AMERICAN BANKRUPTCY INSTITUTE

2022 Winter Leadership Conference

Confirmation Roundtable: Top Tips to Confirm a Chapter 11 Plan

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CONFIRMATION ROUNDTABLE –
STRATEGIES FOR CONFIRMING A CHAPTER 11 PLAN

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Panelists

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I. Chapter 11 Plan Classification Conundrums and Treatment Traps[1]

A. First, a Primer

The contents of a chapter 11 plan must include classifications of claims and interests and must specify how each class will be treated under the plan. 11 U.S.C. § 1123. Holders of "impaired" claims and interests – *i.e.*, those whose contractual rights are to be modified or who will be paid less than the full value of their claims and interests under the plan – vote on the plan by ballot if they are to receive distributions under the plan. 11 U.S.C. § 1126.

Except with respect to a class of "administrative convenience" claims, a plan may place a claim or interest in a particular class "only if such claim or interest is substantially similar to the other claims or interests in such class." 11 U.S.C. § 1122. The Bankruptcy Code does not define "substantially similar." Courts construe the term to mean similar in legal character or effect as a claim against the debtor's assets or as an interest in the debtor.

In evaluating a plan's classification scheme, courts generally examine the nature of the claim or interest (*e.g.*, senior or subordinated, secured or unsecured, debt or equity) and the relationship of the claim or interest to the debtor's property. Although the Bankruptcy Code provides that only substantially similar claims or interests may be classified together, it does **not** require that *all* substantially similar claims or interests be placed into a single class. Instead, substantially similar claims or interests may be divided into separate classes if separate classification is reasonable.

A classification scheme devised to engineer an impaired accepting class under section 1129(a)(10) of the Bankruptcy Code is referred to as class "gerrymandering." The practice may involve, among other things, (1) classification of claims or interests whose holders favor a plan in the same class with the claims or interests of holders who do not, with the expectation that supporting claims or interests will sufficiently outnumber dissenting claims or interests to ensure acceptance of the plan by the class as a whole or (2) separately classifying claims or interests of dissenting holders from the claims or interests of holders who favor the plan to ensure that the dissenting holders cannot defeat cram-down confirmation.

The latter form of gerrymandering has arisen almost exclusively in single-asset real estate cases, where a plan proponent attempts to classify a mortgagee's unsecured deficiency claim separate from the claims of other unsecured creditors. That practice has been invalidated by a majority of the circuit courts of appeals that have addressed the issue.

[1] Prepared by Peter J. Young, Proskauer Rose LLP.

B. <u>A Twist on the Single-Asset Real Estate Case Gerrymandering Classification Issue: Classification of an Undersecured Claim</u>

A relatively recent case from the Bankruptcy Court for the Northern District of West Virginia answered the question of what is a debtor to do when, in a single-asset real estate case, a dissenting secured creditor's unsecured deficiency claim is large enough to occupy a "blocking position" in the debtor's proposed general unsecured claims class. *In re Tara Retail Group, LLC*, No. 17-bk-57 (Bankr. N.D.W. Va. Jan. 27, 2018).

Debtor Tara Retail Group owned and operated a mall that sustained flood damage, after which the debtor's tenants ceased operations and stopped paying rent, which, in turn, rendered the tenant unable to pay its mortgage. The debtor filed a chapter 11 case. Ultimately, the debtor and its mortgagee each proposed its own chapter 11 plan; the debtor's plan contemplated a reorganization and the mortgagee's plan contemplated a liquidation. The debtor's plan did **not** bifurcate the secured creditor's claim into secured and undersecured portions and instead relegated the entire claim to its own class.

Both plans received acceptances sufficient for confirmation but mortgagee objected to debtor's plan arguing that it improperly classified its entire (under)secured claim in a single class and, thus, separated its deficiency claim from the general unsecured class, whose affirmative vote in favor of the plan mortgagee otherwise would have defeated. Mortgagee argued that the debtor's plan was unconfirmable as a matter of law because it gerrymandered classification to obtain at least one consenting, impaired class.

The court overruled mortgagee's objection. Since the debtor did not propose to bifurcate the claim, the court did not see any issue preventing confirmation. The court determined that while Bankruptcy Code section 506(a) provides for the determination of a creditor's secured interest, it has no bearing on proposed plan treatment, classification, or confirmation.

The court's opinion in *Tara Retail Group* provides support for a debtor to skip bifurcating a single undersecured creditor's claim into secured and unsecured deficiency portions and rather propose plan treatment to that single claim.

C. <u>Same Class, Different Recoveries: Exclusive Opportunities Provided to Some, but Not All, Members of a Class</u>

Preserving exclusive financial opportunities for select creditors without offering that opportunity to all creditors in a particular class – in exchange, at least in part, for voting in favor of the debtor's plan – is trending in some of the largest recent chapter 11 cases. *In re Peabody Energy Corp*. (Bankr. E.D. Mo. 2017); *In re LATAM Airlines Grp. S.A.* (Bankr. S.D.N.Y. 2022); *In re Grupo Aeromexico*, SAB (Bankr. S.D.N.Y. 2022); *In re Pacific Drilling* (Bankr. S.D.N.Y. 2018); *TPC Group Inc.* (Bankr. D. Del. 2022).

In situations under which a debtor proposes under an RSA (or something similar) "fees" (in the form of cash, equity or investment opportunities) to creditors who provide both (1) commitments and (2) agreements to vote their existing claims in favor of a chapter 11 plan, it is difficult, if not impossible, to determine what portion of the "fees" are attributable to the value of the creditors' commitments themselves versus a commitment to support the debtor's treatment of their existing claims under the plan.

The Bankruptcy Code specifies that a chapter 11 plan "shall" – *i.e.*, must – "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." 11 U.S.C. § 1123(a)(4). Courts are questioning whether "exclusive opportunities" that flow to certain members of – but not the entire – class run afoul of this requirement.

D. <u>In a State of Unimpairment</u>

Although unsecured creditors generally are not entitled to post-petition interest in bankruptcy cases, one rare exception applies to that rule: the case of the solvent debtor. In those cases, in which creditors are paid in full and holders of equity interests receive a distribution, courts generally agree that unsecured creditors can receive *some* amount of post-petition interest but courts disagree about *how much* interest those unsecured creditors must receive in order to be unimpaired under a plan.

In two recent opinions, *In re Ultra Petroleum Corp.*, No. 21-20008, 2022 WL 8025329 (5th Cir. Oct. 14, 2022), and *In re PG&E Corp.*, No. 21-16043, 2022 WL 3712478 (9th Cir. Aug, 29, 2022), the U.S. Courts of Appeals for the Fifth and Ninth Circuits each held that unsecured creditors in solvent-debtor cases must receive post-petition interest at the contractual rate or state judgment rate in order to be deemed unimpaired (and, therefore, not entitled to vote on the debtor's plan). These opinions were accompanied by dissents that took different views, as did the Bankruptcy Court for the District of Delaware in *In re The Hertz Corp.*, 637 B.R. 781, 800–01 (Bankr. D. Del. 2021) (unimpaired unsecured creditors in solvent-debtor cases are only entitled to receive post-petition interest at the federal judgment rate).

These cases highlight the importance, in a solvent debtor case, of whether a class of claims or interests is designated as impaired or unimpaired. In the Fifth and Ninth Circuits, unimpaired creditors of a solvent debtor have a common law equitable right to receive post-petition interest at the applicable contract or state law interest rate, while a solvent debtor that designates a creditor class as "impaired" and satisfies the standard for confirming a plan over the objection of an impaired objecting class may pay post-petition interest at the federal judgment rate. The *PG&E* and *Ultra Petroleum* decisions provide support for unimpaired creditors of solvent debtors asserting claims not only for post-petition interest but also other for other contractual rights.

E. Administrative Convenience Classes

Although section 1122(a) of the Bankruptcy Code requires a debtor to classify similar claims in the same class, section 1122(b) provides a narrow exception to that rule: "[a] plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience." 11 U.S.C. § 1122.

These claims may often (though not always) be paid quickly, in cash, in full – even though their larger-sized counterparts in other unsecured classes may receive entirely different plan treatment. Debtors use convenience classes to ease the administrative burden that would be imposed on them were they forced to process many smaller claims in the same manner as larger ones.

The express language of section 1122(b) does not specify a monetary threshold for convenience claims, instead leaving it up to the debtor to propose, and ultimately the bankruptcy court to determine, what that threshold should be. Although the subjective nature of the section allows for each debtor to establish what is reasonable and necessary in its bankruptcy case, it also means that not all "convenience classes" will be upheld in the plan confirmation process. Simply because a debtor has collected several small claims into a single class does not necessarily mean it will be able to meet the requirements of section 1122(b).

In the limited number of cases in which a debtor has proposed its convenience class as its sole impaired, accepting class, for example, bankruptcy courts have looked skeptically at the proposed classification, questioning whether the convenience class is being used as a gerrymandering scheme to garner confirmation of a plan.

PLAN TIPS – CLASSIFICATION

1. Carefully consider your plan classification scheme – and alternatives available to you under applicable precedent – as a means to maximize the potential that your proposed plan will receive the requisite votes necessary to meet the Bankruptcy Code's cram-down standards, should they be necessary.

2. Market test exclusive opportunities so to demonstrate to the court that the debtor's estate is receiving maximum value. Eliminate exclusive opportunities by making them available to all members of a similarly-situated class. Consider separate classification as a means to address disparate treatment proposed by exclusive opportunities afforded to favored creditors within an otherwise similarly-situated class.

3. Solvent debtors in many jurisdictions may still propose plans that deem certain classes of creditors unimpaired and pay only the federal judgment rate for post-petition interest and divergent decisions on the issue may provide those debtors with negotiating leverage.

4. If your plan proposes an administrative convenience class, be prepared to justify to the court the proposed administrative convenience class claim cap and to articulate why it is reasonable and necessary and what sizeable burden(s) on the estate the class is devised to ease.

II. Deploying § 105 to Streamline the Confirmation Process[2]

A. Introduction

Section 105 of the Bankruptcy Code provides bankruptcy courts with authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. While this provision is both embraced and criticized for its potential breadth in application, section 105(d) explicitly allows courts to help streamline the bankruptcy process by authorizing them to hold conferences and issues orders that "further the expeditious and economical resolution of the case.[3]

Section 105(d)(2)(B)(vi) expressly provides that courts may hold combined hearings on the approval of a disclosure statement and the confirmation of a plan in chapter 11 cases. As a result, this is one of the first streamlining tools that a court and the parties should consider in trying to confirm a chapter 11 plan. Additional tools include a court-approved fast-track process, a pre-arranged or pre-packaged plan, and other helpful processes codified in local rules.

B. The Disclosure Statement and Plan Process

Parties should probably consider combining approval of the disclosure statement with confirmation of the plan more often. While the tool is used mostly in small business cases, a combined hearing in larger chapter 11 cases is almost never requested but could serve as a helpful timesaver under the right circumstances.[4]

Disclosure statements, of course, provide interested parties with information about chapter 11 debtors and their proposed plans. They are generally required to be filed with a proposed plan so that the two can be considered together.[5] For final approval, a disclosure statement must provide enough information to enable an interested party to make an informed judgment about the related plan.[6] Deferring final review and approval of disclosure statements until confirmation comes with benefits and risks.

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[2] Prepared by Hon. Janet S. Baer, U.S. Bankruptcy Court for the Northern District of Illinois, and Derrick Loving, law clerk to Judge Baer.

[3] In fact, subsection (d) of § 105 uses the words "expeditious" and "economical" twice, so Congress must really mean it!

[4] Congress may want to consider taking a page out of the Subchapter V playbook, which eliminates the *absolute requirement* of a disclosure statement. Specifically, § 1181(b) provides that "[u]nless the court for cause orders otherwise," the requirement of a disclosure statement under § 1125 does not apply.

[5] Fed. R. Bankr. P. 3016(b).

[6] 11 U.S.C. § 1125(a)(1). *See also* Hon. Joan N. Feeney, et al., 2 *Bankruptcy Law Manual* § 11:59 (5th ed. 2022).

1. *The Benefits of Combined Disclosure Statement Approval and Plan Confirmation Hearings*

Efficiency is the primary benefit of deferring a hearing on disclosure statement approval until a confirmation hearing. No additional time or resources need be expended on a separate disclosure statement hearing when it is ruled on simultaneously with plan confirmation. This benefit can be particularly advantageous if courts pre- or conditionally-approve a disclosure statement prior to a combined hearing or if no objection or issue regarding a disclosure statement is ever raised (by a court or any party).

2. *The Risks of Combined Disclosure Statement Approval and Plan Confirmation Hearings*

The main risk of combined disclosure statement approval and plan confirmation hearings is that time and resources can actually be wasted by not having them heard separately. A stand-alone hearing on a disclosure statement can help both courts and parties recognize fatal issues in a plan before confirmation is addressed.[7]

Another risk of combining the hearing arises when the information in the disclosure statement is deficient. If such deficiencies are not identified until the combined hearing, after the disclosure statement and plan have been sent to all creditors for voting, the time and expense of solicitation will have been for naught.

C. <u>Other Ways to Ensure That Confirmation Is More Expeditious and Economical</u>

Several other tools are potentially available to streamline the chapter 11 plan process. These include instituting a "fast-track" process for appropriate chapter 11 cases, filing a pre-arranged or pre-packaged chapter 11 case, or promulgating other local rules and procedures aimed at increasing the efficiency of the chapter 11 process.

1. *The Fast-Track Process*

Several jurisdictions and individual judges have developed "fast-track systems" to streamline confirmation of plans in certain traditional chapter 11 cases. One of the first known fast-track systems was implemented by now retired Judge Thomas Small in the

[7] William L. Norton III, 6 *Norton Bankr. Law & Prac. 3d* § 110:15 (2022) (explaining that "legal issues such as the plan's classification of claims and interests may surface early on. Thus, it may be both economically prudent as well as helpful to the plan proponent for the court to consider these matters, at least in a preliminarily manner, at the disclosure hearing" (citations omitted)). *See also In re Am. Cap. Equip., LLC*, 688 F.3d 145, 154 (3rd Cir. 2012) (recognizing the benefit of pre-confirmation disclosure statement hearings–while implicitly acknowledging the risks of combined hearings–when holding that courts "may address the issue of plan confirmation where it is obvious *at the disclosure statement stage* that a later confirmation hearing would be futile because the plan . . . is patently unconfirmable") (emphasis added); Jill Nicholson, *Knowing When to Pull the Plug Prior to Plan Confirmation*, 31 Am. Bankr. Inst. 52, 52–53, 74 (2012) (discussing *Am. Cap. Equip.*).

Eastern District of North Carolina.[8] Judge Small's process was triggered by his review of a newly filed chapter 11 debtor's schedules to determine if the case could likely be expedited.[9] Under Judge Small's fast-track program, if a plan and disclosure statement had not been submitted, the court would set accelerated deadlines for their filing.[10] Once the documents were filed, the court would promptly review and conditionally approve the disclosure statement if it was not facially defective and then set a combined disclosure statement approval and plan confirmation hearing.[11] Interested parties were allowed to file objections to the disclosure statement that were heard at the combined hearing.[12]

Other courts subsequently designed fast-track systems similar to the one developed by Judge Small. One such court is the Eastern District of Michigan where several of its current bankruptcy judges appear to encourage a version of the fast-track process and have provided template forms and/or orders for practitioners to use to set chapter 11 cases on the fast-track course.[13]

Generally, the following benefits of such a system exist:

- Streamlining the time from case filing to plan confirmation;[14]
- Substantially reducing motions for stay relief and dismissal filings;[15]
- Decreasing the rate of conversion (primarily) to chapter 7.[16]

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[8] *See generally* Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1 Am. Bankr. Inst. L. Rev. 305 (1993). Although Judge Small's article describing the fast-track process focuses largely on small business debtors, many of the concepts may be equally applicable to traditional chapter 11 cases. *See also* Hon. Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 Am. Bankr. Inst. L. Rev. 85, 99 (1996) (explaining that while the "most complex cases . . . tended not to be assigned to the fast track program" but that "the actual case size was not the determining factor . . . .").

[9] Small, *supra* note 7, at 307; Bufford, *supra* note 7, at 99 (explaining that Judge Geraldine Mund, using the Central District of California's version of the fast-track system, did not designate fast-track cases using "any specific criteria" but instead made the determination based on "knowledge she had gained during her years as a bankruptcy judge . . . .").

[10] Small, *supra* note 7, at 308.

[11] *Id.* at 309–10.

[12] *Id.* at 309.

[13] *See Forms,* U.S. Bankr. Ct. Eastern District of Mich., http://www.mieb.uscourts.gov/forms/all-forms (last visited Oct. 28, 2022).

[14] Judge Small explain that use of the fast-track system in his district reduced the average time between a debtor's petition date and plan confirmation "from 18 to 24 months" to "6 to 8 months." Small, *supra* note 7, at 315. A study of Judge Mund's modified version of Judge Small's fast-track system explained that the median reduction of "the time from filing to confirmation" was approximately four months; for uncomplicated chapter 11 cases, approximately five months; and for more complicated cases, approximately nine months. *See also* Bufford, *supra* note 7, 103–05.

[15] Small, *supra* note 7, at 315 (explaining that "[c]reditors know that the case will be resolved quickly, and the expedited confirmation hearing has become the occasion for resolving all disputes").

[16] Bufford, *supra* note 7, at 111.

On the other hand, fast-track systems can have the following risks:

- Increased rate of dismissal;[17]
- Debtors and their counsel not timely completing pre-confirmation prerequisites[18] or seeking to delay the case to comply with the Code.[19]

2. *Pre-Arranged or Pre-Packaged Plans*

In a perfect world, no chapter 11 case would be filed until the debtor has had the time to prepare—to hire counsel and other professionals; to become educated on the chapter 11 process; to prepare schedules, the statement of financial affairs, and first and second day motions; to arrange for post-petition financing; and to negotiate creditor treatment under the chapter 11 plan. In most cases in the real world, however, a chapter 11 bankruptcy filing is prompted by something "bad"—the final forbearance agreement with key lenders has expired; a significant judgment has been entered; the debtor has run out of operating cash; or the landlord has locked the debtor out of its premises, just to name few. The unplanned or "free fall" chapter 11, which is reactive to these types of events, is generally guaranteed to be the most expensive and least effective chapter 11 case.

In contrast, a pro-active, pre-planned chapter 11 filing insures a prompt and efficient case, most of the time. Indeed, the ultimate goal is a pre-arranged or, even better, pre-packaged chapter 11 plan. In a pre-arranged plan, the debtor, pre-petition, reaches agreements with major creditors but does not solicit any votes on a plan. Upon filing, the plan and the disclosure statement—consistent with creditor agreements—is filed, and the debtor promptly requests court approval of both on an expedited basis.[20] In a pre-packaged plan, the debtor does everything necessary to confirm its chapter 11 plan pre-petition, including soliciting votes. The case is then filed, and the debtor seeks a prompt confirmation hearing to approve the pre-packaged plan. In recent years, there have been some pre-packaged plans that have been confirmed in as little as twenty-four to forty-eight hours.[21]

The pre-arranged and pre-packaged processes, of course, are not for every case. It takes a specific type of debtor with a specific type of circumstances. For example, due to their expedited nature, pre-packaged plans are generally limited to restructuring funded debt and do not typically restructure trade debt or reject

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[17] *Id.*

[18] Small, *supra* note 7, at 315.

[19] *Id.* at 316.

[20] *See* Dennis F. Dunne, et al., *Pre-packaged Chapter 11 in the United States: An Overview*, Glob. Restructuring Rev. (Dec. 11 2019), https://globalrestructuringreview.com/guide/the-art-of-the-pre-pack/edition-1/article/pre-packaged-chapter-11-in-the-united-states-overview#footnote-153-backlink.

[21] *See*, *e.g.*, *In re Belk,* No. 21-30630 (Bankr. S.D. Tex.), in which the debtor obtained confirmation within sixteen hours of filing, and *In re HighPoint Resources Corp.*, No. 21-10565 (Bankr. D. Del.), in which the debtor obtained confirmation within four days of the petition date, a record in Delaware last year.

burdensome contracts and leases.[22]

The advantages of the pre-packaged and pre-arranged processes include the following:

- Debtors generally face less uncertainty and disruption because of and during their bankruptcy case;[23]
- Less time is spent in bankruptcy, and, as a result, there are fewer administrative costs.[24]

However, these processes come with certain clear disadvantages:

- There is no automatic stay protection during the pre-petition negotiation or solicitation period.[25]
- If the court deems the disclosure statement inadequate or finds that the pre-petition solicitation of votes was improper, a re-solicitation of plan votes and/or significant plan amendments may be necessary.
- The process comes with limited oversight by the bankruptcy court, the U.S. Trustee, and small stakeholders. Thus, due process concerns arise and generally trigger objections from the U.S. Trustee.

3. *Local Rule Changes*

Individual bankruptcy courts have broad discretion to promulgate local rules, general orders, and individual standing orders that are procedural in nature and consistent with the Bankruptcy Code and Rules, as well as other statutes and federal rules. This provides additional opportunity to streamline the confirmation process. For example, the U.S. Bankruptcy Court for the District of Delaware has Local Rule 3017-2, in which it has memorialized when it will permit, and the procedures for, a combined disclosure statement and confirmation hearing for applicable traditional chapter 11 cases.[26] In addition, the U.S. Bankruptcy Court for the Southern District of New York has procedural guidelines for pre-packaged chapter 11 cases.[27]

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[22] For further discussion of pre-packaged plans, see these articles from the *ABI Journal*: Joshua Sussberg, et al., *Speeding Through Chapter 11: An Overview of Expedited Prepackaged Bankruptcies and Why Critics Are Flat Wrong*, 40 Am. Bankr. Inst. J. 20 (2021); David I. Swan, et al., *Prepackaged Plans in 24 Hours*, 38 Am. Bankr. Inst. J. 28 (2019); and John Yozzo, et al., *For Better or Worse, Prepackaged and Pre-Negotiated Filings Now Account for Most Reorganizations*, 37 Am. Bankr. Inst. J. 18 (2018).

[23] Dunne, *supra* note 19.

[24] *Id.*

[25] *Id.*, n.17.

[26] *See* Del. Bankr. L.R. 3017-2.

[27] S.D.N.Y. LBR 3018-2.

Further, many bankruptcy courts have recently enacted Complex Chapter 11 Rules which are designed to provide a more standard, predictable, and streamlined process for first day motions, financing orders, and other key matters in the largest chapter 11 cases.[28] Given the time and complexity involved in attempting to revise the Bankruptcy Code and Rules, the opportunity to streamline the process through local rules changes is, perhaps, one of the most powerful tools in the court's tool chest for making bankruptcy cases and the confirmation process more efficient and economical.[29]

[28] *See*, for example, *Local Rules of the U.S. Bankruptcy Court for the Northern District of Illinois*, as amended April 19, 2022, Rules 9090-1, 9090-2 and 9090-3.

[29] For an interesting discussion of some creative ideas in this regard, *see generally* Edward P. Mahaney-Walter, *Could Local Rules Drastically Streamline Chapter 11?*, 41 Am. Bankr. Inst. J. 46 (2022).

III. Of Co-Proponents, Joint Plans and Plan Supporters[30]

At the heart of a successful restructuring is a compromise between a debtor and its creditors. Very rarely will all parties get exactly what they want, but all parties can at least agree that they want confirmation to succeed. It is important for a debtor and its counsel to understand the objectives of each creditor constituency and to consider those factors as it develops a bankruptcy strategy.

A. Balancing Objectives Against Opposition

From the start, a debtor should identify its goals in the bankruptcy process, who may disagree with those goals, and why. Without doing this, a debtor may not fully understand the tools in its toolbox, and what that debtor may offer to creditors to gain support both in and out of court.

A debtor may have a wide range of objectives. On one end of this range, the debtor may wish to emerge from Chapter 11 as an operating business run by the same management; on the other end, the debtor may wish to sell its assets in a § 363 sale and file a liquidating plan. Every debtor is different, and a debtor's counsel must endeavor to understand what the debtor wants at the end of the process and why the debtor has that end goal.

Perhaps, for instance, the debtor may be willing to change management, but is concerned with continuity of the business for other reasons (e.g., job preservation, tax consequences, protection of strategic non-debtor constituents, etc.). If the debtor decides not to continue the business, what does the debtor hope to gain through a debtor-managed liquidation (reduction of guaranty exposure or negotiation of guaranty releases, among other concerns)? These inquiries can help a debtor crystalize its reasons for filling Chapter 11, know its "dealbreakers," and to explain them at the negotiating table.

Second, a debtor must perform the same inquiry for its creditor constituencies. A debtor may ask:

- Why might a creditor oppose the debtor's desire to keep its directors and officers?

Perhaps, for instance the unsecured creditors committee has come to the consensus that the business shows promise but has missed out on opportunities to thrive due to poor leadership.

- Why might a creditor oppose a debtor-led liquidation?

[30] Prepared by Laura E. Appleby and Andrew Page, Faegre Drinker Biddle & Reath LLP.

Perhaps these creditors have more faith in a Chapter 7 trustee than the debtor-in-possession. The more likely case is that unsecured creditors may recognize they would not receive any distributions in a liquidation and would rather leave the debtor intact for trade creditors to continue to have a customer.

These are all things that the debtor and its counsel should appreciate beforehand. Absent extenuating circumstances, the debtor's counsel should be so informed that they are not surprised by any opposition raised. By isolating objectives and opposition, the debtor will be able to craft an exit plan surmounting obstacles and picking up allies along the way.

In the case in which the unsecured creditors committee wants a leadership change, the debtor could isolate key vendors who disagree and can add creditability to the existing board, or establish a structure to keep old leaders in a supervisory capacity. The debtor might also use an agnostic comfortably oversecured creditor to allow a relatively small amount of its value to flow to a class to gain acceptance, although in this case, the debtor should consider the likelihood of other creditors challenging any such distribution if they feel the plan treats them unfairly. In the case in which the debtor wants to liquidate, there may be intercreditor conflicts between a secured creditor who wants a quick turnaround in liquidation and the unsecured creditors who would fare better with by achieving recovery through continued work with a restructured company.

Without the support of creditors, the debtor may not have the votes for confirmation, and neither group may be willing to budge. In that scenario, the debtor who is comfortable liquidating may opt instead for a going concern sale whereby the secured creditor takes its recovery and the unsecured creditors might form an accepting impaired class based on the possibility of some recovery in the future rather than none.

B. <u>Credibility and Trust</u>

If the debtor wants creditors to support the plan, the debtor should be transparent and credible in dealing with the creditor constituencies. The debtor may be clear on its objectives and opposition, but it cannot guarantee that creditors will extend the same foresight and understanding in return. The debtor has a much better chance of convincing a creditor to cooperate if the debtor lets the creditor meaningfully participate in the process and helps the creditor understand the stakes. And, perhaps most importantly, the debtor must stick to its word when it makes promises and compromises.

Take the following hypothetical:

- The debtor is forced to file a petition without adequate preparation, with the initial goal of selling its assets. Following the filing, it is quickly revealed that insiders of the debtor hold hundreds of millions of dollars of secured and unsecured debt. How can the debtor's counsel establish trust in this scenario?

- While one of the debtor’s main objective may be an asset sale, the debtor’s counsel must recognize that the unsecured creditors committee will want to pursue insider claims and that any secured creditors may have questions regarding their collateral.

The debtor’s counsel may offer a compromise:

- With respect to unsecured creditors, the debtor could abstain from taking a strong position on the insider issue so long as the unsecured creditors committee supports the sale process. The debtor and unsecured creditors committee could dual-track the issue and be forthcoming with each other along the way. That said, the sale process will have to come first, and the unsecured creditors committee will need to trust that the debtor will not change its mind after achieving its objective.

- Similarly, debtor’s counsel could have open and frank conversations with any secured creditors and provide those creditors with information regarding their collateral and claims, proposed treatment, and recovery.

- If the unsecured creditors committee and other creditors cannot trust the debtor, the debtor cannot trust those creditors to provide votes and support for its plan. Unless circumstances change, the debtor should stay true to its word in order to streamline and finalize the bankruptcy process.

The debtor’s professionals should not hesitate, confidentiality-permitting, to share its motions with the relevant creditor constituencies before filing. This type of transparency will likely reduce opposition to motions, saving on court fees and creating a more streamlined process. But the debtor needs to be the one to take the first step. It needs creditor support to get the plan across the finish line and that support might not be provided without an underlying trust between the parties. A draft plan of reorganization acceptable to the major creditor constituencies leads to a smoother confirmation and often a higher return for all parties involved.

Thus, the debtor’s counsel must remember that, even with the best planning and projections, credibility and trust must be present in order to succeed.

IV. Decluttering Releases, Exculpation and Injunctions

Third-party releases (i.e., a release by creditors of their direct claims against non-debtor parties) have garnered recent attention in the mass tort context. Notwithstanding the dispute over whether such releases are lawful or suitable, the plan provisions for releases, exculpations and injunctions have grown increasingly complex and the lines between the competing forms of relief have become increasingly blurred. How can we disentangle their purposes and underpinnings in an effort to clarify the terms of the plan and increase the likelihood of confirmation?

For an overview of the issues, the attached pleading filed by the Office of the United States Trustee in the Chapter 11 case of *TPC Group, Inc.*, pending in Delaware highlights some of the concerns about overlapping relief.

Even a rather non-controversial debtor release of claims can sometimes raise issues when the release purports to treat direct claims as derivative claims that belong to the estate. Even a rather non-controversial exculpation provision can cross the line by extending its reach to non-fiduciaries or by covering conduct outside the temporal boundaries of case. Even a rather non-controversial injunction can begin to look like a release when it appears to cover parties that do not offer a meaningful contribution to the reorganization effort.

V. Plans That Vary the Defenses of Setoff and Recoupment[31]

It is not uncommon for plans to contain detailed procedures for determining the allowance of claims that are entitled to a distribution. Typically, the plan will spell out deadlines for bringing objections to claims, the manner of resolving disputes and parameters for court approval of settlements, among other requirements for establishing a creditor's entitlement to a dividend. Sometimes, a plan will also seek to streamline the allowance process by varying a creditor's ability to deploy its non-bankruptcy rights of setoff and recoupment.

For example (actual plan excerpts):

> *Effective as of the Effective Date, pursuant to section 524(a) of the Bankruptcy Code, to the fullest extent permissible under applicable law, and except as otherwise expressly provided in the Plan or for obligations issued or required to be paid pursuant to the Plan or the Confirmation Order, all Entities that have held, hold, or may hold claims or interests or Causes of Action that have been released, discharged, or are subject to exculpation are permanently enjoined, from and after the Effective Date, from taking any of the following actions against, as applicable, the Debtors, the Reorganized Debtors, the Exculpated Parties, or the Released Parties: . . . (4) asserting any right of setoff, subrogation, or recoupment of any kind against any obligation due from such Entities or against the property of such Entities on account of or in connection with or with respect to any such claims or interests or Causes of Action unless such Holder has Filed a motion requesting the right to perform such setoff on or before the Effective Date, and notwithstanding an indication of a claim or interest or otherwise that such Holder asserts, has, or intends to preserve any right of setoff pursuant to applicable law or otherwise; and . . .*
>
> *In no event shall any Holder of Claims or Interests be entitled to recoup any Claim or Interest against any Claim, right, or Cause of Action of the Debtors, the Reorganized Debtors, the Liquidation Trustee, or GUC Trustee (as applicable), unless such Holder actually has performed such recoupment and provided notice thereof in writing to the Debtors on or before the Confirmation Date, notwithstanding any indication in any Proof of Claim or otherwise that such Holder asserts, has, or intends to preserve any right of recoupment.*

Are these efforts "inconsistent with the applicable provisions of this title," as prohibited by sections 1123(b)(6) and 1129(a)(2) of the Bankruptcy Code? Although it might seem desirable to prune back these vexing defenses, vigilant creditors might be able to derail the confirmation train if a plan unduly alters these rights.

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[31] Prepared by Henry C. Kevane, Pachulski Stang Ziehl & Jones LLP.

Setoff is a common law right, rooted in early Roman and English law, which allows a creditor and a debtor to adjust mutual obligations. It is based on the "common sense notion that 'a man should not be compelled to pay one moment what he will be entitled to recover back the next.'" See In re Wood, -- F.3d. – (4th Cir. 2021) (quoting *The Development of Setoff*, 64 U. Pa. L. Rev. 541, 541 (1916)). As articulated more famously by the Supreme Court, setoff allows entities that owe each other money to apply their mutual debts against each other, "thereby avoiding the absurdity of making A pay B when B owes A." *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995).

At its core, setoff is a defense to the payment of an otherwise valid debt. Subject only to certain specified exceptions (under sections 362, 363 and 553), section 553 of the Bankruptcy Code ensconces the common law right of setoff – "this title *does not affect* any right of a creditor to offset a mutual debt owing by such creditor to the debtor … against a claim of such creditor against the debtor."[32] Yet, only mutual[33] pre-petition debts and claims can be offset[34] and the act of making the deduction (i.e., actually accomplishing the setoff), is subject to the automatic stay.[35] As an aside, although section 553 does not address mutual post-petition debts, most courts have acknowledged that such obligations may be offset.

Unlike setoff, which presupposes competing debts and claims, recoupment does not involve the netting of independent obligations but rather the determination of the proper liability on a claim. The competing obligations that give rise to recoupment must arise from the same transaction or occurrence. In order to meet this requirement, courts typically assess whether there is a "logical relationship" between the obligations.

That test does not measure temporal proximity (*i.e.,* did the claims arise contemporaneously), but whether they are logically connected. Neither a single contract, nor the same parties, nor a similar subject matter, nor a shared legal framework will necessarily satisfy the same transaction test to permit recoupment. *In re University Medical Center*, 973 F.2d 1065 (3rd Cir. 1992). Similarly, a statutory right of

[32] By way of a glossary, the Bankruptcy Code defines a "claim" to include every right to payment, whether or not liquidated or unliquidated. A creditor is an entity that holds a claim against the debtor that arose prior to the commencement of the bankruptcy case. A "debt," on the other hand, is a liability on a claim. For purposes of section 553, the Code treats an obligation ***owed by a creditor*** to the debtor as a debt, whereas the obligation ***owed by the debtor*** to the creditor is a claim.

[33] To be mutual, each of the obligations must be held by the creditor and the debtor standing in the same bilateral right and capacity. Private contracts can neither create mutuality (for purposes of Section 553), nor opt-out of the mutuality requirement. *In re Orexigen Therapeutics*, 990 F.3d 748 (3rd Cir. 2021).

[34] Moreover, a creditor cannot acquire, post-petition, a claim for purposes of offset. See Bankruptcy Code § 553(a)(2) (setoff prohibited to the extent that the claim against the debtor was transferred to the creditor owing a debt to the debtor "after the commencement of the case.").

[35] In order to actually make a permanent deduction, the creditor must first seek relief from the stay. In the *Strumpf*, decision, however, the Supreme Court permitted a creditor to temporarily "freeze" countervailing obligations (*i.e.,* preserve the status quo as of the petition date) without violating the stay until the outcome of a subsequent motion to lift the stay. Such an administrative hold, pending further instructions from the court or the parties, does not result in the permanent settlement of accounts that is needed for a setoff to actually occur.

deduction of "any" debts or claims is also insufficient, on its own, to create a right of recoupment.

Recoupment, thus, is a defense *embedded within* a debt. It is meant to compute the "proper amount" of a particular claim. As a result, recoupment is neither subject to the automatic stay nor restricted to pre-petition debts and claims (*i.e.,* it may be deployed across the petition date). A setoff typically arises from separate and distinct transactions. A recoupment, on the other hand, is a right to reduce the common nucleus of a single obligation. See, e.g., *In re Gardens Regional Hospital*, 975 F.3d 926 (9th Cir. 2020). The dueling payment streams must arise from the "very same acts" to meet the logical relationship test for recoupment. The fact that payment streams may be cabined within a single contract, a single statute or even a single commercial relationship, is insufficient alone to qualify for recoupment. And yet, the *Gardens* court has cautioned that the test should not be applied "so loosely that multiple occurrences in any continuous commercial relationship would constitute one transaction."

Most courts have accepted the principle that setoff and recoupment cannot be affected in bankruptcy because they are neither claims, debts nor interests.[36] Instead, they are defenses to enforcement. Despite this, some plans purport to affect the ability of creditors to exercise or effectuate rights of recoupment or setoff. Seemingly, these provisions fly in the face of the admonition under section 553 that nothing in the Bankruptcy Code may affect a right of setoff. And, although recoupment is not mentioned in the Bankruptcy Code, how could a plan affect what is, fundamentally, merely a right of subtraction? Yet, plans are often drafted with an eye to enhancing the post-confirmation debtor's (or a liquidating trust's), ability to recover assets for distribution to creditors. And sometimes, provisions that vary the survival of setoff and recoupment rights are buried in the plan's claims determination section to escape notice.

PLAN TIPS: SETOFF AND RECOUPMENT

1. Provisions that purport to restrict the exercise of recoupment are bound to fail – neither the plan nor the confirmation order should disturb a creditor's defenses or rights of recoupment under applicable non-bankruptcy law. Of course, if the recoupment yields an outstanding debt due to the debtor (or its successor), a plan may properly preserve the enforcement and collection of such balance.

[36] Of course, insofar as the Bankruptcy Code treats a claim that is secured by a right of offset as a secured claim, the recourse entitlements of that secured claim may be altered by a sale free and clear under sections 363(f) or 1123 of the Bankruptcy Code. Thus, a purchaser of accounts receivable that may be encumbered by rights of offset may acquire the assets free and clear of defenses to payment based on setoff. The setoff, however, will be preserved against the debtor, qua seller, and the proceeds of sale. By contrast, however, a valid right of recoupment may not be stripped pursuant to a sale and will likely persist as a defense to payment even as against the purchaser.

2. What about plan provisions that purport to define what is or is not recoupable? Some courts may be receptive to ensuring that a plan does not tips the scales in favor of the creditor by treating certain debts held by the creditor as arising from the same transaction or occurrence as the claim owed by the debtor.

3. Provisions that alter setoff rights beyond the limitations expressed by section 553 are similarly questionable.

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	**Chapter 11**
TPC GROUP INC., *et al.*,	**Case No. 22-10493 (CTG)**
Debtors. [1]	**(Jointly Administered)** **Hearing Date: November 7, 2022 at 10:00 a.m. (ET)**[2] **Objection Deadline: November 7, 2022 at 4:00 p.m. (ET) (by agreement for U.S. Trustee)**[3] **RE: D.I. Nos. 216, 707, 793, 857-1**

UNITED STATES TRUSTEE'S OBJECTION TO SECOND AMENDED JOINT CHAPTER 11 PLAN OF TPC GROUP INC. AND ITS DEBTOR AFFILIATES

Andrew R. Vara, the United States Trustee for Region 3 ("U. S. Trustee"), through his counsel, files this objection (the "Objection") to confirmation of the *Second Amended Joint Chapter 11 Plan of TPC Group Inc. and Its Debtor Affiliates* (the "Plan") filed at D.I. 857-1, and in support of his Objection, states:

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: TPC Group Inc. (3618); TPC Holdings, Inc. (7380); TPC Group LLC (8313); Texas Butylene Chemical Corporation (7440); Texas Olefins Domestic International Sales Corporation (4241); TPC Phoenix Fuels LLC (9133); Port Neches Fuels, LLC (1641); and TP Capital Corp. (6248). Each Debtor's corporate headquarters and mailing address is 500 Dallas St., Suite 2000, Houston, Texas 77002.

[2] This date is the originally-scheduled confirmation hearing date, which as of this filing has been cancelled. The Debtors' representatives, however, announced at a status conference that due to forthcoming plan modifications, the confirmation hearing date would be adjourned to a date to be determined.

[3] This is the agreed-upon confirmation objection deadline for the Plan filed at D.I. 857-1. By agreement, the deadline for the U.S. Trustee to object to provisions in the Plan filed at D.I. 857-1 concerning the payment of fees under 28 U.S.C § 1930 is November 18, 2022.

PRELIMINARY STATEMENT

1. The Plan should not be confirmed for the following reasons:

- The Debtor Release and the Third-Party Release each explicitly discharge non-debtors, contrary to section 524(e) of the Code, and each include what could be hidden, non-consensual third-party releases;
- The Plan includes an impermissibly broad exculpation clause that (a) does not make an exception for gross negligence, (b) protects numerous non-fiduciaries, (c) fails to include the necessary temporal scope, (d) includes a non-consensual third-party release, and (e) sets forth findings of fact that are not appropriate in a Plan;
- The claims allowance process is contrary to section 502(a) of the Bankruptcy Code and Local Rule 3002-1(a);
- The Plan contravenes section 1129(a)(4) with respect to the payment of fees and expenses of certain secured creditors;
- The Plan provides for the assumption of employment agreements which may circumvent section 503(c) of the Code;
- The Plan proposes a case closing procedure that runs afoul of Federal Rule of Bankruptcy Procedure 3022 and Local Rule 3022-1; and
- The Plan Supplement was not timely filed under Local Rule 3016-2.

2. For these reasons, set forth in more detail below, confirmation of the Plan should be denied. [4]

[4] The U.S. Trustee's counsel has provided comments to Debtors' counsel regarding proposed changes to the Plan other than those addressed in this Objection, and anticipates that a resolution on those items will be reached before the hearing. The U.S. Trustee reserves the right to supplement this Objection, or to assert additional objections at the hearing on the Plan, if such modifications are not made. The U.S. Trustee also preserves, reserves and retains any and all rights, duties, obligations and remedies found at law, equity or otherwise to, *inter alia*, revise, augment and/or modify this Objection, and take any necessary discovery. Additionally, the Objection does not raise the U.S. Trustee's objections to the

JURISDICTION, VENUE AND STANDING

3. Under (i) 28 U.S.C. § 1334; (ii) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a); and (iii) 28 U.S.C. § 157(b)(2)(A), this Court has jurisdiction to hear and determine this Objection.

4. Pursuant to 28 U.S.C. § 586, the U. S. Trustee is charged with the administrative oversight of cases commenced pursuant to chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). This duty is part of the U. S. Trustee's overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that the U.S. Trustee has "public interest standing" under 11 U.S.C. § 307, which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the U. S. Trustee as a "watchdog").

5. Pursuant to 28 U.S.C. § 586(a)(3)(B), the U.S. Trustee has the duty to monitor plans and disclosure statements filed in chapter 11 cases, and to comment on such plans and disclosure statements.

6. Pursuant to 11 U.S.C. § 307, the U. S. Trustee has standing to be heard with regard to this Objection.

BACKGROUND

7. On June 1, 2022 (the "Petition Date") the above-captioned cases were commenced by the filing of voluntary petitions in this Court.

Modified Plan which appears to have been filed at D.I. 1143, as the deadline to object to the Modified Plan has not yet been set.

8. On January 14, 2022, the U.S. Trustee appointed an official committee of unsecured creditors ("Committee"). D.I. 207.

9. On July 22, 2022, the Debtors file the Disclosure Statement Motion, which sought approval of (i) of the Disclosure Statement filed at D.I. 217; and (ii) certain procedures concerning the solicitation of votes on the Plan of Reorganization. D.I. 216. The Debtors thereafter filed a revised Disclosure Statement and a revised Second Amended Plan of Reorganization. D.I. 793, 826.

10. On September 27, 2022, after a contested hearing on the Disclosure Statement Motion, the Court approved the Disclosure Statement and Solicitation Procedures only if the Debtors revised said procedures to allow creditors accepting the Plan an opportunity to opt out of the proposed third-party release in the Plan. *See* D.I. 857-1.

11. The operative plan for purposes of this objection is the Plan filed at D.I. 857-1.

RELEVANT PLAN PROVISIONS

Release and Exculpation Provisions

12. The Plan's Debtor Release provides in relevant part:

> **Releases by the Debtors.** As of the Effective Date, except for the rights and remedies that remain in effect from and after the Effective Date to enforce the Plan and the obligations set forth in the Definitive Documents, including the documents in the Plan Supplement, except as provided for in the Schedule of Retained Claims and Causes of Actions, for good and valuable consideration, the adequacy of which is hereby confirmed, on and after the Effective Date, ***the Released Parties will be*** deemed conclusively, absolutely unconditionally, irrevocably, and forever released and ***discharged, by the Debtors,*** the Reorganized Debtors, and the Estates, in each case on behalf of themselves and their respective successors, assigns, and representatives and any and all other Persons that may purport to assert any Cause of Action derivatively, by or through the foregoing Persons, from any and all claims and Causes of Action ***(including any derivative claims, asserted or assertable on behalf of the Debtors, the Reorganized Debtors, or the Estates)***, whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, accrued or unaccrued, existing or hereinafter

> arising, whether in law or equity, whether sounding in tort or contract, whether arising under federal or state statutory or common law, or any other applicable international, foreign, or domestic law, rule, statute, regulation, treaty, right, duty, requirements or otherwise that the Debtors, the Reorganized Debtors, the Estates, or their affiliates would have been legally entitled to assert ***in their own right*** (whether individually or collectively) ***or on behalf of the holder of any Claim or Interest or other Person***, based on or relating to, or in any manner arising from, in whole or in part, the Debtors, ...

Plan § 10.7(a) (emphasis added) (the "Debtor Release").

13. The third-party release in the Plan provides, in relevant part, as follows:

> **Releases by Holders of Claims and Interests.** As of the Effective Date, except for the rights and remedies that remain in effect from and after the Effective Date to enforce the Plan and the obligations contemplated by the Definitive Documents (including the documents in the Plan Supplement) or as otherwise provided in any order of the Bankruptcy Court, for good and valuable consideration, the adequacy of which is hereby confirmed, on and after the Effective Date, ***the Released Parties will be*** deemed conclusively, absolutely, unconditionally, irrevocably, and forever released and ***discharged by the Releasing Parties***, from any and all claims and Causes of Action whatsoever (including any derivative claims, asserted or assertable on behalf of the Debtors, the Reorganized Debtors, or their Estates), whether liquidated or unliquidated, fixed or contingent, matured or unmatured, known or unknown, foreseen or unforeseen, existing or hereinafter arising, in law, equity, contract, tort, or otherwise by statute, violations of federal or state securities laws or otherwise, that such holders or their estates, affiliates, heirs, executors, administrators, successors, assigns, managers, accountants, attorneys, representatives, consultants, agents, and any other Persons claiming under or through them would have been legally entitled to assert ***in their own right*** (whether individually or collectively) ***or on behalf of the holder of any Claim or Interest or other Person***, based on or relating to, or in any manner arising from, in whole or in part, the Debtors, ...

Plan § 10.7(b) (emphasis added) (the "Third-Party Release").

14. The Plan also contains an Exculpation provision, which states:

> To the fullest extent permitted by applicable law, no Exculpated Party will have or incur, and each Exculpated Party ***will be released*** and exculpated from, any claim or Cause of Action in connection with or arising out of the administration of the Chapter 11 Cases; the negotiation and pursuit of the ABL DIP Facility, the Priming Notes DIP Roll-Up, the Term Loan DIP Facility, the Exit ABL Facility, the Exit Notes, Holdco Notes, the Debt Rights Offering, the Equity Rights Offering, the Backstop Agreements, the Management Incentive Plan, the Disclosure Statement,

> the Restructuring Support Agreement, the Restructuring, and the Plan, the Solicitation Materials and any other Definitive Documents (including the documents in the Plan Supplement), or the solicitation of votes for, or confirmation of, the Plan; the funding of the Plan; the occurrence of the Effective Date; the administration of the Plan or the property to be distributed under the Plan; the issuance of securities under or in connection with the Plan; the purchase, sale, or rescission of the purchase or sale of any security of the Debtors or the Reorganized Debtors; or the transactions in furtherance of any of the foregoing; ***other than claims or Causes of Action arising out of or related to any act or omission of an Exculpated Party that constitutes intentional fraud or willful misconduct*** as determined by a Final Order, but in all respects such Persons will be entitled to reasonably rely upon the advice of counsel with respect to their duties and responsibilities pursuant to the Plan. ***The Exculpated Parties have acted in compliance with the applicable provisions of the Bankruptcy Code with regard to the solicitation and distribution of securities pursuant to the Plan and, therefore, are not, and on account of such distributions will not be, liable at any time for the violation of any applicable law, rule, or regulation governing the solicitation of acceptances or rejections of the Plan or such distributions made pursuant to the Plan, including the issuance of securities thereunder.*** The exculpation will be in addition to, and not in limitation of, all other releases, indemnities, exculpations, and any other applicable law or rules protecting such Exculpated Parties from liability.

Plan § 10.8 (emphasis added).

15. The Plan defines Exculpated Parties as follows:

> ***Exculpated Parties*** means, collectively, (i) the Debtors, (ii) the Reorganized Debtors, (iii) any statutory committee appointed in the Chapter 11 Cases, ***(iv) the Supporting Noteholders, (v) the Backstop Parties, (vi) the agents and lenders under the Exit ABL Facility, (vii) the agents and lenders under the Prepetition ABL Credit Agreement, (viii) the Supporting Sponsors, (ix) the agents and lenders under the DIP Facilities (x) the holders of the Exit Notes and HoldCo Notes and any agents or trustees thereunder*** and (xi) with respect to each of the foregoing Persons in clauses (i) through (x), ***such Persons' predecessors, successors, assigns, subsidiaries, affiliates, current and former officers and directors, principals, equity holders, members, partners, managers, employees, agents, advisory board members, financial advisors, attorneys, accountants, investment bankers, consultants, representatives, management companies, fund advisors, and other professionals, affiliated investment funds or investment vehicles, managed accounts or funds,*** and such Persons' respective heirs, executors, estates, and nominees, in each case in their capacity as such.

Plan § 1.1 (emphasis added).

Claims Allowance Process

16. The Plan contains several provisions purporting to address issues concerning the claims allowance process.

17. The Plan defines a claim or interest that is "Allowed" as:

> with respect to any Claim against or Interest in a Debtor, (a)(i) that is timely filed by the Bar Date or (ii) as to which there exists no requirement for the holder of a Claim to file such Claim under the Plan, the Bankruptcy Code, the Bankruptcy Rules or a Final Order, (b)(i) that is listed in the Schedules as not contingent, not unliquidated, and not disputed and (ii) for which no contrary proof of claim has been ***timely filed,*** or (c) allowed under the Plan or by a Final Order. . . .

Plan § 1.1 (emphasis added).

18. Additionally, the Plan defined a claim that is "Disputed" as:

> with respect to a Claim, (i) any Claim, which Claim is disputed under Article VII of the Plan or as to which the Debtors have ***interposed*** and not withdrawn an objection or request for estimation that has not been determined by a Final Order; (ii) any Claim, proof of which was required to be filed by order of the Bankruptcy Court but as to which a proof of claim was not timely or properly filed; (iii) any Claim that is listed in the Schedules, if any are filed, as unliquidated, contingent or disputed, and as to which no request for payment or proof of claim has been filed; or (iv) any Claim that is otherwise disputed by any of the Debtors, Reorganized Debtors, the GUC Trustee, or the Required Supporting Noteholders in accordance with applicable law or contract, which dispute has not been withdrawn, resolved or overruled by a Final Order. To the extent any such party disputes only the amount of a Claim, such Claim shall be deemed Allowed in the amount such party does not dispute, if any, and Disputed as to the balance of such Claim.

Plan § 1.1 (emphasis added).

19. In Article 2.1 of the Plan, which concerns administrative claims, there is no clarification that, pursuant to Local Rule 3002-1(a), the government is not required to file a proof of claim or application for allowance of any claims covered by section 503(b)(1)(B), (C), or (D). Del. Bankr. L.R. 3002-1(a).

20. There are also several provisions of the Plan that purport to govern the claims objection process, and such sections entitle only the Reorganized Debtor and no other party in

interest to object to claims, contrary to the express language of section 502(a) of the Code. Plan § 7.2 (stating that only "Debtors" or the "Reorganized Debtors" shall be entitled to object to claims); Plan § 7.5.

Fees and Expenses of Certain Creditors

21. The Plan contains several provisions which purport to obligate the Reorganized Debtors to pay pre- and post-petition expenses of certain secured creditors.

22. Specifically, at sections 5.13, 5.14. and 5.15 of the Plan provides that the outstanding expenses whether incurred prepetition or postpetition shall be paid in full in cash on the Effective Date for each of the Supporting Noteholders Advisors, Cerberus/Bayside Advisors, the Mockingbird Advisors, and the Indenture Trustee. Plan §§ 5.13, 5.14, 5.15. Other than with respect to the Supporting Noteholder Advisor fees, the Plan does not specify the basis for the payment of these fees.

Assumption of Employment Agreements

23. The Plan purports to treat all "Employment Arrangements" as executory contracts, and all such Employment Arrangements will be assumed by the Debtors on the Effective Date. Plan § 5.17. Such Employment Arrangements may require the payment of retention bonus and severance obligations in favor of insiders of the Debtors, without the requirement of compliance with section 503(c) of the Code.

Closing of Chapter 11 Cases

24. Section 12.16(a) of the Plan purports to allow the Debtors to close the chapter 11 cases without the filing of a motion, as required by Local Rule 3022-1(a); the provision appears to allow them to close the cases by the filing of orders under certification of counsel. Plan § 12.16 ("as of the Effective Date, the Reorganized Debtors shall submit separate orders to the Bankruptcy Court under certification of counsel. . . .").

LEGAL ARGUMENT

I. The Debtor and Third-Party Release Contain Impermissible Discharge Language and a Hidden Non-Consensual Third-Party Release

25. The Plan's Debtor Release and Third-Party Release render the Plan unconfirmable because they (1) include a discharge of non-debtors contrary to section 524(e) of the Bankruptcy Code; and (2) include a hidden non-consensual third-party release of claims held by holders of claims and interest and "other persons." Plan §§ 10.7(a), 10.7(b).

26. Section 524(e) of the Bankruptcy Code provides that "[e]xcept as provided in subsection (a)(3) of this section, discharge of a debt of the debtor ***does not affect the liability of any other entity on, or the property of any other entity for, such debt***." 11 U.S.C. § 524(e) (emphasis added).

27. Here, both the Debtor Release and the Third-Party Release indicate that the Debtors and the Releasing Parties, respectively, "discharge" a slew of non-debtor Released Parties. The word "discharge" in the context of a bankruptcy plan has a specific meaning, and as stated in section 524(e), a discharge does not affect the liability of non-debtor parties. Therefore, the discharge language should be stricken from both the Debtor Release and the Third-Party Release.

28. Additionally, the Debtor Release includes a release of claims "on behalf of the holder of any Claim or Interest or other Person," and the Third-Party Release includes a release of claims "on behalf of the holders of any Claim or Interest or Other Person" ***other than*** the Releasing Parties who are giving the Third-Party Release. Plan §§ 10.7(a), 10.7(b). It is unclear the nature of the claims this language is intended to release. It is not a release of claims that holders of Claims and Interest could assert derivatively on behalf of the Debtors, or the claims of the Releasing Parties who are deemed to give the Third-Party Releases, because those claims are addressed

elsewhere in the Debtor Release and the Third-Party Release provisions. The quoted language is sufficiently unclear that it could be interpreted to be a release of direct claims of holders of Claims or Interests who are not themselves giving Third-Party Releases. If so, it would act as a non-consensual third-party release in favor of non-debtors.

29. The U.S. Trustee's counsel has proposed revisions to the Plan to address the issues set forth above, but as of this filing, the U.S. Trustee and the Debtors have not reached an agreement on such revisions. Accordingly, the Plan should not be confirmed unless these provisions are stricken from the Plan.

II. The Proposed Exculpation Provision Is Overly Broad.

30. The exculpation provision is overbroad, and inconsistent with controlling case law, because it (a) does not include an exception for gross negligence, (b) is not limited to estate fiduciaries, (c) is not temporally limited to the period between the Petition Date and the Effective Date of the Plan, (d) includes a "release," in addition to an exculpation, and (e) includes what amount to findings of fact that are not appropriate to include in a plan.

31. It is clear that any exculpation provision must make an exception for gross negligence. In the leading Third Circuit case addressing exculpation provisions, *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000), the Court affirmed the confirmation of the debtor's plan over an objection to the exculpation provision as it related to the unsecured creditors' committee. The Court held that, under the exculpation provision, "members of the Committee and professionals who provided services to the Debtors remain liable for willful misconduct or ***gross negligence***. Because we conclude that this standard of liability is the standard that already applies in this situation, we believe that [the exculpation provision] affects no change in liability." *Id.* at 246 (emphasis added).

32. In reaching its decision in *PWS Holding Corporation*, the Third Circuit determined that section 1103(c) of the Bankruptcy Code implies both a fiduciary duty and a limited grant of immunity to members of the unsecured creditors' committee. *Id.* This Court has repeatedly interpreted *PWS Holding Corporation* and uniformly held that a party's entitlement to exculpation is based upon its role or status as an estate fiduciary. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011); *accord In re Tribune Company*, 464 B.R. 126, 189 (Bankr. D. Del. 2011); *Indianapolis Downs*, 486 B.R. 286 (Bankr. D. Del. 2013); *In re PTL Holdings LLC*, No. 11-12676 (BLS), 2011 WL 5509031, at *12 (Bankr. D. Del. Nov. 10, 2011).

33. The Plan definition of Exculpated Parties includes many parties who are not fiduciaries of the estates, namely the Supporting Noteholders, the Backstop Parties, the agents and lenders under the Exit ABL Facility, the agents and lenders under the Prepetition ABL Credit Agreement, the Supporting Sponsors, the agents and lenders under the DIP Facilities, and the holders of the Exit Notes and HoldCo Notes and any agents or trustee thereunder. The definition of Exculpated Parties also includes about 30 categories of parties who are "related" to each Exculpated Party. Yet, even as to the few Exculpated Parties that are estate fiduciaries, it is not true that every person and entity related to them are entitled to exculpation. Not every employee and every equity holder of the Debtors is an estate fiduciary, nor is every employee and equity holder of every member of the Creditors' Committee, or the law firms that represent the individual members of the Creditors' Committee. None of them qualify for exculpation.

34. The Plan cannot be confirmed unless its definition of Exculpated Parties is limited to: (i) the Debtors; (ii) the directors and officers of the Debtors who served during any portion of the cases; (iii) the Creditors' Committee; (iv) the members of Creditors' Committee, in their capacity as such; (v) the individuals who sat on the Creditors' Committee, in their capacity as such;

and (vi) the professionals retained in these cases by the Debtors or the Creditors' Committee. *See Wash. Mut.*, 442 B.R. at 350-51 ("[An] exculpation clause must be limited to the fiduciaries who have served during the chapter 11 proceeding: estate professionals, the Committees and their members, and the Debtors' directors and officers.").

35. The temporal scope of the Exculpation provision in Article 10.8 is also overly broad in two ways. First, it is not limited to actions and omissions taking place during the bankruptcy case, but instead extends back to pre-petition activity that cannot be covered by a plan exculpation provision. *See Wash. Mut.*, 442 B.R. at 350 (exculpations cover "actions in the bankruptcy case," not before the case was filed) (citing *PWS,* 228 F.3d at 246). In considering the U.S. Trustee's objection to the temporal scope of the exculpation clause in *In re Mallinckrodt PLC*, 639 B.R. 837 (Bank. D. Del. 2022), this Court recently held that exculpation "only extends to conduct that occurs between the Petition Date and the effective date," and ordered the debtors to strike contrary language from the exculpation provision. *Id.* at 883.

36. Second, the temporal scope has no end date, and therefore could be interpreted to provide a prospective exculpation that extends past the Effective Date, especially as it covers entities that will not exist until after the Effective Date of the Plan, such as the Reorganized Debtors, and the holders of Exit Notes. Exculpation clauses should not extend past the effective date of a plan, to avoid exculpating actions that have not yet occurred and are as of yet unknown. *See Mallinckrodt,* 639 B.R. at 883. In addition, post-effective date entities cannot receive prospective immunity by way of exculpation, just as they cannot receive prospective immunity through a release. *See Wash. Mut.*, 442 B.R. at 348 ("The Liquidating Trust and its Trustee have not done anything yet for which they need a release. They will not even come into existence until the Plan is confirmed.").

37. The exculpation provision also includes a "release" as well as an exculpation, of various non-debtor parties. Because that release is binding on all holders of claims and equity interests, regardless of how they vote on the Plan or whether they opt out of giving third-party release (if they are permitted to do so), such release constitutes an impermissible non-consensual third-party release.

38. Lastly, the exculpation provision includes what amount to findings of fact that are not appropriate to include in a plan, namely that "[t]he Exculpated Parties have acted in compliance with the applicable provisions of the Bankruptcy Code with regard to the solicitation and distribution of securities pursuant to the Plan and, therefore, are not, and on account of such distributions will not be, liable at any time for the violation of any applicable law, rule, or regulation governing the solicitation of acceptances or rejections of the Plan or such distributions made pursuant to the Plan, including the issuance of securities thereunder."

39. Based on the foregoing, this Court should deny confirmation of the Plan.

III. <u>The Claims Allowance Process Is Inconsistent With The Bankruptcy Code.</u>

40. Section 502(a) of the Bankruptcy Code provides that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a).

41. Here, as set forth above, both the definition of "Allowed" and "Disputed" establish that a claim is not allowed and disputed if a claim is not "timely" filed. Plan at §1.1. The text of section 502(a) of the Code, however, states that the filing of a proof of claim deems the claim allowed. There is no exception for claims that are not timely filed. Rather, it is the Debtors' burden, or that of another party in interest, to file an objection to a claim on the basis of untimeliness in order to have such claim treated as disputed or, if the Court grants the objection, disallowed.

Moreover, section 502(a) provides that any "party in interest," and not just the debtor, may object to a claim. The Debtors' Plan, however, restricts the right to assert claim objections to Reorganized Debtors. Plan at §§ 7.2, 7.5,

42. The Plan should not be confirmed unless and until the Debtors modify the relevant provision of the Plan concerning the claims allowance process to make clear that (a) claims that are the subject of a filed proof of claim are Allowed, regardless of when such proof of claims are filed, unless and until an objection is filed, and (b) all parties in interest may assert claims objections.

43. At Article 2.1 of the Plan which concerns administrative claims, there is no clarification that pursuant to Local Rule 3002-1(a), the government is not required to file a proof of claim or application for allowance of any claims covered by section 503(b)(1)(B), (C), or (D). Del. Bankr. L.R. 3002-1(a). The Plan should be revised to address this clarification.

44. For these reasons, the Plan should not be confirmed.

IV. <u>The Payment of Fees and Expenses Of Secured Creditors Does Not Satisfy Section 1129(a)(4) of the Bankruptcy Code.</u>

45. Section 1129(a)(4) of the Bankruptcy Code provides that a "court shall confirm a plan ***only if*** all of the following requirements are met: (4) [a]ny payment made or to be made by the . . . debtor . . . for services or for costs and expenses in or in connection with the case, or in connections with the plan and incident to the case, ***has been approved by, or is subject to the approval of, the court as reasonable***." 11 U.S.C 1129(a)(4) (emphasis added).

46. Here, the Plan proposes that the Debtors will pay the "Restructuring Expenses" of the Supporting Noteholders, the Cerberus/Bayside Advisor Fees, the Mockingbird Advisor Fees, and the Indenture Trustee Fees and Expenses. Plan §§ 5.13, 5.14, 5.15. The Plan contemplates that

as to the Supporting Noteholders and the Indenture Trustee Fees and Expenses, these parties will submit invoices to the Debtors estimating their fees. The Plan does not itemize these expenses nor provide that the Court must approve these expenses as reasonable contrary to 1129(a)(4) of the Bankruptcy Code. Even if the Debtors are obligated to pay such fees under the Final DIP Order, the Debtors should, in accordance with 1129(a)(4), fully disclose what additional fees they are committing to pay these parties under this Plan and require this Court's express approval of such fees as reasonable. The Final DIP Order at paragraphs 3, 11(c)(ii)(3) and 11(e)(ii)(3) obligates the Debtors to pay the professional fees and expenses of certain of its secured lenders. *See* D.I. 566. However, paragraph 12 of the Final DIP Order requires that invoices on such fees "shall be provided to counsel to the Debtors, counsel to the Official Committee, and the U.S. Trustee." D.I. 566 at ¶ 12. Such parties have a ten-day review and objection period as to such fees, and the fees are subject to an adequate remedy (like, disgorgement) in the event of a successful challenge to a roll up. *Id.* The Plan should include these same requirements, and there is no justification for deviating from them.

47. As to the Cerberus/Bayside Advisor Fees and the Mockingbird Advisor Fees, the Plan does not require the submission of invoices to any party or approval by the Court. Furthermore, Cerberus/Bayside and Mockingbird, to the U.S. Trustee's understanding, were not DIP Lenders; therefore, the obligation to pay their advisor fees appears to be a creature of this Plan. The amount of the fees they have incurred has not been itemized or otherwise disclosed. Accordingly, the proposed payment of the Cerberus/Bayside Advisor Fees and the Mockingbird Advisor Fees runs afoul of section 1129(a)(4) of the Bankruptcy Code.

48. For these reasons, this Court should deny confirmation of the Plan.

V. The Assumption Of Employment Arrangements May Circumvent Section 503(c) Of The Bankruptcy Code.

49. Section 503(c) of the Bankruptcy Code explicitly prohibits the allowance or payment of certain transfers to insiders unless certain condition are met. *See* 11 U.S.C § 503(c). The requirements of section 503(c) of the Code apply whether a transfer to an insider is proposed under a plan of reorganization or by way of assumption of employment agreements under a plan. The general prohibition of section 503(c) is clear and without qualification: "there shall neither be allowed, nor paid," certain transfers. 11 U.S.C. § 503(c). Moreover, section 1129(a)(1) provides that the Plan must comply with the applicable provisions of the Bankruptcy Code. This includes section 503(c) of the Bankruptcy Code.

50. In *In re AMR Corporation.*, 497 B.R. 690, 697-698 (Bankr. S.D.N.Y. 2013), the Court denied approval of an executive severance payment that did not comply with section 503(c)(2), even though the payment was a condition precedent to the plan going effective. In so doing, the Court noted that "attempts to bypass the requirements of section 503(c) given the history and intent of the section" are disfavored. *Id.* at 697. The *AMR* Court also held that, "[i]f Section 1129(a)(1)'s instruction that a plan must comply with all applicable provisions of the Bankruptcy Code means anything, the Court cannot approve a payment that is clearly prohibited by another, more specific part of the Bankruptcy Code." *Id.* at 696-7.[5]

51. The *AMR* court also noted the effect of the Supreme Court's ruling in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* 566 U.S. 639 (2012), that a specific prohibition or

[5] Although not in the context of a plan, this Court declined to permit a debtor to circumvent the provisions of Section 503(c) of the Bankruptcy Code by attempting to use Sections 365 and 363 of the Code to assume an executory contract to pay insider bonuses. *See In re Foothills Texas, Inc.*, 408 B.R. 573 (Bankr. Del. 2009).

permission trumps a more general provision. This same principle was restated by the Supreme Court in the case of *Law v. Siegel*, 571 U.S. 415 (2014). In discussing the principle that section 105(a) of the Bankruptcy Code may not be used to override explicit mandates of the Bankruptcy Code, the Supreme Court noted: "That is simply an application of the axiom that a statute's general permission to take actions of a certain type must yield to a specific prohibition found elsewhere." 571 U.S. at 420.

52. Notably, because section 503(c) concerns the allowance as well as the payment of obligations, it applies with equal force regardless of whether the payment is to be made by the debtor prior to plan confirmation, or whether the successor of the debtor is directed to make such a payment after emergence from bankruptcy. *See In re Dana Corp.*, 351 B.R. 96, 102 (Bankr. S.D.N.Y. 2006) (applying 11 U.S.C. § 503(c) to bonus and severance payments that were to be made to debtor's insider upon emergence from bankruptcy); *In re TCI 2 Holdings, LLC*, 428 B.R. 117, 171-72 (Bankr. D.N.J. 2010) (holding severance provision invalid under section 503(c)(2) notwithstanding fact that severance was to be paid after plan effective date by reorganized debtor).

53. Here, the Debtors generally propose to assume all "Employment Arrangements" under the Plan without establishing or disclosing whether (1) these arrangements are with insiders of the Debtors; and (2) if they are, whether the arrangements obligate the payment of severance or retention bonus payments. The Debtors have the burden of proof of this issue, and the U.S. Trustee reserves argument until the record at the confirmation hearing is closed.

VI. <u>The Proposed Procedures For Closing Of Cases Is Inconsistent With the Bankruptcy Code and the Local Rules.</u>

54. Federal Rule of Bankruptcy Procedure 3022 provides that "[a]fter an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on motion of a party in interest, shall enter a final decree closing the case." Fed. R. Bankr. P. 3022.

55. Local Rule 3022-1(a) provides:

> ***Upon written motion***, a party in interest may seek the entry of a final decree at any time after the confirmed plan has been fully administered provided that all required fees due under 28 U.S.C. § 1930 have been paid. Such motion shall include a proposed final decree order that (i) orders the closing of the case and (ii) identifies in the caption and in the body of the order the case name and the case number of each case to be closed under the order.

Del. Bankr. L.R. 3022-1(a)(emphasis added).

56. Such motion "shall be served upon the debtor, the trustee, if any, the United States Trustee, all official committees and all creditors who have filed a request for notice under Fed. R. Bankr. P. 2002 and Local Rule 9013-1, at least twenty-one (21) days prior to the hearing on the motion." *Id.*

57. Here, section 12.16(a) of the Plan purports to allow the Debtors to close the chapter 11 cases without the filing of any motions; the provision appears to allow them to close the cases by the filing of orders under certification of counsel. Plan § 12.16 ("as of the Effective Date, the Reorganized Debtors shall submit separate orders to the Bankruptcy Court under certification of counsel. . . ."). This procedure runs afoul of Federal Rule of Bankruptcy Procedure 3022 and Local Rule 3022-1, because it does not require a motion, nor service of the same on the parties indicated in Local Rule 3022-1. The Debtors cannot circumvent necessary administrative procedures established the Federal Rule of Bankruptcy Procedure and the Local Rules of this Court merely because another procedure is more convenient for them. This portion of the Plan must be revised to conform to the Rules.

VII. <u>The Plan Supplement and Pertinent Information Has Not Been Timely Filed.</u>

58. Under Local Rule 3016-2 "[t]he plan proponent must file any plan supplement on or before seven (7) days prior to the earlier of (a) the deadline for submission of ballots to vote to

accept or reject a plan, or (b) the deadline to object to the confirmation of the plan, unless otherwise ordered by the Court."

59. Here, a plan supplement was filed on October 17, 2022 at D.I. 1036. The supplement was incomplete at that time and remains so. It did not include the GUC Trust agreement which contains provisions important to the creditor beneficiaries of that trust. As of this filing, the GUC Trust agreement has not been filed. The Debtors should not be allowed blanket authority to file important plan confirmation documents at their discretion after the voting and confirmation deadlines have passed. These actions impede the rights to parties in interest to fully evaluate their rights under the Plan.

60. Because the Debtors' filing of a complete Plan Supplement will be untimely, in contravention of Local Rule 3016-2, parties in interest should be allowed a reasonable amount of time to review the missing information before being foreclosed from raising any issues in connection with confirmation.

CONCLUSION

WHEREFORE, the U.S. Trustee requests that this Court enter an order (i) denying confirmation of the Plan, and (ii) granting such other relief that the Court deems just and proper.

Dated: November 7, 2022
Wilmington, Delaware

Respectfully submitted,

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UNITED STATES TRUSTEE
REGIONS 3 and 9

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