American Bankruptcy Institute

Views from the Bench, 2018

Confirmation Roundtable

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2018

ABI Bankruptcy 2018: Views from the Bench

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Do Creditors Have a Statutory Basis to Demand Participation in Rights Offerings?

CHC Group Ltd., Case No. 16-31854 (Bankr. N.D. Tex. 2016)

I. Introduction

A. In CHC, members of a majority group of the debtors' senior notes were permitted to (a) participate in a rights offering and (b) receive a backstop fee for backstopping the rights offering. The minority senior noteholders, whose prepetition claims were substantively identical to the claims of majority noteholders, were not invited to participate in the rights offering or in the related backstop agreement. Both majority and minority noteholders occupied the same class under the CHC debtors' plan of reorganization. The group of minority noteholders objected to the debtors' plan on the basis that the plan "unfairly discriminated" against them under 11 U.S.C. § 1123(a)(4) of the Bankruptcy Code.

B. 11 U.S.C. § 1123(a)(4): "Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall . . . provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest."

II. Background

A. CHC Group Ltd. and certain of its affiliates (the "**Debtors**") filed their chapter 11 cases on May 5, 2016. On the petition date, the Debtors' capital structure included approximately $1.068 billion outstanding (including principal, unpaid interest, fees and other expense) in 9.25% Senior Secured Notes that were scheduled to mature on 10/15/2020 (the "**Senior Notes**").

B. Approximately 5 months after filing, the Debtors and certain of their key creditors entered into a Plan Support Agreement (the "**PSA**") and related Backstop Agreement (the "**Backstop Agreement**") and moved the bankruptcy court to approve the Backstop Agreement and PSA.

1. An ad hoc group (the "**Ad Hoc Group**") made up of approximately 67.5% of the holders of Senior Notes (the "**Majority Noteholders**") served as sponsors (the "**Plan Sponsors**") under the PSA. The remaining 32.5% of the holders of Senior Notes (the "**Minority Noteholders**") were not members of the Ad Hoc Group, Plan Sponsors under the PSA, or parties to the Backstop Agreement.

C. <u>The Plan, PSA, and Backstop Agreement</u>

1. Under the PSA and Backstop Agreement, the Debtors sought to raise $300 million through a rights offering (the "**Rights Offering**"). The Plan Sponsors were granted subscription rights, allowing them to purchase New Second Lien Convertible Notes

(the "**Convertible Notes**") which would mandatorily convert to new equity in the reorganized debtors (the "**New Equity**").

2. Convertible Notes sold through the Rights Offering would be sold at a discount. Thus, the $300 million raised through the Rights Offering would result in the issuance of $433.3 million in aggregate principal amount of Convertible Notes.
3. The Majority Noteholders also agreed to guarantee the purchase of all Convertible Notes that remained unsold after the closing of the Rights Offering (the "**Backstop Parties**"). The Backstop Parties, who were completely comprised of the Majority Senior Noteholder, were eligible to receive a "Put Option Premium" (the "**Backstop Fee**") consisting of Convertible Notes in a principal amount of approximately $30.8 million.
4. In total, an aggregate principal amount of $464.1 million in Convertible Notes would be issued pursuant to the Rights Offering, which, upon conversion, would be equal to 85.4% of the New Equity in the reorganized Debtors (on a fully diluted basis).
5. Shortly after moving to seek approval of the PSA and Backstop Agreement, the Debtors filed a plan of reorganization (the "**Plan**") and related disclosure statement that sought to implement the transactions described in the PSA and Backstop Agreement.
6. Under the Plan, all claims arising under the Senior Notes were classified as Class 5 Secured Claims and allowed in the amount $1,067,832, 576.
7. All holders of claims arising under the Senior Notes were eligible to receive their pro rata share of 79.5% of New Equity—which the Plan acknowledged would actually be diluted down to 11.6% of New Equity after conversion of the Convertible Notes.

D. <u>Minority Noteholder Objections</u>

1. A Senior Noteholder ("**AGCO**") holding approximately $100 million of Senior Notes objected to the PSA and Backstop Agreement. AGCO claimed that its offers to serve as Plan Sponsors and Backstop Parties were spurned, and thus, the Plan was unconfirmable because it unfairly discriminated against the Minority Noteholders in violation of section 1123(a)(4) of the Bankruptcy Code.
2. The court approved the PSA and Backstop Agreement over AGCO's objection, but preserved interested parties' rights to assert any objections to confirmation of the Plan at such time that the Debtors moved to confirm the Plan.
3. At confirmation, KLS Diversified Asset Management LP ("**KLS**"), a Minority Noteholder holding $51.15 million in Senior Notes brought an 1123(a)(4) objection on the same basis as AGCO. AGCO did not file and objection to the Plan.
4. KLS argued that in forming the Ad Hoc Group, the Majority Shareholders owed a fiduciary duty to the Minority Noteholders and were obligated to negotiate the PSA and Backstop Agreement in a manner that considered the interests of the entire class. The Minority Noteholders claimed that the Majority Noteholders extracted value away from Minority Noteholders while enhancing their own returns through increased fees.

5. KLS also argued that section 1123(a)(4) requires that similarly situated creditors be granted the same opportunity to recover on their claims. Because the Minority Noteholders did not have the same opportunities to participate in the Rights Offering and Backstop Fee, and their recovery under the Plan would be diluted by the exercise of the Convertible Notes, this constituted disparate treatment and violated Section 1123(a)(4).
    a) KLS cited to *In re Washington Mut., Inc.*, 442 B.R. 314, 360 (Bankr. D. Del. 2011) and *In re Northwest Airlines Corp*., Case No. 05-17930 (ALG) (Bankr. S.D.N.Y.) (May 18, 2007) in support of its position.

III. Bankruptcy Court Analysis

A. Judge Isgur ultimately found that nothing in section 1123(a)(4) provided for an equal opportunity to participate in the Backstop Agreement or Rights Offering.

B. Judge Isgur discounted the argument that the Ad Hoc Group owed a fiduciary duty to other Senior Noteholders, and, ultimately, the court did not believe any such fiduciary duty implicated 1123(a)(4).

    1. Further, to the extent that the Ad Hoc Group owed any fiduciary duty to the Minority Noteholders, Judge Isgur noted that *Washington Mutual* and *In re Northwest Airlines* were concerned with how such duty affected the prepetition claims of similarly situated class members. The Backstop Fee and Subscription Rights, however, were not being paid or awarded on account of prepetition claims. Thus, under the Plan, the Backstop Parties/Majority Noteholders were not receiving more on account of their prepetition Senior Notes claims than any other Senior Noteholders—including the Minority Noteholders.

C. Ultimately, Judge Isgur found that there was no evidence on the record that KLC was "frozen" out of participation in the Ad Hoc Group.

    1. To the extent there may have been evidence that other Minority Noteholders other than KLS were improperly shut out of participating in the Ad Hoc Group, Judge Isgur ruled that KLS had no standing to assert grievances on their behalf.

IV. *In re TCI 2 Holdings, LLC*, 428 B.R. 117 (Bankr. D.N.J. 2010)

A. Like *CHC*, *TCI* involved a minority group of noteholders arguing that their lack of inclusion in a backstop agreement and related backstop fee constituted unfair discrimination under 11 U.S.C. § 1123(a)(4).

B. TCI 2 Holdings, LLC and certain of its affiliated debtors (the "**TCI Debtors**") were wholly owned subsidiaries of Trump Entertainment Resorts, which owned and operated three casino hotel properties in Atlantic City as well as other casino properties in California and Indiana.

    1. This was the third chapter 11 for the TCI Debtors and their predecessor entities, having been through bankruptcies in 2004 and 2009. They would go through another bankruptcy in 2016.

C. The court was faced with two competing plans of reorganization:

1. a plan proposed by Icahn Partners and Beal Bank, who collectively held $485 million in first lien claims against the TCI Debtors; and
2. a plan proposed in tandem by an ad hoc group of the holders of $1.25 billion in second lien notes (the "**Second Lien Notes**") and the TCI Debtors (the "**Debtor/AHC Plan**").

D. The court ultimately confirmed the Debtor/AHC Plan. Under the Debtor/AHC Plan, $225 million in new investment capital would be generated through a rights offering. The rights offering was open to holders of claims arising under the Second Lien Notes and general unsecured claims who would receive subscription rights to purchase 70% of new common stock in the reorganized TCI Debtors.

1. All Second Lien Notes Claims were classified as Class 4 Claims under the Plan
2. The Rights Offering would be backstopped by the members of an Ad Hoc Group made up of certain holders of the Second Lien Notes (the "**TCI Backstop Parties**"). Members of the Ad Hoc Group, who signed up to a backstop agreement (the "**TCI Backstop Agreement**"), would receive a backstop fee (the "**TCI Backstop Fee**") representing 20% of the new common stock of the reorganized debtors.
3. Certain of the holders of the Second Lien Notes, which included Icahn Partners, were precluded from participating in the backstop agreement.
   a) The TCI Debtors noted that Icahn Partners had been invited to participate, but chose not to participate until very late in the process, at which, point the Ad Hoc Group elected not to include Icahn Partners so late in the process.

E. *TCI* Bankruptcy Court Analysis

1. The *TCI* Bankruptcy Court observed that the argument that the AHC/Debtor plan classification scheme unfairly discriminated against certain noteholders depended upon the designation of the TCI Backstop Fee as a distribution on account of the Backstop Parties' status as holders of Second Lien Note claims.
2. Without detailed discussion, the *TCI* Bankruptcy Court ultimately determined that of the Backstop Fee was not a distribution to the Second Lien Noteholders on account of their Second Lien Note claims. Rather, the TCI Backstop Fee was offered as consideration for the $225 million commitment made by the TCI Backstop Parties. Thus, there was no violation of the classification mandate of section 1123(a)(4).

V. Recent Rights Offering/Confirmation Cases

A. *Peabody Energy Corporation*, Case No. 16-42529 (Bankr. E.D. Mo. March 30, 2017)

1. A court-mandated mediation between the debtors and certain of their lenders led to a plan-related agreement to raise $1.5 billion in form of a new equity investment: $750MM to be raised through private placement of preferred equity sold at a 35% discount ("**PPA**") and $750MM to be raised through rights offering, sold at a 45% discount ("**Rights Offering**").

a) Certain beneficial holders of second lien notes and senior unsecured claims (the "**Ad Hoc Committee**") elected not to participate in the mediation.

2. Entities purchasing equity under the PPA were also required to agree to backstop the Rights Offering and sign a Plan Support Agreement ("**PSA**"). Signatories to the PPA received premiums and fees for their financing commitment. Non-signatories to the PPA could participate in Rights Offering, but not in the private placement.

    a) Participation in the PPA and PSA was limited to the holders of 40% of second lien notes and class 5B claims under the Plan ("**Noteholder Co-Proponents**").

3. The Plan provided that the purchase of preferred equity under PPA "shall be solely on account of the new money provided" and not the purchasers' prepetition claims. The plan classified Ad Hoc Committee members together with the participants in the PPA.

4. The Ad Hoc Committee objected to approval of PPA and related agreements, arguing that together they effected a violation of § 1123(a)(4) and failure to maximize value of debtors' estate violated good faith requirement of § 1129(a)(3).

5. The *Peabody* court ultimately concluded that (a) the consideration provided for under the PPA was on account of postpetition financing, not on account treatment of creditors' prepetition claims under § 1123(a)(4) and (b) plan was good-faith attempt to provide greatest creditor recovery, to satisfy stakeholders, and to emerge with a feasible plan.

    a) "I view the participation in the private placement, and therefore the backstop obligation, to be an investment, an obligation, a commitment – those are commas between those words – and not a treatment of the plan or treatment provided for under the plan."

B. *Breitburn Energy Partners LP*, Case No. 16-11390 (Bankr. S.D.N.Y. 2016)

1. A proposed plan split the debtors into separate creditor-owned companies ("**New Permian**" and "**LegacyCo**"). Bondholders were slated to receive interests in New Permian, but were bifurcated based on qualification under the securities laws.

    a) Accredited investors were given an opportunity to participate in a rights offering to acquire equity of New Permian.

    b) Unaccredited investors were separately classified, and offered a combination of cash and shares of a trust holding new equity of New Permian.

2. Because unaccrediteds had to certify to non-accredited status through ballots, failure to certify meant no distribution at all. Accredited investors participating in the rights offering would receive an approximately 11.94% dividend on claims, while unaccredited investors received only 4.5%. In addition, creditors classified below unaccredited investors also received a larger dividend. Non-participating accrediteds would receive no distribution.

    a) Debtors were unable to show that plan did not unfairly discriminate and filed a revised plan that provided increased consideration to unaccredited investors.

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Substantive Consolidation with Non-Debtors

In re Archdiocese of Saint Paul and Minneapolis, 888 F.3d 944 (8th Cir. 2018)

I. Overview of Substantive Consolidation

A. Substantive consolidation allows courts to consolidate the assets and liabilities of distinct legal entities so that assets and liabilities can be dealt with as if owned by a single entity.

1. Substantive consolidation "treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities (save for inter-entity liabilities, which are erased). The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor." *In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005).

B. Neither the Bankruptcy Code nor the Bankruptcy Rules define or authorize substantive consolidation.

1. Instead, substantive consolidation is a construct of federal common law.
2. Courts generally find authority for substantive consolidation in Section 105(a), which allows courts to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code]."

C. While courts regularly consolidate multiple debtors, there is greater disagreement as to whether courts may order consolidation of a debtor with a non-debtor. *Compare In re Bonham*, 229 F.3d 750, 765 (9th Cir. 2000) (agreeing with the courts that "permit[] the consolidation of non-debtor and debtor entities in furtherance of the equitable goals of substantive consolidation.") *with In re Pearlman*, 462 B.R. 849, 854 (Bankr. M.D. Fla. 2012) (siding with those courts that "conclude that substantive consolidation is purely a bankruptcy remedy and does not extend to the assets and affairs of a non-debtor.").

II. Background of In re Archdiocese of Saint Paul and Minneapolis

A. The Archdiocese filed for Chapter 11 in response to more than 400 claims made by victims of alleged clergy abuse.

B. The Unsecured Creditors' Committee, representing the abuse claimants, moved to have the Debtor substantively consolidated with over 200 non-debtor entities, including various parish corporations, schools, and other affiliated non-profit groups (the "**Target Entities**").

C. The Committee identified a number of factors supporting substantive consolidation, including the role of the Archdiocese in incorporating the Target Entities, setting their bylaws, and overseeing their employment policies and financial decision-making.

D. After converting the Committee's motion to an adversary proceeding, the bankruptcy court granted the Debtor's motion to dismiss. The district court affirmed.

III. Bankruptcy Court Analysis

A. The Eighth Circuit affirmed the bankruptcy and district courts' denial of the Committee's motion to consolidate.

B. The Court acknowledged that the broad equitable powers afforded to bankruptcy courts by Section 105(a) allowed for substantive consolidation "in appropriate situations."

   1. The Court noted, however, that these equitable powers could not be used to "contravene specific statutory provisions of the Bankruptcy Code." (*citing Law v. Siegel*, 571 U.S. 415 (2014)).

C. Section 303 of the Code, governing involuntary bankruptcy cases, provides that an involuntary case may not be commenced against a "corporation that is not a moneyed, business, or commercial corporation."

   1. The statutory history showed that "[e]leemosynary institutions, such as churches, schools, and charitable organizations and foundations" were intended to be "exempt from involuntary bankruptcy."
   2. The Court concluded that the statutory phrase "not a moneyed" corresponded to the contemporary terms "not-for-profit" or "non-profit."

D. The court ultimately held that the bankruptcy court lacked legal authority to substantively consolidate the Debtor and Targeted Entities because to do so would override an explicit statutory protection in the Bankruptcy Code.

   1. The Targeted Entities, which were all religious organizations with non-profit status under Minnesota law, were non-moneyed corporations for the purposes of Section 303.
   2. Allowing substantive consolidation would necessarily pull those non-profit entities into bankruptcy involuntarily in contravention of Section 303(a).

IV. Lingering Questions

A. By relying upon Section 303(a)'s limitation on involuntary bankruptcies, the Court avoided the more fundamental question of whether (and under what circumstances) substantive consolidation with non-debtors may be appropriate.

B. The Court also "[left] for another day the issue of whether a non-profit non-debtor that is the alter ego, under state law, of the debtor, or has been formed as part of a fraudulent scheme, such as a Ponzi scheme, can be consolidated."

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Enforceability of Make-Whole Premiums in Chapter 11

Matter of MPM Silicones, L.L.C., 874 F.3d 787 (2d Cir. 2017)

I. Introduction

A. In *MPM*, the Second Circuit considered the enforceability of "make-whole" contract clauses in chapter 11. The *MPM* litigation began in the Bankruptcy Court for the Southern District of New York when Judge Drain confirmed a plan over the objections of creditors. In issuing a decision on confirmation (*In re MPM Silicones, LLC*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014), Judge Drain held that, as drafted, the make-whole provision in the applicable indentures was unenforceable pursuant to established New York law construing similar provisions. The District Court affirmed the Bankruptcy Court on appeal. *See In re MPM Silicones, LLC*, 531 B.R. 321 (S.D.N.Y. 2015). On appeal, the Second Circuit affirmed the District Court. Creditors subsequently appealed *MPM* to the Supreme Court and on June 18, 2018, the Supreme Court denied cert.

II. Background

A. In 2014, MPM Silicones, LLC and certain of its affiliates (the "**Debtors**") commenced their chapter 11 cases in the Southern District of New York with three tranches of secured notes:

1. $1.1 billion in first lien notes at 8.875% per annum (the "**1st Lien Notes**");
2. $250 million in 1.5 lien notes at 10% per annum (the "**1.5 Lien Notes**" and, together with the 1st Lien Notes, the "**Senior Notes**"); and
3. $1.61 billion in second lien notes at 9.0% per annum and €133 million at 9.5% per annum.

B. The Make-Whole Premium and Operative Clauses

1. Holders of Senior Notes (the "**Noteholders**") argued that the indentures governing the Senior Notes (the "**Indentures**") entitled them to collect a make-whole premium. Specifically, if the Senior Notes were redeemed or accelerated prior to maturity, pursuant to the operative provisions of the indentures, the Noteholder argued that they were entitled to receive a premium (estimated to be approximately $170 million) to compensate the Noteholders for the lost return on their investment.
    a) Optional Redemption Clauses: Senior Notes could be redeemed "at the option of [the Debtors], in whole at any time or in part from time to time" after October 15, 2005.
    b) Acceleration Clauses: If the Debtors sought bankruptcy protection, they would be in default and "the principal of, ***premium, if any***, and interest on all the [Senior Notes] shall . . . be immediately due and payable."

c) Rescission Clauses: "Under certain circumstances [Noteholders] may rescind any such acceleration with respect to the Notes and its consequences."

2. The Indentures governing the Senior Notes were governed by New York Law

C. Chapter 11 Plan

1. Momentive's plan linked the effectiveness of the make-whole by giving the Noteholders two options (also known as a "death trap") when voting on the Plan:

a) Option 1: If Noteholders voted in favor of the Plan (a) their claims would be paid in full on the face amount of the Senior Notes, plus accrued interest, in cash, on the effective date of the Plan and (b) any right to assert the make-whole would be waived; or

b) Option 2: If Noteholders voted against the Plan, their claims would be crammed down pursuant to 11 U.S.C. §1129(b) with:

(i) replacement notes (the "**Replacement Notes**") with a present value equal to the allowed amount of the Senior Notes claims in exchange for and in discharge of the Senior Notes;

(ii) Noteholders would retain the right to litigate the make-whole (as well as any cramdown rates of interest).

(iii) 1st Lien Notes would be crammed down to 3.6% with a 7-year maturity, which was equal to the 7 year treasury rate plus 1.5 percent.

(a) Bankruptcy Court later adjusted the cramdown rate to 4.1%

(iv) The 1.5 Lien Notes would be crammed down to 4.1% with a 7.5-year maturity, which was equal to the 7.5-year treasury rate plus 2 percent.

(a) Bankruptcy Court later adjusted the cramdown rate to 4.85%

2. The Noteholders voted against the Plan and commenced litigation seeking to enforce make-whole as well as challenging the cramdown rates of interest

III. Second Circuit Make-Whole Analysis

A. The Bankruptcy Court and the Second Circuit relied heavily on New York contract law construing the make-whole provisions. The Second Circuit relied on *In re AMR Corp.*, 485 B.R. 279 (Bankr.S.D.N.Y.2013) in particular in reaching its conclusion.

B. Optional Redemption

1. The Second Circuit held that under established New York contract law, given that the chapter 11 filing triggered a default that ***automatically*** accelerated the Senior Notes, the chapter 11 petition date became the operative maturity date.

2. With the deemed maturity date having been deemed to occur ***prior*** to the date of redemption (*i.e.*, when the Replacement Notes were issued), the Second Circuit

reasoned that it was impossible to either prepay or redeem the Senior Notes prior to maturity.

3. The Second Circuit glossed over any distinction between a "redemption" and "prepayment" when construing the Indentures, noting that *AMR* had not found any material difference in the terms when applied under similar circumstances: *i.e.,* determining whether issuing replacement notes as a consequence of an acceleration clause constituted either a "redemption" or a "prepayment".

    a) In the Bankruptcy Court, Judge Drain held that under existing New York contract law, a make-whole provision must contain language explicitly acknowledging that the make-whole would be payable ***notwithstanding the acceleration of the loan***. The Second Circuit did not address this aspect of the lower court's reasoning in reaching its conclusion.

C. Right to Rescind

1. The Noteholders argued they could rescind acceleration under the Indentures, which rescission would have the effect of reinstating the original maturity date of the loan and therefore entitle the Noteholders to the make-whole because issuance of the Replacement Notes would constitute a "redemption" of the Senior Notes prior to maturity.

2. The Second Circuit held that attempting to rescind an acceleration clause post-petition would effectively allow the Noteholders to exercise a contract right that effectively transferred valuable property of the estate, and that such "an attempt to modify contract rights" would therefore be subject to the automatic stay under section 362 of the Bankruptcy Code.

    a) Given that allowing the Noteholders the ability to rescind the acceleration clause would enhance their claims (potentially by hundreds of millions of dollars), the Bankruptcy Court denied lifting the stay to allow Noteholders to rescind, finding that courts routinely refused to lift the stay under such circumstances.

    b) The Second Circuit agreed with the Bankruptcy Court's reasoning, also noting that the right to rescind acceleration under the circumstances "would serve as an end-run around their bargain by rescission."

IV. *In re Energy Future Holdings Corp.*, 842 F.3d 247, 251 (3d Cir. 2016) ("EFH")

A. In *MPM*, the Second Circuit acknowledged that its holding was in direct conflict with the Third Circuit's holding in *EFH*.

1. In *EFH*, the EFH debtors made a public disclosure in advance of their bankruptcy filing that they would be filing for bankruptcy with the express purpose of refinancing existing debt without paying the applicable make-whole premium. The EFH Debtors refinanced their existing secured notes several weeks after entering chapter 11, triggering an attempt by the holders of such notes to exercise the make-whole clause in the applicable indentures.

2. The Third Circuit considered language in the applicable indentures around the make-whole, redemption, and acceleration that was substantially similar to the language at issue in *MPM*. The applicable indentures in EFH were also governed by NY Law.

B. <u>Acceleration Clause and Make-Whole</u>

1. The Third Circuit found that reference to the payment of a "premium" in the applicable acceleration clause was sufficient to establish entitlement to a make-whole premium on, or after, acceleration. In effect, the Third Circuit concluded that acceleration did not in any way negate the applicability of the make-whole provision.
2. This runs directly counter to the reasoning of the courts considering the indentures in *MPM*, which ultimately concluded that to preserve a make-whole upon acceleration, acceleration clauses must contain a more explicit reference to a make-whole provision, otherwise acceleration effectively rendered a make-whole provision inoperative.

C. <u>Optional Redemption</u>

1. The EFH debtors argued that because the acceleration clause made the replacement notes due and payable automatically upon filing for chapter 11, optional redemption was impossible prior to maturity and therefore the make-whole clause was not triggered.
2. The Third Circuit held that redemption was indeed "optional" on the EFH Debtors' part because:
    a) months before the chapter 11 filing, the Debtors announced their plan to redeem certain of their notes before their stated maturity date;
    b) the Debtors voluntarily filed a chapter 11 plan; and
    c) redemption was effected on a non-consensual basis given that the EFH noteholders had actively attempted to rescind the acceleration.

D. <u>Prepayment vs. Redemption</u>

1. The Third Circuit acknowledged that under New York law, a "prepayment" premium cannot be enforced when triggered by an acceleration clause ***absent language explicitly providing for the payment of such premium in a default/acceleration scenario***.
    a) Third Circuit held, however, that both New York and federal courts deem "redemption" to include both pre- and post-maturity repayments of debt.
    b) The Third Circuit held that the issuance of the EFH replacement notes was a "redemption" because (i) the make-whole provision in the EFH indenture made no reference to "prepayments" and (ii) the EFH debtors opted to redeem the notes before the call date specified in the applicable redemption provision. Ultimately, the Third Circuit held that the make-whole provision "on its face requires that EFIH pay the Noteholders the yield protection payment."

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Two Approaches to Confirmation: "Per Plan" and "Per Debtor"

Matter of Transwest Resort Properties, Inc., 881 F.3d 724 (9th Cir. 2018)

I. Introduction

A. In *Transwest*, the Ninth Circuit Court of Appeals considered whether it was appropriate to use a "per plan" approach to confirmation rather than a "per debtor" approach for the purposes of confirming a plan over dissenting class of creditors under 11 U.S.C. § 1129(a)(10).

1. The "per plan" approach requires that that at least one impaired class under a plan of reorganization accept the plan.
2. The "per debtor" approach requires that at least one impaired class at *each* debtor accept the plan.

B. The Ninth Circuit approved a "per plan" approach, construing section 1129(a)(10) of the Bankruptcy Code to permit confirmation of a joint chapter 11 plan in a multi-debtor case, so long as one impaired class under the joint plan voted in favor of the plan.

C. *Transwest* was decided by a three-judge panel. Judge Milan D. Smith authored the opinion and Judge Michelle Friedland authored a concurrence.

II. Background Facts

A. Transwest Resort Properties, Inc. and its affiliates (the "**Debtors**") operated and owned the Westin Hilton Head Resort and Spa in South Carolina and the Westin La Paloma Resort and Country Club in Tucson Arizona. The Debtors filed chapter 11 petitions in the United States Bankruptcy Court for the District of Arizona in 2010.

B. There were 5 debtor entities in total that were configured as follows: two operating companies ("**Opcos**"), two intermediary mezzanine companies that held the equity interests in each of the Opcos ("**Mezzcos**"), and one holding company which held all the equity interests in each of the Mezzcos ("**Holdco**").

C. The Debt Structure was relatively straightforward:

1. $209 million in mortgage-related debt at Opcos secured by the hotel properties; and
2. $21.5 million loan at Mezzcos secured by Mezzcos' equity interests in Opcos.

D. Post-filing, the lender (the "**Lender**") who held the Opcos' debt also purchased Mezzcos' debt and filed a $298 million claim against Opcos (the "**Opco Claims**") and a $39 million claim against Mezzcos (the "**Mezzco Claims**").

E. Although there were various types of claims other than the Opco Claims at the Opcos, the Mezzco Claims were the only claims outstanding at Mezzcos.

F. Administration of the Case and Plan of Reorganization

1. The Debtors filed a "joint" chapter 11 plan (the "**Plan**") that sought to administer all claims of all the Debtors.
    a) Although the Debtors' cases were jointly administered, they were never substantively consolidated.
    b) The value of the hotels held by Opcos was stipulated to be approximately $90 million—far less than the claims against Opcos.
2. Mezzco Claims and Opco Claims were classified into two separate classes of claims.
    a) Under the plan, a third-party would become the new sole owner of Opcos and all the debt at Mezzcos would be cancelled.
    b) The Lender voted all its claims—the Mezzco Claims and the Opco Claims—against the Plan.
    c) Notwithstanding, the Lender's "No" votes, several other impaired classes voted to approve the Plan, thereby "cramming" down all the Lender's claims under 11 U.S.C. §1129(b). The Lender objected to confirmation of the Plan.

G. Lender Objection to Confirmation

1. Under section 1129(a)(10) of the Bankruptcy Code "[i]f a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan [must have] accepted the plan" for such a plan to be confirmed.
2. The Lender argued that courts should apply the "per debtor" approach to confirmation, which would require plan approval from at least one impaired creditor class *for each debtor involved in the Plan*.
3. Because the Mezzco Claims were the only existing claims against Mezzcos, Mezzcos did not have an impaired class of claims voting in favor of the Plan. Thus, applying a "per debtor" approach, because the case was never substantively consolidated, the Plan could not satisfy section 1129(a)(10) as no impaired class of claims at Mezzcos had voted in favor of the Plan.
4. The Bankruptcy Court approved the Plan over the Lender's objections and the Lender appealed to the District Court. The District Court dismissed the Lender's appeal as equitably moot, but in 2015, the Ninth Circuit reversed the District Court's dismissal and remanded the matter back to the District Court. On remand, the District Court held that section 1129(a)(10) applies on a "per plan" basis and the Lender appealed to the Ninth Circuit.

III. Ninth Circuit Analysis

A. The Ninth Circuit took a narrow, textual approach in construing section 1129(a)(10) and concluded that the "plain language" of the statute necessitated a "per plan" approach to confirmation of a plan, stating that:

   1. "[T]he statute does not make any distinction concerning or reference to the creditors of different debtors under 'the plan,' nor does it distinguish between single-debtor and multi-debtor plans. Under its plain language, once a single impaired class accepts a plan, section 1129(a)(10) is satisfied as to the entire plan. Obviously, Congress could have required plan approval from an impaired class for each debtor involved in a plan, but it did not do so."

B. The Ninth Circuit also considered whether 11 U.S.C. §102(7)—a statutory rule of construction which provides that "the singular includes the plural" when construing the Bankruptcy Code—was inconsistent with a "per plan" approach.

   1. The Ninth Circuit found that, notwithstanding the reference to a singular "plan" in section 1129(a)(10), section 102(7) effectively converted section 1129(a)(10) to require "at least one class of claims that is impaired under the **plans** has accepted the **plans.**" The Ninth Circuit determined that the "per plan" approach was consistent with this reading of the statute.

      a) Although it is not explicitly stated in the decision, the Ninth Circuit appears to assume that the "plans" referenced in the modified version of 1129(a)(10) above would be identical "plans" for each debtor, with identical classes of claims.

C. <u>Conflict with *Tribune*</u>

   1. The Ninth Circuit acknowledged that its ruling was in direct conflict with the Delaware Bankruptcy Court's finding in favor of a "per debtor" approach in *In re Tribune Co.*, 464 B.R. 126 (Bankr. D. Del. 2011).

      a) In *Tribune*, two competing plans were proposed for over 100 jointly administered debtors. The cases were not substantively consolidated and the *Tribune* court construed the joint plans as separate plans *for each debtor*.

      b) Noting that "in the absence of substantive consolidation, entity separateness is fundamental" the *Tribune* court held that the plain language of § 1129(a)(10) was unambiguous and requires that § 1129(a)(10) be satisfied by each debtor in a joint plan.

      c) The *Tribune* court's reading of 11 U.S.C. § 102(7) is diametrically opposed to the Ninth Circuit's reading of the statute, noting that "the singular includes the plural" and therefore, because § 1129(a)(10) refers to a singular plan rather than multiple plans it "is not a basis, alone, upon which to conclude that, in a multiple debtor case, only one debtor—or any number fewer than all debtors—must satisfy this standard."

   d) Parsing through the other subsections of § 1129(a), the *Tribune* court noted that each of the other 1129(a) confirmation requirements could be met only if *all* debtors proposing a joint plan satisfied such requirements.

   e) The *Tribune* court acknowledged that although "complex, multiple-debtor chapter 11 proceedings are often jointly administered for the convenience of the parties and the court . . . convenience alone is not sufficient reason to disturb the rights of impaired classes of creditors of a debtor not meeting confirmation standards."

2. The Ninth Circuit dismissed the *Tribune* court's reasoning that 1129(a)(10) must apply on a "per debtor" basis simply because other subsections of 1129(a) apply on a "per debtor" basis and restated its position that the plain language of the statute directs a "per plan" approach.

3. The Ninth Circuit also noted that the Lender provided no argument (other than its reliance on *Tribune*) that all subsections of the Bankruptcy Code should be read on a "per debtor" basis, especially given the fact that the Bankruptcy Code uses varying language in each subsection.

IV. Substantive Consolidation and Judge Friedland Concurrence

A. The Ninth Circuit dismissed any argument that the jointly administered plan was a *de-facto* substantive consolidation on the basis that the Lender's objection to confirmation had not raised the issue of substantive consolidation.

B. The Ninth Circuit also dismissed any concern regarding the "Parade of Horribles" that could be visited upon mezzanine lenders, stating that any policy considerations were for Congress to address rather than courts.

C. Friedland Concurrence

1. Judge Friedland acknowledged that the plan's distribution scheme "involved a degree of substantive consolidation" and that while the Debtors' estates may technically have remained separate, the Plan treated the Debtors as a single entity.

2. Although Judge Friedland saw no issue with "de facto" substantive consolidations when "the constituents in the chapter 11 proceeding either reach this result by consensus, or, no objection is made by any creditor or party in interest," Judge Friedland suggested that had the bankruptcy court conducted an analysis of whether substantive consolidation was appropriate, the outcome may have been different.

   a) Specifically, Judge Friedland observed that given that "the original loan documents required maintaining the [Opcos] and [Mezzcos] as separate entities . . . the special-purpose entity structure prevented the [Debtors'] assets from becoming entangled—thus rendering substantive consolidation unavailable under this circuit's test."

3. Judge Friedland's ultimate recommendation was that rather than adopting a "blanket statutory solution" where courts would apply the "per debtor" approach in all cases, in cases where creditors believed "that a reorganization improperly intermingles

different estates" creditors should simply object to confirmation on the basis that the plan effects a *de facto* substantive consolidation.