposing party.” *Tolan v. Cotton*, 572 U.S. 650, 657, 660 (2014) (quotations omitted).

Analysis

I. *Fiduciary Duty Claim Relating to DIP Financing (against Defendants Brandon, Short, Bekenstein, Levin, Raether, Taylor, Macnow and Silverstein)*

Defendants maintain that the Court’s final order approving the DIP financing and finding that the financing was an exercise of the Debtor’s prudent business judgment consistent with their fiduciary duties is the binding law in this case. On October 24, 2017, over a month after conducting first day hearings and approving DIP financing on an interim basis, the Court held a final hearing on the Debtors’ motion for authorization to obtain postpetition financing. No party opposed the proposed financing or its terms, and it was approved by the Court on a final basis. The Court subsequently entered an order (the “Final DIP Order”) authorizing the Debtors to access the financing on the terms set forth therein.¹⁷

The Final DIP Order concluded that the financing was “necessary and vital to the preservation and maintenance of the going concern values of the DIP Loan Parties and to a successful reorganization”¹⁸ The Final DIP Order also found that the terms of the financing were “fair and reasonable, reflect the DIP Loan Parties’ exercise of prudent

¹⁷ ECF 711.

¹⁸ ECF 711 ¶5(b).

business judgment consistent with their fiduciary duties and constitute reasonably equivalent value and fair consideration.”¹⁹

The Defendants emphasize that the Final DIP Order specifically provides that it “shall be binding upon all parties in interest in these Chapter 11 Cases, including . . . any . . . fiduciary appointed as a legal representative of any of the Debtors or with respect to the property of the estate of any of the Debtors.”²⁰ According to the Defendants, the Trust, as the successor in interest to the Debtors in connection with the claims asserted in the Complaint, is included and, therefore, bound by this language. The Final DIP Order was not challenged or appealed.

In support of their position, Defendants cite the case of *LNV Corp. v. Ad Hoc Group of Second Lien Creditors (In re La Paloma Generating Co.)*, No.16-12700 (JTD), 2020 WL 224569 (Bankr. D. Del. Jan. 13, 2020), for the proposition that the law of the case doctrine bars the relitigation of matters already decided. In *La Paloma*, the court stated that the “doctrine applies to factual findings made in a main bankruptcy proceeding and is binding on parties to a subsequent adversary proceeding.” *Id.* at *3. Defendants argue that the Court’s factual finding that they, on behalf of the Debtors, exercised prudent business judgment consistent with their fiduciary duties has been decided and can no longer be challenged.

In addition, the Defendants assert that the Trust should be estopped from arguing that the DIP financing was improper after its nominal predecessor, the Official Committee of Unsecured Creditors (the “UCC”), previously argued in favor of granting its approval. IN support, among other cases, the Defendants cite *Ryan, Inc. v. Circuit City Stores, Inc.*, Civil Action No. 3:10CV496–HEH, 2010 WL 4735821, at *5 (E.D. Va. Nov. 15, 2010) (quoting with

¹⁹ ECF 711 ¶5(d).

²⁰ ECF 711 ¶27.

approval *Wheeling-Pittsburgh Steel Corp. v. West Penn Power Co. (In re Wheeling-Pittsburgh Steel Corp.)*, 72 B.R. 845, 850 (Bankr. W.D. Pa. 1987) (“It cannot be supposed that the committee of unsecured creditors, which is duty bound to act in the best interest of unsecured creditors, would support a decision which is inimical to the best interests of the debtor’s estate and unsecured creditors.”).

In response to the Defendants’ contentions, the Trust asserts that the Final DIP Order was interlocutory in nature rather than an appealable final order. The Trust argues that the Court’s plan confirmation orders (the “Confirmation Orders”) and the language establishing the duties and authority of the Trust take precedence over, or supersede, the Final DIP Orders.²¹ And, the Trust points out, the Confirmation Orders expressly preserve the claims assigned to the Trust that it is now asserting against the Defendants.²²

The Trust also argues that the law of the case doctrine does not apply because certain material facts were not before the Court when it approved the DIP financing. In particular, the Trust alleges that the declarations of Defendants Brandon and Short that were provided in support of the financing motion, as well as the pleadings and arguments relying on those declarations, were false and misleading, and omitted important facts. The Trust cites *Smith v. North Carolina*, 528 F.2d 807, 810 (4th Cir. 1975), for the proposition that the existence of this new evidence is sufficient to defeat the operation of the law of the case doctrine.

Finally, the Trust parses the language of the orders approving the DIP financing, claiming that they did not address whether greater value would be preserved by an immediate wind-down but only that the “DIP Loan Parties” exercised prudent business judgment. The Trust maintains that because the Court received no evidence regarding the

²¹ See note 8, *supra*.

²² In both Confirmation Orders, the Court expressly ordered that all claims against the Defendants were preserved, that the Trust had the authority to prosecute those claims without further order from the Court, and that no doctrine of preclusion applied to the claims.

actions that the specific directors took prior to approving the DIP financing, the Court did not actually rule on whether the Defendants complied with their fiduciary duties.

Responding to the Defendants' estoppel defense, the Trust asserts that it is not bound by the positions taken by the UCC (or Mattel, a vendor who assigned its claim to the Trust whom the Defendants also argue is estopped due to its prior stance) because it is not the UCC's (or Mattel's) successor but rather is the successor to the Toys "R" Us corporations. According to the Trust, because those entities, the Toys Delaware and Geoffrey Debtors and the Taj and TRU, Inc. Debtors, would not be estopped from asserting claims against the Defendants for breaching their fiduciary duties to the debtor corporations, neither would the Trust.

In the first step of its analysis, the Court must determine whether the Final DIP Order was an interlocutory rather than an appealable final order. On this point, it is undisputed that the Final DIP Order was not appealed, nor was leave to appeal sought, within the allowable 14-day appeal period after October 24, 2017, its date of entry.²³

Courts in our jurisdiction, and elsewhere, recognize that "[i]n the bankruptcy context, the concept of finality 'has traditionally been applied in a more pragmatic and less technical way . . . than in other situations.'" *First Owners' Ass'n of Forty Six Hundred v. Gordon Props, LLC*, 470 B.R. 364, 369 (E.D. Va. 2012), (quoting *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1009 (4th Cir.1986)).²⁴ This is because bankruptcy cases typically consist of various

²³ Rule 8002(a)(1) of the Federal Rules of Bankruptcy Procedure, Fed. R. Bankr. P. 8002(a)(1), provides that "a notice of appeal must be filed with the bankruptcy clerk within 14 days after entry of the judgment, order, or decree being appealed." If an appeal is not filed in a timely fashion, "the ability to appeal is lost, and the order, judgment, or decree becomes final." 10 Collier on Bankruptcy ¶8002.01 (16th ed.).

²⁴ As the Fourth Circuit stated in *Robins*, "[t]he special or unique reason for this relaxed rule of appealability in bankruptcy is that '[b]ankruptcy cases frequently involve protracted proceedings with many parties participating. To avoid the waste of time and resources that might result from reviewing discrete portions of the action only after a plan of reorganization is approved, courts have permitted appellate review of orders that in other contexts might be considered interlocutory.'" *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1009 (quoting *In Re Amatex*, 755 F.2d 1034, 1039 (3d Cir. 1985)).

contested matters, motions, applications, adversary proceedings and other sub-issues that must be disposed of by court order during the pendency of, and after, the underlying lead bankruptcy cases. To address the need for finality of certain issues in the context of the larger case that may remain pending for months if not years, courts, including the Fourth Circuit Court of Appeals, have held that orders in a bankruptcy case “may be immediately appealed if they finally dispose of discrete disputes within the larger case.” *See Gold v. Guberman (In re Computer Learning Centers, Inc.)*, 407 F.3d 656, 660 (4th Cir.2005) (quoting *In re Saco Local Dev. Corp.*, 711 F.2d 441, 444 (1st Cir.1983)).

Section 364(e) of the Bankruptcy Code provides that a reversal on timely appeal of an order authorizing the extension of postpetition credit to a debtor in possession “does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.” 11 U.S.C. § 364(e). Congress, when it enacted § 364(e), recognized that parties, in particular those extending postpetition credit to debtors in bankruptcy, should be entitled to rely on the approval of the bankruptcy court when disbursing loan proceeds to a debtor in bankruptcy. Since this provision protects a lender who relies upon the bankruptcy court’s order when extending credit *before* the order becomes final (and even while an appeal is pending), it is difficult to envision that finality would not be afforded *after* the 14-day appeal period has run. Moreover, § 364(e) suggests that the immediate, timely appeal of an order authorizing debtor-in-possession financing is necessary to avoid its finality, since the provision would be unnecessary if Congress had intended that finality does not occur until a confirmation order is entered. Instead, the language of the statute contemplates that an appeal would stem from the “authorization under [§ 364] to

obtain credit or incur debt,” in this case the Final DIP Order, rather than a subsequent confirmation order that may be entered months or years later, if at all.

The Trust’s position, that the Final DIP Order was interlocutory and only became final upon entry of the Confirmation Orders, disregards the intent of Congress and Fourth Circuit precedent that together compel the conclusion that a bankruptcy court order approving postpetition debtor-in-possession financing on a permanent basis should be considered final and subject to immediate appeal.²⁵ The Final DIP Order finally disposed of a discrete issue by authorizing and establishing the terms of the Debtors’ postpetition debtor-in-possession financing. Nothing in the Final DIP Order indicates that it was intended to be anything other than the granting of final approval of the DIP financing or that its finality was contingent on entry of a confirmation order. Accordingly, the Court finds that the Final DIP Order was a final and not an interlocutory order. Having not been timely challenged or appealed, it remains final.²⁶

In the Final DIP Order, the Court found as a matter of fact that the DIP Financing was an exercise of the Debtors’ “prudent business judgment consistent with [their] fiduciary duties.” The Court also ordered that its provisions “shall be binding upon all parties in interest in these Chapter 11 Cases, including, without limitation . . . the Debtors and their respective successors or assigns . . . or any other fiduciary appointed as a legal representative of any of the Debtors or with respect to the property of the estate of any of the

²⁵ Final approval of the DIP financing did not occur until the Court entered the Final DIP Order. ECF 711. The order approving interim DIP financing in connection with first day hearings was intended to be temporary in order to provide parties with an opportunity to educate themselves, whether through discovery or otherwise, on the terms, conditions, and feasibility of the proposed financing.

²⁶ The Trust’s reliance on *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502 (2015), is misplaced. *Bullard* dealt exclusively with chapter 13 plan confirmation, did not address debtor-in-possession financing, and has no bearing on this case other than to affirm that “orders in bankruptcy cases [are] immediately appealable ‘if they finally dispose of discrete disputes within the larger case.’” 575 U. S. at 501 (quoting *Howard Delivery Service, Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 657, n.3 (2006)). In this case, the Final DIP Order “altered the status quo and fixed the rights and obligations of the parties” *Bullard*, 575 U.S. at 502. Among other provisions, the Final DIP Order permitted secured parties’ liens to be primed to enable the Debtors to obtain postpetition financing on a superpriority basis.

Debtors.” Defendants assert these findings are “the law of the case” that neither have been nor could be altered by subsequent orders. The Trust counters that the law of the case doctrine doesn’t apply because the Defendants misrepresented the facts and omitted important evidence in connection with the Court’s approval of the financing.

The District Court recently, and extensively, discussed the law of the case doctrine:

Under the law of the case doctrine, “when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent states in the same case.” *TFWS, Inc. v. Franchot*, 572 F.3d 186, 191 (4th Cir. 2009); *Sejman v. Warner-Lambert Co.*, 845 F.2d 66, 68 (4th Cir. 1988) (“Accordingly, when a decision of an appellate court establishes ‘the law of the case,’ it must be followed in all subsequent proceedings in the same case in the trial court or on a later appeal”). Unlike *res judicata* or *stare decisis* involving issues of preclusion following a final judgment, the law of the case doctrine “regulates judicial affairs prior to the entry of final judgment.” *Hill v. Pitt & Greene Elec. Membership Corp.*, 161 F.3d 2, 1998 WL 482784, at *1 (4th Cir. 1998) (Table). In short, previous legal rulings apply in subsequent proceedings. *U.S. ex rel. Oberg v. Pennsylvania Higher Educ. Assistance Agency*, 804 F.3d 646, 665-66 (4th Cir. 2015). The doctrine “applies both to questions actually decided as well as to those decided by necessary implication.” *Sejman*, 845 F.2d at 69 (internal quotations omitted); see also *CSX Transportation, Inc. v. S.C. Dep’t of Revenue*, 959 F.3d 622, 629 (4th Cir. 2020) (summarily rejecting an argument raised by the appellee, because the appellate court had answered the same question in previous appeal). This prudential doctrine exists, because “[c]learly, courts could not perform their duties satisfactorily and efficiently if a question once considered and decided were to be litigated anew in the same case upon any and every subsequent appeal.” *Sejman*, 845 F.2d at 68-69 (quoting *Great Western Tel. Co. v. Burnham*, 162 U.S. 339, 344, 16 S.Ct. 850, 40 L.Ed. 991 (1896)). Moreover, “[p]erpetual litigation of any issue — jurisdiction or nonjurisdictional — delays, and therefore threatens to deny, justice.” *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 816 n.5, 108 S.Ct. 2166, 100 L.Ed.2d 811 (1988).

Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Servs U.S., LLC, 469 F.Supp.3d 505, 524-26 (E.D. Va. 2020).

Mar-Bow is consistent with this Court’s finding that the Final DIP Order was a final, appealable order. One could imagine the uncertainty that would ensue if final orders authorizing DIP financing, which typically are entered near the beginning of a bankruptcy

case, were to remain subject to challenge throughout the pendency of the case until confirmation, which usually portends the closing of the bankruptcy case.

The Fourth Circuit has held that application of the law of the case doctrine is not mandatory;²⁷ however, the Supreme Court has cautioned that while a “court has the power to revisit prior decisions of its own . . . as a rule courts should be loathe [sic] to do so in the absence of extraordinary circumstances.” *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 817 (1988).²⁸ This policy, as espoused by the Supreme Court, recognizes the need for parties to be able to rely on the terms of a final order that establishes important rights and duties, such as an order approving the terms of debtor-in-possession financing.

The District Court in *Mar-Bow* observed that the Fourth Circuit recognizes three exceptions to the law of the case doctrine; “(1) a subsequent trial produces substantially different evidence, (2) controlling authority has since made a contrary decision of law applicable to the issue, or (3) the prior decision was clearly erroneous and would work manifest injustice.” 469 F. Supp. 3d at 525 (quoting *TFWS, Inc. v. Franchot*, 572 F.3d 186, 191 (4th Cir. 2009)). The Trust has not offered a subsequent, contrary, and controlling decision of law, nor has it mounted a clearly erroneous/manifest injustice argument; rather, it relies on the first exception—that there is new evidence that “defeats the operation of the law of the case.” *See Smith v. North Carolina*, 528 F.2d at 810.

²⁷ *See CNF Constructors, Inc. v. Donohoe Constr. Co.*, 57 F.3d 395, 398 n.1 (4th Cir. 1995) (quoting *United States v. Houser*, 804 F.2d 565, 567–69 (9th Cir.1986)) that “the law of the case doctrine is discretionary and not mandatory”).

²⁸ Courts would be unable to perform their duties “satisfactorily and efficiently ... if a question once considered and decided ... were to be litigated anew in the same case upon any and every subsequent appeal.” *Sejman v. Warner-Lambert Co.*, 845 F.2d 66, 68–69 (4th Cir. 1988) (quoting *Great Western Tel. Co. v. Burnham*, 162 U.S. 339, 344 (1896)). That being said, “the law of the case doctrine is not an ‘inexorable command’ but rather a prudent judicial response to the public policy favoring an end to litigation.” *Id.* (quoting *White v. Murtha*, 377 F.2d 428 (5th Cir. 1967)). *See also Messenger v. Anderson*, 225 U.S. 436, 444 (1912) (“the phrase ‘law of the case,’ as applied to the effect of previous orders on the later action of the court rendering them in the same case, merely expresses the practice of courts generally to refuse to reopen what has been decided”).

In *In re La Paloma Generating Company, LLC*, a first lien lender moved to dismiss a counterclaim brought by a group of second lien creditors who alleged that the first lien creditor breached the covenants of good faith and fair dealing under an intercreditor agreement by taking certain actions that the second lien creditors claimed intentionally impaired their rights as unsecured creditors. Specifically, the second lien creditors asserted that the first lien creditor excluded them from negotiations with the debtors regarding potentially avoidable liens and coerced the debtors into a settlement “designed to trample on the Second Lien Lenders’ rights under the Intercreditor Agreement.” *Id.* at *2. That settlement had been incorporated in the debtor’s chapter 11 plan and had led to prior litigation in which the bankruptcy court held that the first lien creditor was entitled to enforce its rights under the intercreditor agreement by proceeding against the collateral “however it sees fit” *Id.* The first lien creditor subsequently brought the new adversary proceeding against the second lien creditors to further enforce its rights under the intercreditor agreement, which resulted in the second lien creditors’ counterclaim. The bankruptcy court dismissed the counterclaim. Referring to its earlier decision, the court held that its prior factual findings “are law of the case, and therefore binding.” *Id.*

The law of the case doctrine “bars the re-litigation ‘of matters once decided during the course of a continuing lawsuit.’” *In re Radnor Holdings Corporation*, 564 B.R. 467, 482 (Bankr. D. Del. 2017) (citing *Casey v. Planned Parenthood*, 14 F.3d 848, 856 (3d Cir. 1994)). The doctrine applies to “‘subsequent rulings by the same judge in the same case or a closely related one [and] to rulings by different judges at the same level.’” *Id.* The doctrine applies to factual findings made in a main bankruptcy proceeding and is binding on parties to a subsequent adversary proceeding. *Id.*

2020 WL 224569, at *3. The court dismissed the second lien creditors’ counterclaim after determining that they had “not cited any new facts or law that would render the Court’s prior ruling . . . ‘clearly erroneous.’” *Id.*

The Trust places great reliance on *Smith v. North Carolina*, 528 F.2d 807, 810 (4th Cir. 1975), in which the Fourth Circuit found that the district court did not violate the law of the case doctrine on remand after the Fourth Circuit had vacated the district court's decision to grant habeas corpus relief for lack of sufficient evidence. On remand, the district court, again, granted the requested relief. The circuit court found that additional evidence was before the district court when it granted the same relief despite having been reversed and, therefore, the law of the case (the appellate court's order reversing the district court) was not applicable. Unlike the present case, however, *Smith v. North Carolina* did not involve a second proceeding where a final order establishing the law of the case already existed; rather, it involved a single proceeding that resulted in an appeal, a remand and then another appeal. *Smith v. North Carolina*, therefore, is distinguishable from the present case.

Another case cited by the Trust, *Graves v. Lioi*, 930 F.3d 307, 318 (4th Cir. 2019), also fails to support the Trust's position. In *Graves*, the court rejected the law of the case doctrine in connection with a summary judgment proceeding when the trial court had previously denied a motion to dismiss. The Fourth Circuit affirmed the granting of summary judgment for the defendants after pointing out the procedural differences between motions to dismiss and summary judgment as well as the ability to develop evidence during discovery. *Graves* involved the progression from review of a motion to dismiss to review of a motion for summary judgment where the court was "presented with a different record at a new stage of the case." *Id.* Here, the "case" was limited to resolving the motion to approve the DIP financing and the "progression" was from approval of the financing on an interim basis to approval on a final basis. The interim order approving the DIP financing, like the *Graves* order denying the motion to dismiss, was not the law of the case, because the opportunity to conduct discovery and present additional evidence at the final hearing may have led to a

different result. The final order granting summary judgment in *Graves* is similar to the Final DIP Order. Either order, if not appealed, would establish the law of the case.

Having reviewed the cases cited by both parties, the Court finds that *Paloma* is more applicable to the case at bar. In contrast, *Smith* and *Graves*, both non-bankruptcy cases, are easily distinguishable.

The Debtors commenced their cases on September 19, 2017. On that same day, the Debtors filed their motion seeking interim and final authority to obtain postpetition financing (the “DIP Financing Motion”).²⁹ During a hearing conducted later that day, the Court granted the DIP Financing Motion on an interim basis and scheduled a final hearing for October 10, 2017.³⁰ The Interim DIP Financing Order was entered on September 20, 2017.³¹

The Interim DIP Financing Order included various factual findings including that the incurrence of indebtedness was “necessary and vital to the preservation and maintenance of the going concern values of the DIP Loan Parties and to a successful reorganization of the DIP Loan Parties.”³² In addition, the Court factually found that the terms of the financing were “fair and reasonable, reflect the DIP Loan Parties’ exercise of prudent business judgment consistent with their fiduciary duties and constitute reasonably equivalent value and fair consideration. . . .”³³ The Interim DIP Financing Order also provided that the terms and conditions of the financing were the best available under the circumstances.³⁴ These findings are antithetical to the facts now being alleged by the Trust.

²⁹ ECF 29.

³⁰ ECF 86.

³¹ ECF 98.

³² ECF 98, ¶5(b).

³³ ECF 98, ¶5(d).

³⁴ ECF 98, ¶5(c).

The Interim DIP Order provided that “[t]he Debtors shall promptly serve copies of this Interim Order (which shall constitute adequate notice of the Final Hearing, including, without limitation, notice that the Debtors will seek approval at the Final Hearing of a waiver of rights under sections 506(c) and 552(b) of the Bankruptcy Code) to the parties having been given notice of the Interim Hearing, to any party that has filed a request for notices with this Court and to the Creditors’ Committee after the same has been appointed, or such Creditors’ Committee’s counsel, if the same shall have been appointed.”³⁵ The final hearing that was originally scheduled to take place on October 10 was subsequently adjourned to October 24, 2017.³⁶

The docket reflects that twelve objections and joinders to the objections to the DIP financing were filed prior to the October 24th hearing.³⁷ The UCC filed a response indicating that it supported the Debtors’ decision to seek postpetition financing, “as the Debtors have a compelling need to obtain capital as they enter the busiest time of the year for their business.”³⁸ The UCC added that it had negotiated several improvements to the Interim DIP Order:

[F]rom the date of its inception, the Committee has worked diligently with the Debtors and their pre- and postpetition lenders to reach consensus regarding the terms on which the estates should be permitted to borrow. The Committee is pleased to report that those efforts have borne fruit, and the parties have reached agreement on modified – and substantially improved – terms for both the North American and International DIP Facilities. These terms, coupled with additional negotiated protections in the critical and foreign vendor and other first day orders, will maintain a level playing field among various parties-in-interest during the case, thereby protecting and preserving the rights of unsecured creditors and maximizing the value available to unsecured creditors, including those providing support postpetition.

³⁵ ECF 711, ¶42.

³⁶ ECF 267.

³⁷ ECF 680.

³⁸ ECF 659, p. 1.

Id. Following additional negotiations with the UCC and the objecting parties, the Debtors filed a revised proposed final financing order.³⁹ On October 24, 2017, the Court heard and granted final approval of the DIP financing and entered the Final DIP Financing Order, substantially in the form of the proposed final financing order.⁴⁰

The Trust does not allege that the Debtors failed to comply with the requirements of Bankruptcy Rule 4001 in connection with their financing motion.⁴¹ Neither does the Trust contend that the Court failed to apply the proper standard when it approved the financing.⁴² Instead, the Trust asserts that “the Court was not provided sufficient disclosures or updated information”⁴³ In its 400-page opposition to the Motion, the Trust repeatedly states that certain facts “were not brought to the attention of the Court.”⁴⁴ It is significant, however, that the Trust does not contend that parties in interest, including those who filed objections, did not have the *opportunity* to conduct discovery, examine witnesses or offer evidence in opposition, including those facts that the Trust alleges were not brought to the Court’s attention.⁴⁵

³⁹ ECF 677.

⁴⁰ ECF 711.

⁴¹ Bankruptcy Rule 4001(c)(1), Fed. R. Bankr. P. 4001(c)(1), requires that a motion for authority to obtain credit shall include “a copy of the credit agreement and a proposed form of order” as well as “a concise statement of the relief requested”

⁴² See, e.g., *In re L.A. Dodgers LLC*, 457 B.R. 308, 313 (Bankr. D. Del. 2011) (“[C]ourts will almost always defer to the business judgment of a debtor in the selection of the lender.”); *Trans World Airlines, Inc. v. Travellers Int’l, AG (In re Trans World Airlines, Inc.)*, 163 B.R. 964, 974 (Bankr. D. Del. 1994) (noting its prior approval of a postpetition loan and receivables facility because such facility “reflect[ed] sound and prudent business judgment”); *In re Ames Dep’t Stores, Inc.*, 115 B.R. 34, 40 (Bankr. S.D.N.Y. 1990) (“cases consistently reflect that the court’s discretion under section 364 is to be utilized on grounds that permit reasonable business judgment to be exercised so long as the financing agreement does not contain terms that leverage the bankruptcy process and powers or its purpose is not so much to benefit the estate as it is to benefit a party-in-interest”).

⁴³ AP ECF 343, p. 91.

⁴⁴ See, e.g., AP ECF 343, ¶ 3(A)(3)(e).

⁴⁵ In its opposition, the Trust refers to deposition testimony to support its contention that material information was withheld: “if someone had gone through the 700 pages of loan documentation in docket 158 and read the language of the January revised budget covenant . . . they likely would not have appreciated their significance without knowing the background” P. 92 (quoting Ex. 70 (Greenspan deposition) ¶¶298-303 (emphasis added)). This suggests that it was not necessarily a lack of disclosure but rather the failure of creditors and other parties in interest to thoroughly vet the proposed financing prior to the October 24, 2017, hearing that resulted in the omission of evidence that the Trust now contends should have been presented.

Having considered the Trust's offerings, the Court finds that there is no "new evidence" that, in the view of the Court, was not available through discovery and that could have been offered prior to the entry of the Final DIP Order. The Court has reviewed the allegations in the Complaint alleging breach of fiduciary duty in connection with the Defendants' authorization of the DIP financing. Those allegations of gross negligence, bad faith, conflicts of interest, reckless indifference, and an abdication of their fiduciary duties fall short of claiming that the Defendants committed a fraud on the Court.⁴⁶ Nevertheless, the Trust now seeks to have the Court reverse the factual findings that were an essential component of a final order entered over four years ago and which concluded that the Defendants, acting on behalf of the Debtors, exercised sound business judgment consistent with their fiduciary duties *and* did so on the basis of all evidence that could have been presented prior to the entry of the Final DIP Order. The Court refuses to exercise its discretion to set aside its prior order and finds that law of the case doctrine is applicable.⁴⁷

⁴⁶ Should the Trust take the position that the evidence establishes that there has been a fraud upon the Court that would go unremedied were the Court to dismiss this count of the Complaint, Judge Novak's opinion in *Mar-Bow* again offers guidance:

Of course, the Court has the inherent authority to remedy a fraud on the court. *Chambers v. NASCO, Inc.*, 501 U.S. 32, 44, 111 S.Ct. 2123, 115 L.Ed.2d 27 (1991); *Universal Oil Prods. Co. v. Root Refining Co.*, 328 U.S. 575, 580-81, 66 S.Ct. 1176, 90 L.Ed. 1447 (1946); *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238, 246, 64 S.Ct. 997, 88 L.Ed. 1250 (1944). Even a party who lacks standing to prosecute may bring the fraud to the Court's attention and *suggest* that it vacate a prior judgment based on a fraud perpetuated on the court. *Kupferman v. Consol. Research & Mfg. Corp.*, 459 F.2d 1072, 1074 n.1 (2d Cir. 1972). . . . Indeed, the U.S. Trustee can raise concerns Finally, the Bankruptcy Court has the inherent authority to *sua sponte* remedy a fraud on the court.

Mar-Bow Value Partners, LLC, 469 F. Supp. 3d at 534.

⁴⁷ The Supreme Court has instructed that:

A fundamental precept of common-law adjudication, embodied in the related doctrines of collateral estoppel and res judicata, is that a 'right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction . . . cannot be disputed in a subsequent suit between the same parties or their privies . . . ' *Southern Pacific R. Co. v. United States*, 168 U.S. 1, 48-49, 18 S.Ct. 18, 27, 42 L.Ed. 355 (1897). Under res judicata, a final judgment on the merits bars further claims by parties or their privies based on the same cause of action. . . . Under collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation. . . . Application of both doctrines is central to the purpose for which civil courts have been established, the conclusive resolution of disputes within their jurisdictions. . . . To preclude parties from contesting matters that they have had a full

The essential facts necessary to establish a breach of fiduciary duty and associated claims in connection with securing the DIP financing have already been decided in favor of the Defendants. These facts were not changed, nor could they be, by subsequent confirmation orders because they had already become the law of the case as a result of the Final DIP Order. For that reason, the Court will grant the Motion as to the count alleging breach of fiduciary duty for authorizing the DIP financing.⁴⁸

II. Fiduciary Duty Claim Relating to the Prepetition Bonus Payments (against Defendants Brandon, Short, Bekenstein, Levin, Raether, Taylor, Macnow, Silverstein and Goodman).

The Trust alleges that Defendants breached their fiduciary duty by approving payment of retention bonuses to 117 TRU executives and management-level employees before the Debtors filed for bankruptcy. The Trust contends that the bonuses resulted in fraudulent transfers under both bankruptcy⁴⁹ and criminal law.⁵⁰

Defendants counter that the Trust is estopped from asserting this claim because the UCC subsequently negotiated a reduction in the amount of the bonuses along with a deferral of the payments. Alternatively, Defendants argue that (1) the undisputed facts establish that they are protected by the business judgment rule, and (2) they are protected by the

and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions.

Montana v. United States, 440 U.S. 147, 153–54 (1979) (citations omitted). This rationale also applies to the Law of the Case Doctrine.

⁴⁸ As the Court has found that the law of the case applies, consideration of the issue of estoppel with respect to the fiduciary duty claim as to the DIP financing is unnecessary.

⁴⁹ See 11 U.S.C. § 548(a)(1)(A) (“The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted . . .”).

⁵⁰ See 18 U.S.C. § 152(7) (“A person who (7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation . . . shall be fined under this title, imprisoned not more than 5 years, or both.”)

internal affairs doctrine and the exculpatory clause contained in TRU's Amended and Restated Certificate of Incorporation.⁵¹

Unlike the action taken by the Defendants in securing the postpetition DIP financing, the prepetition executive bonus plan was not subject to court approval, for which creditors and interested parties would have been given an opportunity to be heard. The Trust has documented extensive evidence and supporting case law in support of its contention that each of the Defendants breached the duties of loyalty, good faith, and care. It argues that this evidence establishes, *prima facie*, that the Defendants were not disinterested, failed to consider material information reasonably available to them, failed to consider reasonable alternatives, and abdicated the decision-making process to Defendant Brandon, the CEO of TRU, who was the recipient of the largest bonus.

The presumption of the protection otherwise afforded the Defendants by the business judgment rule is rebutted by a showing of the breach of the duties of loyalty, care, or good faith. *See Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 52 (Del. 2006) ("Those presumptions can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith."); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 371 (Del. 1993). If that is shown, the burden then shifts to the Defendants to establish that the transaction "was the product of both fair dealing and fair price." *Basho Techs. Holdco B, LLC v. Georgetown Basho Inv'rs, LLC*, C.A. No. 11802-

⁵¹ The parties agree that Delaware law governs the breach of fiduciary duty claims. *See* TRU's Amended Certificate of Incorporation, AP ECF 322, Ex. 126, Art. Eight ("A director . . . shall not be liable to the corporation . . . for breach of fiduciary duty as a director, except to the extent that exculpation is not permitted under the DGCL as in effect at the time such liability is determined."); 8 Del. C. 102(b)(7) (providing that an exculpatory provision is effective under Delaware Law in eliminating personal liability of directors for breaches of their duty of care but "such provision shall not eliminate or limit the liability of a director (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit."). *See also Pereira v. Farace*, 413 F.3d 330, 342 (2d Cir. 2005) ("[B]ecause breach of fiduciary duty claims belong to the corporation, they are subject to the exculpatory clause defense even when pressed by a trustee.").

VCL, 2018 WL 3326693, at *35 (Del. Ch. July 6, 2018); *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 at 52 (“the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders.”). The extensive evidence submitted by the Trust, if proven, is sufficient to establish a breach of the Defendants’ fiduciary duties and rebut the presumption associated with the business judgment rule. The Defendants have not shown that the undisputed evidence demonstrates that the transaction was the product of fair dealing and fair price. These issues are a question for the trier of fact. Thus, the issue is ineligible to be determined on summary judgment.

Defendants’ argument that the Trust is estopped from litigating the retention payments is similarly unavailing. Defendants maintain that the UCC told the Court that the payments were “addressed” through adjustments to the Senior Employee Incentive Program (“SEIP”) approved by the Court with the UCC’s support. A review of the order approving the SEIP does not support a finding that the retention payments claim was resolved, released, or even addressed. Moreover, contrary to the statements made by the UCC’s counsel, the UCC’s subsequent pleading in support of the Settlement Agreement⁵² made clear that claims against the Defendants were preserved, as did the Confirmation Orders.⁵³

The Court also rejects the Defendants’ contention that the exculpatory provision in TRU’s certificate of incorporation bars the Trust’s duty of care claim. The evidence submitted by the Trust, if proven, is sufficient to establish a *prima facie* case that the Defendants violated their duties of loyalty and good faith in addition to their duty of care.

⁵² ECF 4033, ¶ 20.

⁵³ ECF 5746 (Delaware order) ¶48; ECF 5979 (Toys, Inc. order). Judicial estoppel “requires a showing of (1) clear inconsistency and (2) that the party estopped obtained an unfair advantage from that inconsistency.” *In re USA Detergents, Inc.*, 418 B.R. 533, 544 (Bankr. Del. 2009).

The Trust has also alleged that the Defendants were grossly negligent⁵⁴ and has offered evidence in support of that allegation. When directors are grossly negligent or breach multiple duties, including the duty of loyalty, then the exculpatory provision does not immunize directors for their breach of the duty of care. *Miller v. Greystone Business Credit II, L.L.C. (In re USA Detergents, Inc.)*, 418 B.R. 533, 54 (Bankr. D. Del. 2009) (“exculpation is only available where the cause of action only states a due care violation and not a claim which alleges gross negligence or breaches of multiple duties”). *See also supra* n.51.

Material questions of fact remain to be decided in connection with the retention payments claim. For this reason, summary judgment will be denied as to the count relating to the prepetition retention payments.

III. Fiduciary Duty Claim Relating to the Advisory Fees (against Defendants Brandon, Beckenstein, Levin, Raether, Taylor, Macnow, and Silverstein)

In the Complaint, the Trust alleges that the Defendants breached their fiduciary duties of loyalty and good faith by authorizing the payment of advisory fees to TRU’s private equity sponsors from the fourth quarter of 2014 through the first quarter of 2017, causing TRU and its creditors to lose \$17,863,110.⁵⁵ The Complaint states that “TRU had been insolvent since at least 2014” and “the officers and directors of TRU each had a fiduciary duty to protect the value of TRU for TRU’s creditors, and not merely to focus on advancing the interests of the majority equity holders—Bain, KKR, and Vornado (the “Sponsors”).”⁵⁶ The Complaint further alleges that “in 2005, Bain, KKR, and Vornado had required that TRU enter an Advisory Agreement that required TRU to pay quarterly advisory fees of millions of dollars to each Sponsor for advisory services, regardless of the actual amount, quality, or redundancy of any advice that the Sponsors provided TRU. Moreover, the

⁵⁴ Complaint, ¶ 86.

⁵⁵ Complaint, ¶¶ 5, 55, 212.

⁵⁶ Complaint, ¶¶ 45, 46.

Advisory Agreement did not actually require any Sponsor to perform any advisory services.”⁵⁷ According to the Complaint, “[b]etween 2005 and 2017, TRU paid Bain, KKR, and Vornado more than \$250,000,000 in ‘Advisory Fees’ as TRU sank further into debt.”⁵⁸

The Defendants assert that they are entitled to summary judgment because the undisputed evidence demonstrates that TRU was solvent when the fees were paid and that payments to a company’s owners when the company is solvent could never equate a breach of the directors’ fiduciary duties.⁵⁹ The Defendants also argue that the payments were contractually required, thus precluding a claim that authorizing the payments was a breach of their fiduciary duties.

The Trust has pointed to “[n]umerous pieces of evidence [that] indicate that Toys “R” Us was not solvent at all times during its payment of the advisory fees.”⁶⁰ “Insolvency is a question of fact” *Heilig-Meyers Co. v. Wachovia Bank, N.A. (In re Heilig-Meyers Co.)*, 328 B.R. 471, 475 (E.D. Va. 2005), quoting *In re Roblin Indus., Inc.* 78 F.3d 30, 35 (2d Cir. 1996). Defendants contend that the Court should disregard the Trust’s evidence of insolvency, finding it “insufficient as a matter of law to create a genuine, triable dispute,”⁶¹ and instead accept their expert’s opinion finding that TRU was solvent when each of the advisory fee payments was made. However, the Defendant’s expert’s opinion is but one piece of evidence that must be assessed by the trier of fact. The Trust has offered competing evidence of insolvency, including the report of the Trust’s expert witness who challenges the conclusions of the Defendant’s expert. The Court views the Trust’s evidence as sufficient to

⁵⁷ Complaint, ¶ 47.

⁵⁸ Complaint, ¶ 48

⁵⁹ See Motion, p. 37-29.

⁶⁰ Opposition, p. 191.

⁶¹ AP ECF 380, p. 57.

establish a genuine dispute and finds that there is a triable issue of fact concerning insolvency. Thus, the Debtors' prepetition solvency is an issue to be determined at trial.

The Defendant's contention that TRU's contractual obligation to pay the advisory fees precludes the Trust's claim for breach of fiduciary duties must also fail. The Trust has submitted evidence that the contractual obligations imposed by the Advisory Fee Agreement at issue were amended several times between 2005 and 2015, and it points to the failure of the Defendants to renegotiate or terminate the agreement prior to the disputed payments having been made. *See Frederick Hsu Living Tr. v. ODN Holding Corp.*, C.A. No. 12108-VCL, 2017 WL 1437308, at *24 (Del. Ch. Apr. 14, 2017) ("the fact that a corporation is bound by its valid contractual obligations does not mean that a board does not owe fiduciary duties when considering how to handle those contractual obligations.").

Payment of the advisory fees was not endorsed by court order, as the payments were made prior to the bankruptcy filings. The evidence offered by the Trust supports a finding that the Defendants were not constrained by their contractual obligations to the Sponsors and had other options available. Again, questions of fact remain to be decided.⁶² Accordingly, granting summary judgment to the Defendants with respect to their approval of the payment of advisory fees is not appropriate.

IV. *The Vendor Claims*

Defendants advance multiple theories in support of their contention that they are entitled to summary judgment on the Vendor Claims. First, Defendants challenge the

⁶² Defendants have also raised an estoppel argument, claiming that because the shareholders who were not Sponsors did not object to the payment of the advisory fees, they "acquiesced" to the payments. Under the doctrine of acquiescence, "accepting the benefits of the transaction, even though the corporation's conduct is a breach of some duty owed to the shareholder, may also serve to bar the shareholder's right to equitable relief." *Kahn v. Household Acquisition Corp.*, 591 A.2d 166, 177 (Del. Ch. 1991). Here, the Trust has presented evidence supporting its contention that neither TRU nor its minority shareholders received a benefit from the payment of the advisory fees. Whether the minority shareholders, or any predecessor to the Trust, "knowingly and deliberately permit[ted]" the payments has also not been undisputedly established. *See Papaioanu v. Comm'rs of Rehoboth*, 186 A.2d 745, 749-50 (Del. Ch. 1962). Acquiescence is therefore a question for the trier of fact.

Trust's standing to pursue the claims of any individual trade vendors. Second, Defendants argue that vendors who signed critical vendor agreements during the Chapter 11 proceedings were contractually obligated to ship goods to TRU, despite the risk of non-payment, in exchange for payments on their prepetition claims. Finally, Defendants assert that the undisputed evidence shows that the Trust cannot carry its burden of proof to establishing the elements necessary to establish tort claims for any of the individual Trade Vendors.

The Trust's Standing to Pursue the Vendor Claims.

There is no dispute that each of the Trade Vendors assigned its claims against the Defendants to the Trust, including the exclusive right to pursue the claims.⁶³ The Fourth Circuit has held that "a trustee has the requisite standing to sue [for] the cause of action he acquired for the estate from the [creditors] after commencement of [a] bankruptcy case." *Logan v. JKV Real Est. Servs. (In re Bogdan)*, 414 F.3d 507, 512 (4th Cir.2005). This Court, applying *Logan*, previously held that a trustee who received an unconditional assignment of a claim from a creditor stands in the place of the creditor and is entitled to pursue the claim on behalf of the estate. *Matson v. S. Anna, Inc. (In re McCurnin)*, 590 B.R. 729, 740 (Bankr. E.D. Va. 2018). Thus, under Fourth Circuit and this Court's precedent, the Trust has standing to pursue the claims assigned to it by the Trade Vendors.⁶⁴

⁶³ "[T]he creditors of the Debtors . . . hereby irrevocably transfer, assign, and deliver to the TRU Creditor Litigation Trust all assets constituting the Non-Released Claims Trust Assets." TRU Trust Agreement, ECF 6925, § 2.5(a). "[N]o Person or creditor . . . other than the TRU Creditor Litigation Trust . . . shall be permitted to assert . . . any Claim or Cause of Action that is transferred to the TRU Creditor Litigation Trust pursuant to this Agreement or the Plans." *Id.* § 2.5(f).

⁶⁴ The result would be the same if, as the Defendants urge, the Court were to apply Delaware law. *See In re Activision Blizzard, Inc. Stockholder Litig.*, 124 A.3d 1025, 1050-51 (Del. Ch. 2015) ("Delaware has a longstanding rule that claims are freely assignable and can be asserted by the acquirer.").

Critical Vendor Agreement.

Defendant's assertion that the critical vendor agreements executed by fifteen of the trade vendors "obligated them to ship regardless of what was said to them"⁶⁵ is belied by the language of the agreements themselves, which stated that the "supplier shall supply goods and/or perform services to the company" based on "Customary Trade Terms."⁶⁶ The "Customary Trade Terms" were defined as "trade terms at least as favorable to the Debtors as those practices and programs, product mix, availability, and other programs, in place in the 180 days prior to the Petition Date"⁶⁷ The Trust has offered evidence that customary trade terms existing in the 180 days prior to the bankruptcy filings included the ability to require payment in advance of shipping and other restrictions, such as reducing the time for payment, that could have protected the trade vendors despite having agreed to the language in the critical vendor agreements. The Trust has also offered evidence that each "critical" vendor would have acted differently had it been aware of the alleged "concealed facts."⁶⁸ The contractual language in the form agreements approved by the Court would not necessarily have required the vendors to continue to ship on credit during the pendency of the bankruptcy cases even in the face of a catastrophic downturn in the Debtors' business. For that reason, execution of the critical vendor agreements does not mandate granting summary judgment.

Sufficiency of Evidence to Establish Elements of the Vendor Claims.

Much of the Motion is devoted to attempting to persuade the Court that the Trust is unable to offer sufficient evidence to establish all the necessary elements to support its

⁶⁵ Motion, AP ECF 315, pp. 34-35.

⁶⁶ See Debtors' Motion for Entry of Interim and Final Orders (I) Authorizing The Debtors to Pay Certain Prepetition Claims of Critical Vendors and (II) Granting Related Relief, ECF 6, Ex. C (Form of Trade Agreement), p. 2.

⁶⁷ *Id.*

⁶⁸ See Trust's Opposition, pp. 344-46.

claims for intentional or negligent misrepresentation, fraudulent concealment, or negligence on the part of each of the individual vendors. In response, much of the Trust's 400-page Opposition is dedicated to identifying evidence refuting the Defendants' insufficient and "undisputed" evidence contentions.

Initially, the parties disagree over which state's laws govern the tort claims, although they concur that because the case was transferred from the Southern District of New York, New York's choice of law principles apply. *See Ferens v. John Deere Co.*, 494 U.S. 516, 532 (1990) ("[W]e believe that applying the law of the transferor forum effects the appropriate balance between fairness and simplicity."). Under New York's choice of law rules, "the first question to resolve in determining whether to undertake a choice of law analysis is whether there is an actual conflict of laws." *Curley v. AMR Corp.*, 153 F.3d 5, 12 (2d Cir. 1998). In *Curley*, the Second Circuit held that if "the applicable law from each jurisdiction provides different substantive rules, a conflict of laws analysis is required." *Id.* Here is where the parties diverge, with the Trust asserting that the law of New York and the law in the states where the vendors are located provide different substantive rules. By way of example, the Trust points to the differences between New York and California law; New York law requires a "special relationship" between the parties in order to state a claim for negligent misrepresentation,⁶⁹ but California law does not.⁷⁰

Defendants' position is that New York substantive law is applicable because "unless the applicable laws from each potentially applicable jurisdiction will have the potential to affect the outcome of the case significantly, New York's choice-of-law rules require the application of New York substantive law to tort claims like fraud and negligent

⁶⁹ *See Anschutz Corp. v. Merrill Lynch & Co.*, 690 F.3d 98, 114 (2d Cir. 2012).

⁷⁰ *See B.L.M. v. Sabo & Deitsch*, 55 Cal. App. 4th 823, 843 (1997).

misrepresentation. . . .”⁷¹ In the Defendants’ view, “there is significant overlap between the law of New York and that of other states that have an interest in the tort claims asserted in this jurisdiction, like New Jersey (TRU’s headquarters) or Virginia (the location of the bankruptcy proceeding).”⁷² Defendants argue that the law of each state where the vendors are located is inapplicable because the substantive tort laws of New York and the states “that have a significant interest in the . . . claims” are similar. Yet, the Motion falls short of adequately explaining why only New Jersey or Virginia, as opposed to the states where other vendors are located, have an interest in the asserted claims.

Although neither party has presented a comprehensive analysis of the tort laws in each state where the vendors are located, it is sufficient to note that the laws of California, where many of the vendors are located, are substantively different from those of New York. At this stage of the proceedings, it would also be fair to assume that the parties would not be advocating their respective positions so vigorously were the substantive laws in the various states where vendors are located and those in New York substantially the same. Accordingly, the Court finds that there is an actual conflict of laws that requires further analysis.

The next step in the analysis requires the Court to determine which jurisdiction’s law to apply. *Curley* again provides guidance:

In tort actions, if there is a conflict of laws, New York courts apply an “interests analysis,” under which the law of the jurisdiction having the greatest interest in the litigation is applied. *AroChem Int’l, Inc. v. Buirkle*, 968 F.2d 266, 270 (2d Cir.1992); *see also Babcock v. Jackson*, 12 N.Y.2d 473, 481, 240 N.Y.S.2d 743, 191 N.E.2d 279 (1963). “In deciding which state has the prevailing interest, we look only to those facts or contacts that relate to the purpose of the particular laws in conflict. ‘Under this formulation, the significant contacts are, almost exclusively, the parties [sic] domiciles and the locus of the tort.’” *AroChem Int’l*, 968 F.2d at 270 (quoting *Schultz v. Boy Scouts of America, Inc.*, 65 N.Y.2d 189, 197, 491 N.Y.S.2d 90, 480 N.E.2d 679 (1985)). “If

⁷¹ Motion, ECF 315, p. 32 n.5.

⁷² *Id.*

conflicting conduct-regulating laws are at issue, the law of the jurisdiction where the tort occurred will generally apply because that jurisdiction has the greatest interest in regulating behavior within its borders.” *Cooney v. Osgood Mach., Inc.*, 81 N.Y.2d 66, 72, 595 N.Y.S.2d 919, 612 N.E.2d 277 (1993). If the choice of law analysis leads to the application of foreign law, a court may refuse to apply that law only if its application would be violative of fundamental notions of justice or prevailing concepts of good morals. *Brink's Ltd. v. South African Airways*, 93 F.3d 1022, 1031 (2d Cir.1996); *cert. denied*, 519 U.S. 1116, 117 S.Ct. 959, 136 L.Ed.2d 845 (1997). The public policy of the forum thus provides an exception to application of foreign law only for law “truly obnoxious” to that policy. *Id.*

Curley, 153 F.3d at 12 (2d Cir. 1998). The tort claims being asserted by the Trust, including claims based on fraud and negligent misrepresentation, are based on legal rules intended to prevent injuries. *Antipodean Domestic Partners, LP, v. Clovis Oncology, Inc.*, No. 655908/16, 2018 WL 2045541, at *28, 2018 N.Y. Slip Op 30809 (U) (N.Y. Sup. Ct. Apr. 30, 2018) (“negligent misrepresentation . . . is a conduct-regulating rule”); *Vandashield LTD v. Isaacson*, No. 652183/2014, 2015 WL 5545382, at *10 n.18, 2015 N.Y. Slip Op 31782(U) (N.Y. Sup.Ct. 2015) (fraud is “a conduct-regulating body of tort law”); *Mark Andrew of the Palm Beaches, Ltd. v. GMAC Com. Mortg. Corp.*, 265 F. Supp.2d 366, 378 (S.D.N.Y. 2003) (noting that fraud and negligent misrepresentation are conduct-regulating), *aff'd*, 96 F. App’x 750 (2d Cir. 2004). Consequently, the law of the place where the alleged torts occurred, which “is considered to be the place where the last event necessary to make the actor liable occurred” is applicable. *Schultz v. Boy Scouts of Am.*, 65 N.Y.2d 189, 195 (N.Y. 1985).

For each vendor, the Trust asserts that the last event necessary to establish the Defendants’ liability occurred in the vendor’s home state, where the vendors relied on the false information allegedly provided. In cases involving fraud and negligent misrepresentation, reliance occurs where the victim is located. *J.A.O. Acquisition Corp. v. Stavitsky*, 745 N.Y.S.2d 634, 639 (Sup.Ct. 2001) (“fraud claims are governed by the law of the place of injury,” i.e., “where plaintiffs are located”); *Geron v. Seyfarth Shaw LLP (In re*

Thelen LLP), 736 F.3d 213, 220 n. 7 (2d Cir. 2013) (“When a person sustains loss by fraud, the place of wrong is where the loss is sustained.”) (quoting Restatement (First) of Conflict of Laws § 377 n. 4). *See also Lewis Tree Serv. v. Lucent Techs., Inc.*, 211 F.R.D. 228, 237 (S.D.N.Y. 2002) (under New York choice of laws rules, the “fraud alleged in this lawsuit arose in all fifty states, and their laws would be applied to the fraud claims.”). For each Vendor Claim in this case, the claim should be governed by the laws of the state where the vendor is located.

Operating under the mistaken assumption that the Court will concur with their position that New York law is applicable to each of the Vendor Claims, Defendants have challenged each individual vendor’s claim by pointing to alleged evidentiary deficiencies existing (primarily) under New York substantive law and asserting that these deficiencies are fatal to the Trust’s claims. In response, the Trust has extensively documented evidence supporting the necessary elements of each vendor’s tort claim under the appropriate state substantive tort law (primarily California). Having reviewed the respective submissions, the Court finds that the Defendants, and each of them, have failed to meet their burden of showing that there is no genuine material issue of fact relating to the Vendor Claims. The Trust, in turn, has submitted sufficient evidence from which a trier of fact may reasonably find in favor of the Trust on each of the claims.

In *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986), the Supreme Court cautioned that “[c]redibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge . . . [who is] ruling on a motion for summary judgment. . . .” The Court instructed trial courts to “act . . . with caution in granting summary judgment” and reiterated that a trial court may “deny summary judgment in a case where there is reason to believe that the better course would be to proceed to a full trial.” *Id.*, citing *Kennedy v. Silas Mason Co.*, 334 U.S. 249 (1948). In this

case, the credibility of the witnesses, particularly the Defendants, is particularly important. It is therefore the view of the Court that the better course would be to proceed to trial.

Rule 56(a) of the Federal Rules of Procedure provides that the trial court “shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.” Since Defendants have failed to establish that there is no material fact in dispute and that they are entitled to judgment as a matter of law, summary judgment must be denied with respect to the Vendor Claims.

Conclusion

For the foregoing reasons, summary judgment will be granted in favor of the Defendants as to the Fourth Cause of Action in the Complaint (Breach of Fiduciary Duty for Authorizing the DIP Financing). For all other counts of the Complaint, including the Vendor Claims, summary judgment will be denied.

A separate order shall issue.

Signed: June 27, 2022

/s/ Keith L. Phillips
United States Bankruptcy Judge

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BANKRUPTCY 2022: VIEWS FROM THE BENCH

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186 A.D.3d 132
 Supreme Court, Appellate Division,
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WESTCHESTER FIRE INSURANCE

CO., Plaintiff-Appellant,

v.

Nicholas S. SCHORSCH, et.
 al., Defendants-Respondents,
 Aspen American Insurance Co.,
 et al., Defendants-Appellants.

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ENTERED: AUGUST 20, 2020

Synopsis

Background: Insurer sought declaratory judgment that directors' and officers' liability policy did not provide coverage for claims asserted by creditor trust against Chapter 11 debtor-insured's officers and directors, and officers and directors counterclaimed for insurer's alleged breach of contract. The Supreme Court, New York County, [O. Peter Sherwood, J.](#), [2019 WL 1901372](#), denied insurer's motion to dismiss counterclaim and entered partial summary judgment in favor of officers and directors, and insurer appealed.

Holdings: The Supreme Court, Appellate Division, Renwick, J., held that:

[1] as matter of first impression, bankruptcy exception to a directors' and officers' liability policy's "insured vs. insured" exclusion was broad enough to apply to claims asserted against an insured corporate debtor's officers and directors by creditor trust;

[2] genuine issues of material fact bearing on applicability of other exclusions precluded entry of summary judgment on officers and directors' breach of contract claims; and

[3] directors and officers named as defendants in cause of action brought against them by representative of corporate debtor-insured's Chapter 11 estate were entitled to advancement of defense costs.

Affirmed as modified.

Procedural Posture(s): On Appeal; Motion to Dismiss; Motion for Summary Judgment.

West Headnotes (17)

[1] [Bankruptcy](#) ➡ [Debtor in possession, in general](#)

"Debtor-in-possession" (DIP) is a corporation or other entity that has filed for Chapter 11 relief, but still holds property to which creditors have a legal claim under a lien or other security interest.

[2] [Bankruptcy](#) ➡ [Debtor in possession, in general](#)

Chapter 11 debtor-in-possession may continue to do business using estate assets, but is required to seek court approval for any actions that fall outside of the scope of regular business activities.

[11 U.S.C.A. § 1107\(a\).](#)

[3] [Insurance](#) ➡ [Policies considered as contracts](#)
[Insurance](#) ➡ [Application of rules of contract construction](#)

In action for a judgment declaring parties' rights under insurance policy, court must be guided by rules of contract interpretation, because insurance policy is contract between insurer and insured.

[1 Cases that cite this headnote](#)

[4] [Insurance](#) ➡ [Questions of law or fact](#)

Construction of insurance policy is usually a court function.

Westchester Fire Insurance Co. v. Schorsch, 186 A.D.3d 132 (2020)

129 N.Y.S.3d 67, 2020 N.Y. Slip Op. 04627

[5] Insurance ➡ [Language of policies](#)

In attempting to resolve dispute regarding the proper interpretation of exception to policy exclusion, court's initial task was to attempt to ascertain the parties' intent from language of insurance contract itself.

[4 Cases that cite this headnote](#)

[6] Insurance ➡ [Construction as a whole](#)

Court must construe an insurance policy as a whole; all pertinent provisions of the policy should be given meaning, with due regard to the subject matter that is being insured and the purpose of the entire contract.

[6 Cases that cite this headnote](#)

[7] Insurance ➡ [Ambiguity in general](#)

Provision in an insurance policy is "ambiguous" if it is subject to more than one reasonable interpretation.

[8] Insurance ➡ [Ambiguity in general](#)

Insurance ➡ [Plain, ordinary or popular sense of language](#)

Court should read policy provisions in order to avoid ambiguities, if the plain language of insurance contract permits.

[1 Cases that cite this headnote](#)

[9] Insurance ➡ [Ambiguity in general](#)

Ambiguity will not be found to exist in language of insurance policy merely because two conflicting interpretations may be suggested.

[1 Cases that cite this headnote](#)

[10] Insurance ➡ [Plain, ordinary or popular sense of language](#)

When the parties differ concerning the meaning of insurance contract, court, in attempting to resolve the conflict, will be guided by a

reasonable reading of the plain language of policy.

[3 Cases that cite this headnote](#)

[11] Insurance ➡ [Disputes among insureds](#)

Bankruptcy exception to a directors' and officers' liability policy's "insured vs. insured" exclusion, which provided coverage for claims asserted by trustee of debtor-insured's bankruptcy estate or "comparable authority," was broad enough to apply to claims asserted against an insured corporate debtor's officers and directors, who were themselves additional insureds under the policy, though these claims were asserted not by trustee of corporate debtor's Chapter 11 estate, but by creditor trust established under debtor's plan to pursue causes of action on behalf of estate; creditor trust, acting as estate representative in pursuing these claims, was a "comparable authority."

[1 Cases that cite this headnote](#)

[12] Bankruptcy ➡ [Leave to sue](#)

Creditor, as party in interest, has right to request authority to pursue causes of action on behalf of bankruptcy estate.

[13] Bankruptcy ➡ [Leave to sue](#)

Creditor may be authorized to pursue claims on behalf of bankruptcy estate upon the satisfaction of three requirements: (1) claims must be colorable, (2) the debtor-in-possession must have unjustifiably refused to pursue the claims, and (3) creditor obtains approval to do so from bankruptcy court.

[14] Judgment ➡ [Insurance cases](#)

While bankruptcy exception to a directors' and officers' liability policy's "insured vs. insured" exclusion meant that this exclusion did not eliminate coverage for claims asserted by creditor trust established in corporate debtor-insured's confirmed Chapter 11 plan against debtor's officers and directors, who were

themselves additional insureds under the policy, genuine issues of material fact bearing on applicability of other exclusions, such as whether the officers and directors named as defendants had engaged in any wrongdoing to benefit separate entity, precluded entry of summary judgment on officers and directors' breach of contract claims against insurer for denying coverage.

[15] [Insurance](#) ➡ [Defense Costs, Supplementary Payments and Related Expenses](#)

[Insurance](#) ➡ [Pleadings](#)

In policies that provide for duty to defend or a duty to advance defense costs to directors and officers, that duty arises whenever the underlying complaint alleges facts that fall within scope of coverage.

[16] [Insurance](#) ➡ [Defense Costs, Supplementary Payments and Related Expenses](#)

Insurer's duty to advance defense costs must be construed broadly in favor of the policyholder, and exists whenever a complaint against the insured alleges claims that may be covered under the policy.

[17] [Insurance](#) ➡ [Defense Costs, Supplementary Payments and Related Expenses](#)

Directors and officers named as defendants in cause of action brought against them by representative of corporate debtor-insured's Chapter 11 estate were entitled to advancement of defense costs under officers' and directors' liability policy that treated them as additional insureds, though there was possibility, as result of "wrong acts" or other exclusion in policy, the policy might not provide coverage; because bankruptcy exception to "insured vs. insured" exclusion rendered this exclusion per se inapplicable, and because there was thus a possibility that coverage might exist, insurer's obligation to advance defense costs was triggered.

****69** Defendants appeal from orders of the Supreme Court, New York County (O. Peter Sherwood, J.), entered May 16, 2019 and June 11, 2019, which, to the extent appealed from, granted the motions of defendants-respondents Nicholas S. Schorsch, Edward M. Weil, Jr., William Kahane, Peter M. Budko, and Brian S. Block (defendants insureds) for partial summary judgment on their first counterclaim alleging breach of contract with respect to the insurance coverage obligations of plaintiff-appellant Westchester Fire Insurance Co., defendant-appellant Aspen American Insurance Co., and defendant-appellant RSUI Indemnity Co. (collectively, Excess Insurers), declared Excess Insurers obligated to pay for all defense and indemnity costs incurred in an action pending in Delaware, and found defendants insureds entitled to attorneys' fees incurred in defending against the instant declaratory judgment action, and denied Excess Insurers' motions to dismiss defendants insureds' counterclaim for breach of contract.

Attorneys and Law Firms

O'Melveny & Myers LLP, Washington, DC ([Jonathan D. Hacker](#), of the Maryland and District of Columbia bars, admitted pro hac vice, [Allen W. Burton](#) and [Gerard A. Savaresse](#) of counsel), for Westchester Fire Insurance Co., appellant.

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McKool Smith P.C., New York ([Orrie A. Levy](#), [Kenneth H. Frenchman](#) and [Robin L. Cohen](#) of counsel), for Nicholas S. Schorsch, Edward M. Weil, Jr., William Kahane and Peter M. Budko, respondents.

[David Friedman](#), J.P., [Dianne T. Renwick](#), [Barbara R. Kapnick](#), [Ellen Gesmer](#), [Cynthia S. Kern](#), JJ.

Opinion

[RENWICK](#), J.

****70 *134** Plaintiff Westchester Fire Insurance Co. (Westchester) commenced this action seeking a declaration

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that it has no coverage obligations to defendants insureds, arguing primarily that the “insured versus insured” exclusion of a Directors and Officers (D & O) liability insurance policy, procured by RCS Capital Corporation (RCAP), bars coverage of claims asserted against defendants,¹ RCAP's former directors and officers. Defendants insureds contend, among other things, that coverage exists under the bankruptcy exception to the insured vs. insured exclusion. The claims, herein, arose after RCAP's bankruptcy.

During the bankruptcy process, negotiations between RCAP and the company's creditors resulted in the bankruptcy court's approval of RCAP's Chapter 11 reorganization plan creating a litigation trust, labeled “Creditor Trust.” The Creditor Trust was formed, pursuant to the reorganization plan, to pursue the bankruptcy estate's legal claims on behalf of the unsecured creditors, after RCAP's emergence from bankruptcy.² Thus, post-confirmation the Creditor Trust sued RCAP's directors and officers alleging they had breached their fiduciary duties to the company. The directors and officers sought coverage *135 under RCAP's D & O liability policy with Westchester. Westchester commenced this action in response, seeking a declaratory judgment that it has no coverage obligations.

This appeal raises an issue of apparent first impression of whether a D & O liability policy's bankruptcy exception, which allows claims asserted by the “bankruptcy trustee” or “comparable authority,” applies to claims raised by a Creditor Trust, as a post-confirmation litigation trust, to restore D & O coverage removed by the insured vs. insured exclusion. For the reasons that follow, we find that the bankruptcy exception to the insured vs. insured exclusion, applies to restore coverage. Specifically, we interpret the broad language “comparable authority” to encompass a Creditor Trust that functions as a post-confirmation litigation trust, given that such a Creditor Trust is an authority comparable to a “bankruptcy trustee” or other bankruptcy-related or “comparable authority” listed in the bankruptcy exception.

Factual Background

RCAP is a wholesale broker-dealer and investment banking and advisory business with significant revenues generated during the relevant time period from services provided to AR Capital LLC. Directors and officers of RCAP formed AR Capital LLC to create and manage non-traded investment vehicles, primarily REITs.³ RCAP, through subsidiaries, was

responsible for marketing and distributing, and providing other services, in connection with AR Capital **71 LLC's investment products. At one point, AR Capital LLC was the largest creator and sponsor of REITs in the United States (see [RCS Creditor Trust v. Schorsch](#), 2017 WL 5904716, 2017 Del. Ch. LEXIS 820 [Del. Ch. 2017]).

Bankruptcy Proceedings

In 2014, a financial scandal, involving an entity connected to RCAP and AR Capital LLC, decimated their businesses, causing the value of RCAP's stock to plummet. Like many companies facing bankruptcy, RCAP recognized that a contentious and prolonged bankruptcy proceeding could result in significant losses to its business. As a result, RCAP negotiated a restructuring support agreement (RSA) with its unsecured creditors, *136 including its largest creditor Luxor Capital Partners. In March 2016, RCAP filed for Chapter 11 bankruptcy in the Bankruptcy Court of Delaware, pursuant to the RSA. The RSA provided for the creation of a Creditor Trust that would be governed by a Creditor Trust Agreement (CTA).

On May 19, 2016, the bankruptcy court issued an order confirming the bankruptcy plan. The “Confirmation Order” incorporated the CTA and distinguished between different types of litigation assets. In relevant part, the Confirmation Order provided that the Creditor Trust, with respect to litigation assets, in accordance with  [Section 1123\(b\) of the Bankruptcy Code](#), shall retain and “may enforce, sue on, settle, or compromise ... all Claims, rights, Causes of Action, suits, and proceedings ... against any Person without the approval of the Bankruptcy Court [and] the Reorganized Debtors[].” The Confirmation Order further provided that based on the “totality of the circumstances,” including “extensive, arm's-length negotiations,” the bankruptcy plan was “proposed with the legitimate and honest purpose of accomplishing [a] successful reorganization[] and maximizing recoveries available to creditors.”

[1] [2] Pursuant to the CTA, rather than all of RCAP's assets remaining with RCAP as the bankruptcy debtor or debtor-in-possession (DIP),⁴ under the default provisions of [Section 1141 of the Bankruptcy Code](#), certain assets were held free and clear of any creditor claims in the bankruptcy and vested in the Creditor Trust.⁵ The Creditor Trust, as a representative of the bankruptcy estate, was

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charged with liquidating and distributing those assets, outside of the bankruptcy proceeding, on behalf of the trust, and, importantly, for the benefit of RCAP's unsecured creditors. The CTA also provided that the Creditor Trust would be administered by a Trust Administrator, who would take direction from a Creditor *137 Trust Board consisting of three Trustees chosen by creditors of RCAP.

Directors' and Officers' Primary and Excess Policies

Westchester issued an excess liability D & O policy to RCAP for the relevant period, **72 April 2014 through April 2015. The policy is the seventh layer of policies over the primary policy issued by XL Specialty Insurance Company. The D & O policy provides \$5 million of coverage in excess of \$35 million of coverage in the primary policy and other levels of excess coverage, subject to applicable retention limits.

The primary policy insures RCAP as well as the individual defendants, since they were officers and directors of RCAP. As relevant here, the primary policy includes an insured vs. insured exclusion, eliminating coverage for “any Claim made against an Insured Person ... by, on behalf of, or at the direction of the Company or Insured Person.” An “Insured Person” is defined as “any past, present, or future director or officer ... of the Company” and the term “Insured” includes the Company (RCAP) as the debtor. However, the insured vs. insured exclusion has a bankruptcy trustee exception, which restores coverage excluded under the insured vs. insured exclusion, for claims “brought by the Bankruptcy Trustee or Examiner of the Company or any assignee of such Trustee or Examiner, or any Receiver, Conservator, Rehabilitator, or Liquidator or comparable authority of the Company.” There is also a similar exception for claims brought by a “creditors committee” of the Company. Finally, the policy provides coverage for “Loss,” defined as “damages, judgments, settlements ... or other amounts ... and Defense Expenses in excess of the Retention that the Insured is legally obligated to pay,” and the policy covers “wrongful acts,” defined as “any actual or alleged act, error, omission, misstatement, misleading statement, neglect, or breach of duty by any Insured Person while acting in his or her capacity as an ... Insured Person of the Company.”

Creditor Trust Action and Denial of D & O Coverage

In March 2017, as aforementioned, the Creditor Trust brought suit in the Delaware Chancery Court against numerous parties, including defendants insureds, former directors and officers of RCAP, alleging they breached their fiduciary duty to RCAP for the benefit of AR Capital LLC (Creditor Trust Action) (see *138 [*RCS Creditor Trust v. Schorsch*, 2017 WL 5904716, 2017 Del. Ch. LEXIS 820 \[Del. Ch. 2017\], supra](#)). The complaint primarily challenges defendants' use of their dual control of AR Capital LLC and RCAP to enrich themselves and their affiliate entities at the expense of RCAP's public stockholders (*id.*). After being named in the Creditor Trust Action, defendants insureds sought coverage and indemnification under RCAP's D & O liability insurance policy which, as indicated above, consisted of a primary policy issued by XL Specialty Insurance Company and numerous layers of similar, or follow form,⁶ excess policies subject to the terms and conditions of the primary policy. Once the primary policy and the first-through-fifth layer excess policies were exhausted through settlements in other cases, the sixth layer excess insurer (Scottsdale Indemnity Company) began advancing defense costs in the Creditor Trust Action.

In March 2018, as the sixth layer policy neared exhaustion, Westchester, the seventh layer insurer, issued a denial letter asserting that coverage for the Creditor Trust Action was barred on various grounds. Westchester claimed that because **73 the Creditor Trust Action was brought on behalf of RCAP, coverage was barred under the insured vs. insured exclusion, excluding claims brought by or on behalf of one insured (here RCAP) against another insured (RCAP's own directors and officers). Westchester contended that none of the exceptions to the exclusion applied, including the bankruptcy exception. Westchester further claimed that the policy did not apply because defendants insureds in the Creditor Trust Action had acted in capacities other than their RCAP director and officer capacities.

Insurer's Declaratory Judgment Action and Insureds' Counterclaim

Shortly after issuing its denial of coverage letter, Westchester initiated the instant action, seeking a declaration that it had no coverage obligations, because of the insured vs. insured exclusion or, alternatively, other policy exclusions. It subsequently amended the complaint to include the remaining excess insurers, Aspen (issuer of the eighth layer policy) and RSUI *139 (issuer of the ninth layer). RSUI

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asserted crossclaims against defendants insureds, raising the same coverage defenses as Westchester. Defendants insureds answered and asserted counterclaims against Westchester and RSUI, asserting a first counterclaim for breach of contract with respect to the excess insurers' coverage obligations, a second counterclaim based on their bad faith breach, and a third counterclaim seeking a declaration of coverage and defense, as well as attorneys' fees.

In May 2018, Westchester and RSUI moved to dismiss, as relevant here, the first counterclaim, for breach of contract, pursuant to [CPLR 3211\(a\)\(1\)](#) and [\(a\)\(7\)](#). They argued that the court could determine, as a matter of law, that coverage was barred by the insured vs. insured exclusion, because the Creditor Trust Action is a claim brought "on behalf of" RCAP, by its assignee, against RCAP directors and officers, and the bankruptcy exception did not apply.

Defendants insureds opposed the motions, contending that the insured vs. insured exclusion did not apply to the claims brought by the Creditor Trust on behalf of the bankruptcy estate for the benefit of RCAP's creditors and, alternatively, that the Creditor Trust fit into the bankruptcy exception to the insured vs. insured exclusion providing coverage for claims brought by certain bankruptcy-related entities. Additionally, defendants insureds moved for partial summary judgment to dismiss Westchester's and RSUI's complaint asserting coverage defenses, for a declaratory judgment on the insurers' coverage and defense obligations, and for a judgment on their counterclaim for breach of contract.

Supreme Court denied plaintiffs excess insurers' motions to dismiss the counterclaims for breach of contract. Instead, Supreme Court granted partial summary judgment to defendants insureds on their counterclaim for breach of contract regarding defense, liability coverage, attorneys' fees, and costs of defense. This appeal ensued.

Discussion

In this case, whether Supreme Court correctly granted defendants insureds partial summary judgment on their counterclaim for breach of contract, on the coverage obligations, depends on whether the court correctly determined, as a matter of law, that plaintiffs insurers have no viable defense against providing coverage. As a threshold consideration, we ^{*140} examine Supreme Court's determination that the insured vs. insured exclusion did not

bar coverage in the underlying Creditor Trust Action, based on its finding that the bankruptcy exception, for claims brought by a bankruptcy trustee or a similar authority, ^{**74} applied to the claims bought by the Creditor Trust.

[3] [4] [5] [6] In an action for a judgment declaring the parties' rights under an insurance policy, this Court must be guided by rules of contract interpretation because "[a]n insurance policy is a contract between the insurer and the insured" ([Bovis Lend Lease LMB, Inc. v. Great Am. Ins. Co.](#), 53 A.D.3d 140, 145, 855 N.Y.S.2d 459 [1st Dept. 2008]). Contract interpretation or construction is usually a court function ([Hartford Acc. & Indem. Co. v. Wesolowski](#), 33 N.Y.2d 169, 172, 350 N.Y.S.2d 895, 305 N.E.2d 907 [1973]; [Broad St., LLC v. Gulf Ins. Co.](#), 37 A.D.3d 126, 130–131, 832 N.Y.S.2d 1 [1st Dept. 2006]). In attempting to resolve the parties' dispute regarding the proper interpretation of the term "comparable authorities" of the bankruptcy exception to the insured vs. insured exclusion, the court's initial task is to attempt to ascertain the parties' intent from the language of the insurance contract itself ([State of New York v. Home Indem. Co.](#), 66 N.Y.2d 669, 671, 495 N.Y.S.2d 969, 486 N.E.2d 827 [1985]; see also 11 Richard A. Lord, Williston on Contracts § 32.2 [4th ed 1999]). In that context, the court must construe the policy as a whole; all pertinent provisions of the policy should be given meaning, with due regard to the subject matter that is being insured and the purpose of the entire contract ([County of Columbia v. Continental Ins. Co.](#), 83 N.Y.2d 618, 628, 612 N.Y.S.2d 345, 634 N.E.2d 946 [1994]).

[7] [8] [9] [10] A provision in an insurance policy is ambiguous if it is subject to more than one reasonable interpretation ([State of New York v. Home Indem. Co.](#), 66 N.Y.2d at 671, 495 N.Y.S.2d 969, 486 N.E.2d 827; [Breed v. Insurance Co. of N. Am.](#), 46 N.Y.2d 351, 355, 413 N.Y.S.2d 352, 385 N.E.2d 1280 [1978]). However, a court should read policy provisions to avoid ambiguities if the plain language of the contract permits (*id.*). Thus, ambiguity in policy language will not be found to exist merely because two conflicting interpretations may be suggested (see [Broad St., LLC v. Gulf Ins. Co.](#), 37 A.D.3d at 131, 832 N.Y.S.2d 1 ["A court should not disregard the provisions of an insurance contract which are clear and unequivocal or accord a policy a strained construction merely because that interpretation is possible"]; see also [Maurice Goldman & Sons, Inc. v. Hanover Ins. Co.](#), 80 N.Y.2d 986, 987, 592 N.Y.S.2d 645, 607 N.E.2d

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[792 \[1992\]](#)). Rather, where the parties differ concerning the meaning of an insurance contract, the court will be guided by a reasonable reading of the plain language of the policy (*id.*;

see also *141  [Automobile Ins. Co. of Hartford v. Cook](#), 7 N.Y.3d 131, 138, 818 N.Y.S.2d 176, 850 N.E.2d 1152 [2006] [“a reasonable insured under these circumstances would have expected coverage under the policy”]).

[11] Applying these principles to the D & O policy here, we find that the exception for “the Bankruptcy Trustee or ... comparable authority ...” applies to restore coverage removed by the insured vs. insured exclusion. Initially, we reject defendants insureds' argument that we do not need to address the bankruptcy exception, because the excess insurers have not established their burden that the insured vs. insured exclusion is implicated as a threshold consideration to whether the exception restores D & O liability coverage. To the contrary, the presence of a provision in the D & O policy that the pre-petition debtor company, here RCAP, is an “insured” covered by the D & O liability policy's insured vs. insured exclusion, and the presence of an exception to the exclusion for claims brought on behalf of the estate by bankruptcy-related entities (bankruptcy trustee and comparable authorities), clearly indicates **75 that in the absence of such a specific exception, the listed bankruptcy-related constituents would fall within the scope of the insured vs. insured exclusion and bar coverage for claims brought by successors-in-interest to the pre-petition debtor, such as RCAP here (see  [Indian Harbor Ins. Co. v. Zucker](#), 860 F.3d 373, 375 [6th Cir.2017];  [Biltmore Assoc. LLC v. Twin City Fire Ins. Co.](#), 572 F.3d 663, 670 [9th Cir.2009]).

Turning to the question of whether the exception for bankruptcy trustees and comparable authorities applies here to restore coverage removed by the insured vs. insured exclusion, we find that the pertinent clauses of the insured vs. insured exclusion and the bankruptcy exception, when read together, are unambiguous. Their plain language indicates no intent to bar coverage for D & O claims brought by the Creditor Trust, as a post-confirmation litigation trust. To begin, the policy included the crucial language brought “by or on behalf of” in the insured vs. insured exclusion and bankruptcy exception. Thus, the exclusion and exception both focused on the identity of the party asserting the claim, not on the nature of the claim being brought. Moreover, the policy included the debtor corporation, or DIP, as an insured under the insured vs. insured exclusion, but did not to include the DIP under the bankruptcy trustee and

comparable authorities exception. Thus, when read together, the bankruptcy exception restores coverage for *142 bankruptcy-related constituents, such as the bankruptcy trustees and comparable authorities, and the insured vs. insured exclusion precludes the possibility of a lawsuit by a company as DIP, or by individuals acting as proxies for the board or the company.

In other words, because the D & O policy covers the debtor in the insured vs. insured exclusion even in the advent of bankruptcy, the D & O policy allows the company when transformed into a DIP or debtor corporation upon the filing of the petition to retain its factual identity as far as the insured vs. insured exclusion is concerned. This is because, “[l]iterally, the debtor's management remains in possession of the estate's property [including cause of action against officers and directors] and remains responsible for managing the estate's financial affairs while the case is pending.”⁷ Thus, the DIP is one and the same with the debtor corporation and necessarily acts in concert therewith.

The D & O claims here, however, are not prosecuted by the debtor corporation or by individuals acting as proxies for the board or the company. On the contrary, the D & O claims are prosecuted by the post-confirmation Creditor Trust, a separate entity.

In fact, pursuant to Bankruptcy Code  [11 USC § 1123\(b\)](#), the specific terms of the Chapter 11 plan and Creditor Trust Agreement both provide that the claims against the directors and officers will inure to the benefit of the corporation's unsecured creditors and exclude the debtor company from recovery of any benefit from the lawsuit. Furthermore, even though the D & O claims are transferred to a Creditor Trust pursuant to the debtor's proposed plan, the creditors selected the Creditor Trustees, which is comprised of the oversight creditor's committee. To be sure, the excess insurers are correct to assert that once a company is in bankruptcy, virtually any claim can be understood as asserted for the creditors. However, **76 what makes a Creditor Trust “comparable” to a bankruptcy-related entity, seeking to recover funds for the creditors, is that the Trust is not merely a creditor. Rather, it is an entity and authority created as part and parcel of the bankruptcy reorganization proceeding, empowered by the bankruptcy court's order of confirmation to file D & O claims.

*143 That the Creditor Trust must be viewed as a separate entity from the debtor finds support in the fact that such a

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litigation trust has standing to pursue post-confirmation D & O claims explicitly pursuant to the Bankruptcy Code. The authority to establish a post-confirmation litigation trust or estate representative to pursue causes of action is found in  [Section 1123\(b\)\(3\)\(B\) of the Bankruptcy Code](#). Although not a mandatory provision in a chapter 11 plan, a plan may nevertheless provide for “the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose” of any claim or interest belonging to the debtor or to the estate ( [11 USC § 1123\[b\]](#) [3][B]). Under  [11 USC § 1123\(b\)\(3\)\(B\)](#), a party other than the debtor or trustee (such as Creditor Trust here) that seeks to enforce a claim must show that (i) it has been appointed under a Chapter 11 plan; and; ii) it is a representative of the estate (see  [McFarland v. Leyh \[In re Tex. as Gen. Petroleum Corp.\]](#), 52 F.3d 1330, 1335 [5th Cir.1995]).

Significantly, in determining whether, as the appointed party, the Creditor Trust's responsibilities qualified as a representative of the estate, the bankruptcy court's primary concern was whether a successful recovery by the appointed estate representative “ ‘would benefit the debtor's estate and, particularly, the debtor's unsecured creditors’ ” ( [Citicorp Acceptance Co. v. Robison \[In re Sweetwater\]](#), 884 F.2d 1323, 1327 [10th Cir.1989] quoting [Temex Energy, Inc. v. Hastie & Kirschner \[In re Amarex, Inc.\]](#), 96 B.R. 330, 334 [W.D. Okla. 1989]). Following such a finding and upon confirmation, RCAP, as the proponent of the plan, became merely a reorganized debtor (rather than a debtor-in-possession) and, as such, could not exercise the powers granted to debtors-in-possession and trustees under the Bankruptcy Code (see USC § 1141[b];  [Dynasty Oil & Gas, LLC v. Citizens Bank \[In re United Operating, LLC\]](#), 540 F.3d 351, 355 [5th Cir.2008]). That power fell upon the Creditor Trust.

In addition to the plain language of the bankruptcy exception and the mandates of the Bankruptcy Code, there are other reasons informing our decision to reject the excess insurers' position in this case. First, we perceive no valid rationale for excluding D & O claims from D & O coverage when asserted by a post-confirmation litigation trust where coverage would otherwise exist for identical claims asserted by a Chapter 11 trustee, liquidator or creditors' committee. The main rationale offered by the excess insurers for excluding D & O claims when asserted by the Creditor Trust in this context is that ownership of such claims is the result of a voluntary assignment by *144 the debtor company, which

itself cannot assert D & O claims covered by the D & O policy. The excess insurers argue that this raises concerns of collusion. However, to hold that vesting estate assets in the Creditor Trust is a mere contractual assignment would ignore that the Creditor Trust Agreement was drafted and executed in a Chapter 11 Bankruptcy proceeding to obtain confirmation of a reorganization plan. In that context, it would be unreasonable to interpret the “assignment” of the D & O claims to the Creditor Trust as just a contractual assignment. On the contrary, the vesting of assets from one entity to another accomplishes the goal of filing for bankruptcy, **77 which is to automatically vest all properties of the estate in the DIP, until there is an order of the bankruptcy court confirming the reorganization plan of the debtor (see USC § 1141[b]).

Further, to hold that the bankruptcy exception does not apply to the Creditor Trust would ignore the rationale and purpose for the creation of a post-confirmation litigation trust. In a Chapter 11 reorganization plan, creation of a post-confirmation litigation trust allows an entity other than the debtor corporation to pursue the cause of action, and permits the reorganized debtor's management to focus on running its business, after emerging from bankruptcy. Often, “the claims transferred to the litigation trust are those that the existing management of the debtor is perceived as being reluctant to pursue.”⁸ Also, like here, customarily, “the claims transferred to the litigation trusts are those brought against former directors or officers, or persons with whom the current directors have close ties.”⁹

  Likewise, the excess insurers' narrow interpretation of the term “comparable authorities,” within the bankruptcy exception, ignores the economic reality of insolvency. The alternative to assigning the D & O claims to a post-confirmation Creditor's Trust is to assign them to a bankruptcy trustee, or other type of estate representative so it can pursue such claims, or to abandon them. Of course, an assignment of the claims to a pre-confirmation bankruptcy trustee, or other type of estate representative, would not exclude them from D & O coverage under the broad bankruptcy exception here. Alternatively, pursuant *145 to the Bankruptcy Code ([11 USC § 554](#)), an abandonment of the claims would require that the plan proponent demonstrate that such claims are of inconsequential value, or that retaining the same would be burdensome. This standard is unlikely to be satisfied here where the claims against the directors and officers have been deemed by the unsecured creditors to be of significant value, and derivative standing could be conferred

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upon a creditors committee, which would also not be excluded from D & O coverage. ¹⁰

Still, the excess insurers argue that if the parties intended a blanket exception, they would not have chosen the listed bankruptcy-related constituents. But the opposite is just as true. Had the parties intended that claims brought on behalf of creditors by the Creditor Trust be excluded from coverage by the insured vs. insured exclusion and not restored under the bankruptcy exception, they would have provided for that as a matter of contract. Instead, by including the undefined and open-ended phrase “comparable authority” into the D & O policy’s bankruptcy exception, the parties created a broadly applicable exception with no clear limiting principles other than that there should be no coverage where the D & O claims are prosecuted by the DIP or by individuals ^{**78} acting as proxies for the board or the company. No amount of case law cited by the excess insurers can change the plain language of the D & O policy.

In any event, none of the cases relied upon by the excess insurers addressed the specific question here: whether the insured vs. insured exclusion bars coverage in the underlying D & O action given the exception applicable to bankruptcy trustees and comparable authorities. The excess insurers rely primarily upon  *Indian Harbor Ins. Company v. Zucker*, 860 F.3d 373 [6th Cir.2017], and its progeny.  *Indian Harbor*, however, is easily distinguishable because that case involved an insured vs. insured exclusion that contained no bankruptcy exception.  *Indian Harbor* declined to read such an exception into the policy. In contrast, in this case, there is a bankruptcy exception explicitly applicable ^{*146} to bankruptcy trustees and comparable authorities, which we interpret to encompass a post-confirmation litigation trust pursuant to the broad “comparable authority” language of the exception. ¹¹

Finally, we reject the excess insurers’ argument that a broad interpretation of the bankruptcy exception impermissibly renders the separate Creditor Committee exception meaningless. We recognize that both the Creditor Trust and Creditor Committee in a Chapter 11 proceeding could seek to obtain assets for creditors. However, the fact that the parties included a specific exception for the Creditor Committee and could have made it clear that the Creditor Trust was intended to be covered by the exception by using the broad “comparable authority” language in the Creditor

Committee exception, does not mean that the Creditor Trust cannot be found to be encompassed by the broad “comparable authority” language as used in the bankruptcy exception.

[14] While we agree with Supreme Court to the extent it determined that the insured vs. insured exclusion did not bar coverage in the underlying Creditor Trust Action, we find that Supreme Court should not have granted partial summary judgment to defendants insureds on their claim for breach of contract on the coverage ^{**79} obligations and in issuing the declaration ^{*147} of coverage. Material factual disputes remain as to the application of other coverage defenses. Specifically, the Creditor Trust Action may reveal that defendants insureds engaged in wrongdoing to benefit a separate entity, AR Capital LLC, while acting in their personal capacities, for which no coverage exists, rather than “solely” in their capacities as directors and officers (see *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Jordache Enters.*, 235 A.D.2d 333, 652 N.Y.S.2d 966 [1st Dept. 1997], *lv denied in part, dismissed in part*, 90 N.Y.2d 931, 664 N.Y.S.2d 263, 686 N.E.2d 1359 [1997]). There are also issues of fact as to whether the sole remedy in the Creditor Trust Action is the disgorgement of ill-gotten gains, which would not be insurable (see  *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 21 N.Y.3d 324, 970 N.Y.S.2d 733, 992 N.E.2d 1076 [2013]). Under the circumstances, it was premature for the court to declare that plaintiff excess insurers were obligated to pay for all indemnity costs incurred in an action pending in Delaware; it was also premature for the court to award defendants insureds attorneys’ fees incurred in defending the declaratory judgment action.

[15] [16] While we find that there are issues fact as to certain coverage defenses, this holding does not require the vacatur of the declaration that plaintiffs insurers are obligated to pay for all defense costs incurred in defending the Credit Trust action pending in Delaware. In policies that provide for a duty to defend or a duty to advance defense costs to directors and officers, the duty arises “whenever the underlying complaint alleges facts that fall within the scope of the coverage” ( *Fed. Ins. Co. v. Kozlowski*, 18 A.D.3d 33, 40, 792 N.Y.S.2d 397 [1st Dept. 2005]). A carrier’s duty to defend and the duty to advance defense costs are triggered by the same allegations ( *id.*). The duty to provide defense costs “must be construed broadly in favor of the policyholder,” and “exists whenever a complaint against the insured alleges claims that maybe covered under the insurer’s policy” ( *Kozlowski*, 18 A.D.3d at 41, 792 N.Y.S.2d 397).

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[17] Here, the policies issued by plaintiffs excess insurers provide a broad right to the provision of defense costs subject to repayment in the event and to the extent that the insured “shall not be entitled under the terms and conditions of this policy to payment of such loss.” The policies further provide that the carrier will advance defense costs for any claim “prior to its final disposition.” This Court’s finding that the Creditor Trust Action “may reveal” that defendants insureds’ claim is not covered necessarily means that there is a possibility of coverage under the policies for the advancement of defense costs for defendants *148 insureds. Therefore, as a matter of law, defendants insureds are entitled to the advancement of defense costs with regard to the Credit Trust Action.

Accordingly, the orders of the Supreme Court, New York County (O. Peter Sherwood, J.), entered May 16, 2019 and June 11, 2019, which, to the extent appealed from, granted the motions of defendants-respondents Nicholas S. Schorsch, Edward M. Weil, Jr., William Kahane, Peter M. Budko, and Brian S. Block (defendants insureds) for partial summary judgment on their first counterclaim alleging breach of contract with respect to the insurance coverage obligations of plaintiff-appellant Westchester Fire Insurance Co., defendant-appellant Aspen American Insurance Co., and defendant-appellant RSUI Indemnity Co. (collectively, Excess Insurers), declared Excess Insurers obligated to pay for all defense and indemnity costs incurred in an action pending in Delaware, and found defendants insureds entitled to **80 attorneys’ fees incurred in defending against the instant declaratory judgment action, and denied Excess Insurers’ motions to

dismiss defendants insureds’ counterclaim for breach of contract, should be modified, on the law, to deny defendants insureds’ motion for partial summary judgment on their first counterclaim, to vacate the declaration that Excess Insurers are obligated to pay for indemnity costs incurred in the Creditor Trust Action, and to vacate the award of attorneys’ fees incurred by defendants insureds in the instant action, and otherwise affirmed, without costs.

The Decision and Order of this Court entered herein on May 14, 2020 is hereby recalled and vacated (*see* M–1999, M–2133, M–2136 and M–2139, [2020 WL 4875953](#), decided simultaneously herewith).

All concur.

Orders, Supreme Court, New York County (O. Peter Sherwood, J.), entered May 16, 2019 and June 11, 2019, modified, on the law, to deny defendants insureds’ motion for partial summary judgment on their first counterclaim, to vacate the declaration that Excess Insurers are obligated to pay for indemnity costs incurred in the Creditor Trust Action, and to vacate the award of attorneys’ fees incurred by defendants insureds in the instant action, and otherwise affirmed, without costs.

All Citations

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Footnotes

- ¹ The individual defendants are Nicholas S. Schorsch, Edward M. Weil, Jr., William Kahane, Peter M. Budko, and Brian S. Block. They will be referred to collectively throughout the opinion as defendants insureds.
- ² The “Creditor Trust” is a type of post-confirmation litigation trust created to pursue a bankruptcy estate’s causes of action prosecuted for the benefit of creditors after a debtor’s reorganization plan has been accepted by the bankruptcy court. As here, bankruptcy-related parties often prefer to postpone litigation of such claims until after approval or confirmation of a Chapter 11 reorganization plan, thus, preserving such claims, held by the bankruptcy estate, for post-confirmation litigation.
- ³ A REIT (Real Estate Investment Trust) is a professionally managed company that mainly owns and operates income-producing real estate (*see* Theodore S. Lynn et al., Real Estate Investment Trusts 1011 [1991]).

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- 4 A debtor-in-possession (DIP) is an entity or corporation that has filed for Chapter 11 bankruptcy protection, but still holds property to which creditors have a legal claim under a lien or other security interest. A DIP may continue to do business using those assets, but is required to seek court approval for any actions that fall outside of the scope of regular business activities (see  [11 USC § 1107\[a\]](#) [rights, powers, and duties of debtor in possession]; see also  [In re International Yacht and Tennis, Inc. v. Wasserman](#), 922 F.2d 659 [11th Cir.1991];  [Zilkha Energy Co. v. Leighton](#), 920 F.2d 1520 [10th Cir.1990]).
- 5 Specifically, RCAP assigned to the Creditor Trust certain of its litigation claims, including the claim in [RCS Creditor Trust v. Schorsch](#), 2017 WL 5904716, 2017 Del. Ch. LEXIS 820 [Del. Ch. 2017], for which defendants insureds now seek coverage from plaintiff Westchester.
- 6 Where an insured purchases a primary insurance policy and “follow form” excess insurance policy, the follow form excess policy generally will contain the same basic provisions as the primary policy with the exception of those provisions that are inconsistent with the terms of the primary policy to which it follows form (Scott M. Seaman and Charlene Kittredge, [Excess Liability Insurance: Law and Litigation](#), 32 Tort & Ins L J 653 [1997]).
- 7 Jeff Ferriell & Edward J. Janger, Understanding Bankruptcy 143–150 [2007]; see also Michael D. Sousa, [Making Sense of the Bramble-Filled Thicket: The “Insured vs. insured” Exclusion in the Bankruptcy Context](#), 23 Emory Bankr Dev J 365, 404 [2007].
- 8 Paige Holden Montgomery and Casey A. Burton, An Introduction to Litigation Trusts, American Bar Association: <https://www.americanbar.org/groups/litigation/committees/commercial-business/articles/2013/an-introduction-to-litigation-trusts> [Last accessed April 23, 2020]
- 9 *id.*
- 10 As a party in interest, a creditor has the right to request authority to pursue causes of action on behalf of the estate (see  [Louisiana World Exposition v. Federal Ins. Co.](#), 858 F.2d 233 [5th Cir.1988]). A creditor may pursue claims on behalf of the estate when three requirements are satisfied: (1) the claim is colorable, (2) the debtor-in-possession has unjustifiably refused to pursue the claim, and (3) the creditor obtains approval to do so from the bankruptcy court ( [id.](#) at 247).
- 11 Where, unlike here, a D & O policy does not explicitly contain a bankruptcy exception, there is a split of authority at the federal level regarding the effects of a bankruptcy proceeding on the exclusion. The split is along the lines of whether a lawsuit brought against officers and directors by the various successors-in-interest to the pre-petition debtor, namely bankruptcy trustees, creditors committees or post-confirmation trustees, serves to trigger the insured vs. insured exclusion in a D & O liability policy. In the First, Eighth and Eleventh Circuits, for instance, the insured vs. insured exclusion bars coverage for lawsuits against former officers and directors by a confirmation plan committee or bankruptcy trustee (see e.g.  [Indian Harbor Ins. Co.](#), 860 F.3d at 375;  [Biltmore Assoc. LLC v. Twin City Fire Ins. Co.](#), 572 F.3d at 670;  [National Union Fire Ins. Co. v. Olympia Holding Corp.](#), 1996 WL 33415761, 1996 U.S. Dist. LEXIS 22806 [N.D. Ga. June 4, 1996];  [Reliance Ins. Co. of Ill. v. Weis](#), 148 B.R. 575 [E.D. Mo. 1992], *affd*, 5 F.3d 532 [8th Cir.1993], *cert. denied sub nom. Plan Comm. of Bank Bldg. & Equip. Corp. of Am. v. Reliance Ins. Co. of Ill.*, 510 U.S. 1117, 114 S.Ct. 1066, 127 L.Ed.2d 385 [1994]). On the other hand, courts in the Second, Third, Sixth and Ninth Circuits have concluded that the insured vs. insured exclusion was not triggered in lawsuits brought by a bankruptcy trustee or other successors-in-interest against the former directors and officers for breach of fiduciary duty (see e.g. [In re Palmaz Scientific, Inc.](#), 2018 WL 3343597, *4–12 [Bankr W.D. Tex. 2018];  [Alstrin v. St. Paul Mercury Ins. Co.](#), 179 F. Supp. 2d 376 [D. Del.2002];  [Cohen v. National Union Fire](#)

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Westchester Fire Insurance Co. v. Schorsch, 186 A.D.3d 132 (2020)

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Ins. Co. [In re County Seat Stores, Inc.], 280 B.R. 319 [Bankr.S.D. N.Y.2002];  *Rieser v. Baudendistel [In re Buckeye Countrymark, Inc.]*, 251 B.R. 835 [Bankr. S.D. Ohio 2000];  *Pintlar Corp. v. Fidelity & Cas. Co. of N.Y. [In re Pintlar Corp.]*, 205 B.R. 945 [Bankr. D. Idaho 1997]).

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Faculty

Hon. Ashely M. Chan is a U.S. Bankruptcy Judge for the Eastern District of Pennsylvania in Philadelphia. Prior to taking the bench, she was a shareholder at Hangley Aronchick Segal Pudlin & Schiller and concentrated her practice in the areas of bankruptcy and corporate restructuring. From 1996-97, Judge Chan clerked for Hon. Gloria M. Burns of the U.S. Bankruptcy Court for the District of New Jersey. Before joining HASPS, she was an associate at Morgan, Lewis & Bockius LLP in its business and finance section, where she focused on bankruptcy, corporate restructuring and corporate finance. Judge Chan has received numerous recognitions, including being selected as a Leader in Bankruptcy/Restructuring by *Chambers USA*, being listed in *The Best Lawyers in America* for Bankruptcy and Creditor-Debtor Rights, and being listed as a Pennsylvania Lawyer on the Fast Track by *The Legal Intelligencer* and *Pennsylvania Law Weekly*. She is an adjunct professor at Temple Law School, where she teaches a course on commercial bankruptcy practice and procedure, and she chairs the Bankruptcy Judges Advisory Group. Judge Chan received her J.D. in 1996 from Rutgers School of Law – Camden, where she received Tax Honors with Distinction and the Rutgers Pro Bono Publico Award.

Jay M. Goffman is client chairman of Teneo’s Financial Advisory Business in New York. In this role, he leads client development and execution for Teneo’s North American Financial Advisory business, while also working across the broader business globally. Prior to joining Teneo, Mr. Goffman was vice chair of Global Advisory at Rothschild & Co., a large international investment bank, where he advised clients across Rothschild’s Restructuring, Debt Advisory and M&A practices. Before Rothschild, he spent 36 years as a lawyer focused on restructuring, debt advisory and distressed M&A. For the last 24 years of his legal career, he practiced at Skadden Arps, where he was the global head of its Corporate Restructuring Department. Over the course of his career, Mr. Goffman has consistently been recognized as one of the leading and most innovative restructuring advisors in the world. He was named a “Dealmaker of the Year” by *The American Lawyer* and one of the “Most Influential Lawyers of the Decade” by *The National Law Journal*. He has also received several Lifetime Achievement and Hall of Fame honors, in addition to numerous philanthropic awards. Mr. Goffman is best known for having devised and pioneered the “prepackaged” restructuring, which revolutionized the field of restructuring and has been successfully used over the past 35 years to reorganize hundreds of companies in a quick, efficient and cost-effective manner. As a result of his efforts, prepacks are now the predominant method used in major restructurings. Mr. Goffman has successfully reorganized businesses out of court and in court across multiple industries and geographies, including some of the largest, most high-profile and most complex cases in history. Many of his deals and accomplishments have been profiled in various publications, including *The Wall Street Journal*. Mr. Goffman has chaired restructuring panels and legislative review committees, in addition to chairing and speaking at numerous restructuring and distressed M&A conferences. He also has published extensively on restructuring, fiduciary duties and distressed M&A. Mr. Goffman received his B.S. in 1980 in chemical psychobiology from the State University of New York at Binghamton and his J.D. in 1983 with honors from the University of North Carolina at Chapel Hill, where he was a member of the *University of North Carolina Law Review*. In 2018, the University of North Carolina School of Law presented him with its Distinguished Alumni Award.

Hon. Michael B. Kaplan is Chief U.S. Bankruptcy Judge for the District of New Jersey in Trenton, initially appointed on Oct. 3, 2006, and named Chief Judge on May 1, 2020. Prior to taking the bench, Judge Kaplan served as a standing chapter 13 bankruptcy trustee, as well as a member of the chapter 7 panel of bankruptcy trustees, where he received case appointments as both a chapter 11 and chapter 12 trustee. His private practice included the representation of institutional lenders consumer debtors (under both chapters 7 and 13), business debtors and individuals undergoing reorganization pursuant to chapter 11. Judge Kaplan is a Fellow of the American College of Bankruptcy and is a member of the National Conference of Bankruptcy Judges, for which he is currently serving as Treasurer and Executive Board Member. Over the past 30 years, he has spoken to numerous bar associations and business organizations, and since 2009 he has taught as an adjunct professor at Rutgers University School of Law. Judge Kaplan has authored several articles relating to bankruptcy issues and is a co-author of West's *Consumer Bankruptcy Manual* and *Consumer Bankruptcy Handbook*. Additionally, he serves on the Editorial Board and as business manager for the *American Bankruptcy Law Journal*. Prior to taking the bench, Judge Kaplan served as mayor and councilman for the Borough of Norwood, N.J., and as a member of the Norwood Planning Board. He received his A.B. from Georgetown University in 1984 and his J.D. from Fordham University School of Law in 1987.

Alexa J. Kranzley is a special counsel in Sullivan & Cromwell LLP's Finance and Restructuring Group in New York. She represents companies and creditors in chapter 11 proceedings and out-of-court corporate and financial restructurings, as well as and private-equity and hedge funds in connection with distressed transactions and special-situation investments. Ms. Kranzley also has experience handling adversary proceedings, contested matters and both debtor and creditor representations in bankruptcy proceedings. Ms. Kranzley's practice is international, and she has worked in collaboration with the firm's other offices on substantive matters involving restructurings in other jurisdictions. Ms. Kranzley was honored as a member of ABI's 2018 "40 Under 40" class and nominated and inducted in 2017 into the International Insolvency Institute's NextGen Leadership Program. She is also recognized by *IFLR1000* 2018 as a "Rising Star" and was named a 2021 "Outstanding Young Restructuring Lawyer" by *Turnarounds & Workouts*. Ms. Kranzley received her B.S. in 2005 from Cornell University and her J.D. in 2008 from Brooklyn Law School.

Hon. Sean H. Lane is a U.S. Bankruptcy Judge for the Southern District of New York in New York, sworn in on Sept. 7, 2010. He previously clerked for Hon. Edmund V. Ludwig, U.S. District Judge for the Eastern District of Pennsylvania, from 1991-92, as well as for Hon. Charles R. Richey, U.S. District Judge for the District of Columbia, from 1992-93. From 1993-97, he practiced with the law firm of BakerHostetler in Washington, D.C., and thereafter served as a trial attorney in the Department of Justice, Civil Division, National Courts Section, until 2000. From 2000 until he was appointed to the bench, Judge Lane served as an assistant U.S. attorney for the Southern District of New York and was also chief of the Tax & Bankruptcy Unit of that office. During his time in the U.S. Attorney's Office, he was awarded the Attorney General's Distinguished Service Award in 2005 and the Henry L. Stimson Medal by the New York City Bar Association in 2008. Judge Lane is a member of the Federal Bar Council and has served as an adjunct professor at both New York University School of Law and Fordham Law School. He received his B.A. from New York University College of Art & Science in 1987 and his J.D. from New York University School of Law in 1991.

Hon. Karen B. Owens is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington. Prior to her appointment, she was a director in the Bankruptcy and Insolvency group of Ashby & Geddes, P.A., where she maintained a diverse practice, representing corporate debtors, estate professionals, various secured and unsecured creditor constituencies, and other interested parties in reorganization and liquidation proceedings and bankruptcy-related litigation. Prior to joining Ashby & Geddes, Judge Owens started her career at Skadden, Arps, Slate, Meagher & Flom as a corporate restructuring associate, and later went on to clerk for Hon. Brendan Linehan Shannon of the U.S. Bankruptcy Court for the District of Delaware. She is an adjunct professor in the Bankruptcy L.L.M. Program at St. John's University School of Law in New York, co-president of the Delaware Bankruptcy American Inn of Court, a member of the board of directors of the Philadelphia/Wilmington Chapter of the Turnaround Management Association, and a member of the International Women's Insolvency & Restructuring Confederation. Judge Owens received her Bachelor's degree from Pennsylvania State University, where she was Phi Beta Kappa, and her J.D. *summa cum laude* from American University's Washington College of Law, where she served as an associate managing editor for the *American University Law Review* and as legal intern to Hon. Stephen S. Mitchell of the U.S. Bankruptcy Court for the Eastern District of Virginia.

