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Bankruptcy 2022: Views from the Bench

Great Debates

Hon. Craig Goldblatt, Moderator
U.S. Bankruptcy Court (D. Del.) | Wilmington

RESOLVED: A bankruptcy is filed in good faith where the debtor is not otherwise in financial distress and has the liquidity to pay its creditors in full, but where the case is filed because the debtor is a defendant facing a deluge of tort claims, and the debtor believes that the mechanism for liquidating those claims through a trust created under a plan of reorganization will be fairer and better for all parties than the results that would otherwise be obtained in the tort system.

Pro: Hon. Marvin P. Isgur
U.S. Bankruptcy Court (S.D. Tex.) | Houston

Con: Hon. Robert D. Drain (ret.)
U.S. Bankruptcy Court (S.D.N.Y.) | White Plains

RESOLVED: A bankruptcy court may approve a plan-support agreement that provides that (1) the debtors will propose a plan that provides specified treatment to the supporting parties, which treatment is materially the same as the plan provides to similarly situated creditors; (2) obligates the supporting parties to vote in favor of the debtor's plan and to vote against any competing plan; and (3) requires that the supporting parties (and only the supporting parties) will provide exit financing to the reorganized debtors at rates and fees that exceed prevailing market terms.

Pro: Hon. Pamela W. McAfee
U.S. Bankruptcy Court (E.D.N.C.) | Raleigh

Con: Hon. Christopher M. Lopez
U.S. Bankruptcy Court (S.D. Tex.) | Houston

BANKRUPTCY VIEWS FROM THE BENCH

AMERICAN BANKRUPTCY INSTITUTE

HOGAN LOVELLS US LLP
WASHINGTON, DC

SEPTEMBER 23, 2022

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BANKRUPTCY VIEWS FROM THE BENCH

SEPT. 23, 2022 | HOGAN LOVELLS US LLP | WASHINGTON, D.C.

Great Debates: Debate 1

RESOLVED that a bankruptcy is filed in good faith where (a) the debtor is spun out of a solvent parent under a transaction that left the debtor with the parent's liabilities; and (b) the parent company is not in immediate financial distress and appears to have the liquidity to pay its creditors in full, but is facing a deluge of tort claims that could at some point threaten the parent's business and where the parent believes that the mechanism for liquidating those claims through a trust created under a plan of reorganization will be fairer and better for all parties than the results that would otherwise obtain in the tort system.

Pro: Judge Marvin Isgur, U.S. Bankruptcy Court for the Southern District of Texas

Con: Judge Robert Drain, U.S. Bankruptcy Court for the Southern District of New York

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BANKRUPTCY VIEWS FROM THE BENCH

SEPT. 23, 2022 | HOGAN LOVELLS US LLP | WASHINGTON, D.C.

Great Debates: Debate 2

RESOLVED that a bankruptcy court may approve an arrangement, set out in a restructuring support agreement, that (a) provides that the debtors will propose a plan that grants specified treatment to the Supporting Parties, which treatment is materially the same as the plan provides to similarly situated creditors; (b) obligates the Supporting Parties to vote in favor of the debtor's plan and to vote against any competing plan; and (c) states that under the plan, the Supporting Parties (and only the supporting parties) will provide exit financing to the Reorganized Debtors, at rates and fees (including a backstop fee) that exceed prevailing market terms.

Pro: Judge Pamela McAfee, U.S. Bankruptcy Court for the Eastern District of North Carolina

Con: Judge Christopher Lopez, U.S. Bankruptcy Court for the Southern District of Texas

BANKRUPTCY VIEWS FROM THE BENCH

SEPT. 23, 2022 | HOGAN LOVELLS US LLP | WASHINGTON, D.C.

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Great Debates: Debate 2

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FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT DISTRICT OF NEW JERSEY **Caption in Compliance with D.N.J. LBR 9004-2(c)**	
In re: LTL MANAGEMENT, LLC, Debtor.	Case No. 21-30589 (MBK) Chapter 11 Hearing Date: February 14-18, 2022 Judge: Michael B. Kaplan, Chief Judge

All Counsel of Record

MEMORANDUM OPINION

This matter comes before the Court upon motions (collectively, "Motions") filed by the Official Committee of Talc Claimants[1] (ECF No. 632) and the law firm of Arnold & Itkin, LLP, on behalf of certain talc personal injury claimants (ECF No. 766) (together, "Movants" or "Claimants"),[2] seeking an order of the Court dismissing the within bankruptcy proceeding

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[1] On November 8, 2021, prior to transferring venue of the Case to this Court, the United States Bankruptcy Court for the Western District of North Carolina entered an order appointing the Official Committee of Talc Claimants (the "Original TCC") (ECF No. 355). On December 23, 2021, subsequent to the filing of the Motions, the United States Trustee for Region 3 docketed a Notice of the United States Trustee's Filing of Reconstituted and Amended: (i) Notice of Appointment of Official Committee of Talc Claimants I; and (ii) Notice of Appointment of Official Committee of Talc Claimants II (ECF No. 965) ("Amended Notice"). The Amended Notice effectively divided the membership of the Original TCC into two committees—the Official Committee of Talc Claimants I ("TCC I"), consisting of ovarian cancer claimants, and the Official Committee of Talc Claimants II ("TCC II"), consisting of mesothelioma claimants—and appointed additional members to each such committee. Each committee has expressed support for the within Motions. At a hearing held on January 20, 2022, this Court granted the motions filed by Debtor and the law firm of Arnold & Itkin, LLP, challenging the validity of the Amended Notice, and struck the Amended Notice, effectively reinstating the Original TCC.

[2] A separate motion and joinder to the Motions has been filed on behalf of Aylstock, Witkin, Kreis & Overholtz, PLLC, ("AWKO") (ECF No. 1003), as well as a joinder by the Barnes Law Group (ECF No. 1092). In addition, three *amici curie* briefs have been filed on behalf of Certain Bankruptcy Law Professors (ECF No. 1384), on behalf of Complex Litigation and Mass Torts Professors (ECF No. 1410), and on behalf of Erwin Chemerinsky, who is Dean of the University of California, Berkeley School of Law (ECF No. 1396). At the hearing held on February 17, 2022, the United States Trustee read a statement into the record supporting either dismissal of the case or the appointment of a chapter 11 trustee. Besides Debtor's objection to the Motions, the Court has also reviewed the Canadian Class

pursuant to § 1112(b) as not having been filed in good faith. For the reasons expressed below, the Court denies the Motions in their entirety. The Court issues the following findings of fact and conclusions of law as required by FED. R. BANKR. P. 7052.[3] The Court has jurisdiction over this contested matter under 28 U.S.C. §§ 1334(a) and 157(a) and the Standing Order of the United States District Court dated July 10, 1984, as amended September 18, 2012, referring all bankruptcy cases to the Bankruptcy Court. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(A). Venue is proper in this Court pursuant to 28 U.S.C. § 1408.

I. Background & Procedural History

On October 14, 2021, LTL Management, LLC ("LTL" or "Debtor") filed a voluntary petition for chapter 11 relief (ECF No. 1) in the United States Bankruptcy Court for the Western District of North Carolina (the "North Carolina Bankruptcy Court"). LTL is an indirect subsidiary of Johnson & Johnson ("J&J") and traces its roots back to Johnson & Johnson Baby Products, Company ("J&J Baby Products"), a New Jersey company incorporated in 1970 as a wholly-owned subsidiary of J&J. *See Declaration of John K. Kim in Support of First Day Pleadings* ("*Kim Decl.*") ¶¶ 9-10, ECF No. 5. J&J, a New Jersey company incorporated in 1887, first began selling JOHNSON'S® Baby Powder ("Johnson's Baby Powder") in 1894, launching its baby care line of products. *Id.* at ¶¶ 10-14. In 1972, J&J established a formal operating division for its baby products business, including Johnson's Baby Powder. *Id.* In 1979, J&J executed a transaction (the "1979

Action Plaintiffs' Opposition to Motions to Dismiss Chapter 11 Case (ECF No. 1432) (the "Canadian Plaintiffs' Opposition").

[3] To the extent that any of the findings of fact might constitute conclusions of law, they are adopted as such. Conversely, to the extent that any conclusions of law constitute findings of fact, they are adopted as such.

Agreement") transferring all assets associated with the Baby Products division to J&J Baby Products. *Id.* In connection with this transfer, J&J Baby Products assumed all liabilities associated with the Baby Products division. *Id.* J&J no longer manufactured or sold baby products, such as Johnson's Baby Powder after this transaction. *Id.* Today, J&J is a global company primarily focused on products relating to human health and wellbeing. *See Expert Report of Saul E. Burian, Ph.D.*, ("*Burian Report*") at 25. J&J is composed of three business segments, including Consumer Health, Pharmaceutical, and Medical Devices. *Id.*

Prior or to October 12, 2021, one of J&J's corporate subsidiaries was Johnson & Johnson Consumer Inc. ("Old JJCI"). *See Kim Decl.* ¶¶ 10-14, ECF No. 5. As the result of a series of intercompany transactions, Old JJCI assumed responsibility for all claims alleging that J&J's talc-containing Johnson's Baby Powder caused ovarian cancer and mesothelioma. *Id.* at ¶¶ 15, 32. In the talc lawsuits, claimants contend generally that multiple scientific studies have repeatedly found (i) that samples of Johnson's Baby Powder contain amphibole asbestos and fibrous talc; (ii) that perineal or genital application of talcum powder increases the risk of and can cause ovarian cancer; and (iii) that exposure to asbestos-contaminated talcum powders can cause mesothelioma. *Original TCC's Motion to Dismiss* ¶ 16, ECF No. 632. Despite this product being sold since 1894, prior to 2010, there were a limited number of isolated cases involving cosmetic talc filed against Old JJCI and J&J, asserting a range of claims including talcosis, mesothelioma, dermatitis, and rashes. *Kim Decl.* ¶ 34, ECF No. 5. Litigation escalated after the 2013 trial *Deane Berg v. J&J*, wherein plaintiff alleged she had developed ovarian cancer as a result of genital exposure to Old JJCI's talc-based product. *Id.* at ¶ 35. The jury found for the plaintiff but awarded no damages. Following that verdict, over thirteen hundred ovarian cancer lawsuits were filed against Old JJCI and J&J by the end of 2015. *Id.* Since 2016, talc-related lawsuits have grown to over 38,000 cases. *Burian Report* at 35. In May 2020, Old JJCI announced their discontinuation of talc-based baby powder in the United States and Canada. *Expert Report of Gregory K. Bell, Ph.D.* ("*Bell Report*") ¶ 17. Debtor contends that from January 2020 to today, the company has been served on average with one or more ovarian cancer complaint every hour of every day, every single day of the week. *Debtor's Informational Brief* 125, ECF No. 3. The $4.69 billion verdict reached in the *Ingham* case[4] (the total award was reduced on appeal to $2.25 billion) certainly raised the stakes for all concerned.

The increase in talc-related litigation imposed a financial burden on Old JJCI. In the seven quarters of operations preceding the bankruptcy filing, the talc litigation led to financial statement charges totaling $5.6 billion and cash payments totaling $3.6 billion. *Bell Report* at ¶ 8. Talc litigation charges—otherwise referred to as "probable costs"—accounted for 51 percent of sales, and the talc litigation payments—or costs previously paid—accounted for 122 percent of the pre-tax cashflows estimated to be generated by operations. *Id.* Old JJCI's income before tax for the business segment dropped from a $2.1 billion profit in 2019 to a $1.1 billion loss in 2020. *Id.* Much of the reverse in profits, of course, were attributable to the *Ingham* charge and payment.

On October 12, 2021, Old JJCI engaged in a series of transactions (the "2021 Corporate Restructuring") through which it ceased to exist, and two new companies, LTL and Johnson & Johnson Consumer Inc. ("New JJCI"), ultimately were formed. *Kim Decl.* ¶¶ 16, 22-23, ECF No.

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[4] *Robert Ingham v. Johnson & Johnson*, 608 S.W.3d 663 (Mo. Ct. App. 2020), *reh'g and/or transfer denied* (July 28, 2020), *transfer denied* (Nov. 3, 2020), *cert. denied*, 141 S. Ct. 2716, 210 L. Ed. 2d 879 (2021).

5. The labyrinthine progression toward the creation of Debtor is somewhat overwhelming. First, Old JJCI's then-direct parent, Janssen Pharmaceuticals, Inc., organized Currahee Holding Company Inc. ("Currahee") to become the new direct parent of Old JJCI. Currahee organized Chenango Zero LLC, a Texas limited liability company, as its wholly-owned subsidiary. After this, Old JJCI merged with Chenango Zero LLC, leaving Chenango Zero LLC as the surviving entity. A funding agreement, as discussed below, was agreed to by J&J and Currahee as payors and Chenango Zero LLC as payee. Using the Texas Business Organizations Code, Chenango Zero (Old JJCI) effected a divisional merger where Old JJCI was dismantled, leaving two new Texas limited liability companies—Chenango One LLC and Chenango Two LLC—to divide all the assets and liabilities of Old JJCI. Chenango Two LLC merged with and into Currahee. As the surviving entity, Currahee then changed its name to Johnson and Johnson Consumer Inc. ("New JJCI"). Chenango One LLC converted from a Texas limited liability company into a North Carolina limited liability company and changed its name to LTL Management, LLC. *Id.* at ¶¶ 22-23.

The supposed purpose of this restructuring was to "globally resolve talc-related claims through a chapter 11 reorganization without subjecting the entire Old JJCI enterprise to a bankruptcy proceeding." *Id.* at ¶ 21. As a result of the 2021 Corporate Restructuring, LTL assumed responsibility for Old JJCI's talc-related liabilities. *Id.* at ¶¶ 16, 24. Through the restructuring, LTL also received Old JJCI's rights under a funding agreement (the "Funding Agreement"). *Id.* at ¶ 24. Under the Funding Agreement, J&J and New JJCI, on a joint and several basis, are obligated to pay "any and all costs and expenses" up to the value of New JJCI[5] excluding the talc liability that LTL incurs during its bankruptcy case, "including the costs of administering the Bankruptcy Case" to the extent necessary. *Funding Agreement* 6, *Annex 2 to Kim Decl.* ECF No. 5. In addition, the Funding Agreement obligates New JJCI and J&J to fund amounts necessary:

> (a) to satisfy the Debtor's talc-related liabilities at any time when there is no bankruptcy case and (b) in the event of a chapter 11 filing, to provide the funding for a trust, in both situations to the extent that any cash distributions received by the Debtor from Royalty A&M are insufficient to pay such costs and expenses and further, in the case of the funding of a trust, the Debtor's other assets are insufficient to provide that funding.

Id. at ¶ 27. Debtor has no repayment obligation as the Funding Agreement does not establish a loan. *Id.*

The 2021 Corporate Restructuring also lays out Debtor as the direct parent of a North Carolina limited liability company, Royalty A&M LLC ("Royalty A&M"), which owns a portfolio of royalty revenue streams, including royalty revenue streams based on third-party sales of LACTAID®, MYLANTA® / MYLICON® and ROGAINE® products. *Burian Report* at 15. Debtor asserts that it intends to review royalty monetization opportunities in the healthcare industry and grow its business by reinvesting the income from these existing royalty revenue streams into both the acquisition of additional external royalty revenue streams, as well as financings to third parties secured by similar royalty streams. *Kim Decl.* ¶ 18. On October 11, 2021, Old JJCI organized Royalty A&M as a direct subsidiary of LTL and—in exchange for full

[5] As explained at trial by Debtor's Counsel, the "floor" of the Funding Agreement is the value of Old JJCI at the time of the merger, minus the talc liability. The value of the Funding Agreement increases, however, as the value of New JJCI post-transaction increases.

ownership of Royalty A&M's equity—contributed $367.1 million. *Id.* at ¶ 22. Subsequently, Royalty A&M used those funds to acquire certain royalty streams from Old JJCI and certain of its affiliates. *Id.* Debtor estimates that the fair market value of its interest in Royalty A&M was approximately $367.1 million as of the petition date. Together with the $6 million in cash it received for its bank account after the merger, Debtor's value is approximately $373.1 million, not including the Funding Agreement with New JJCI and J&J. *Id.* at ¶ 26. Thereafter, on October 14, 2021, LTL filed a voluntary petition for chapter 11 relief in the North Carolina Bankruptcy Court.

On December 1, 2021, the Original TCC filed a motion to dismiss Debtor's chapter 11 bankruptcy case with prejudice pursuant to § 1112(b) of the Bankruptcy Code (ECF No. 632). Shortly thereafter, the law firm of Arnold & Itkin LLP ("A&I") filed its own motion (ECF No. 766) also seeking dismissal of Debtor's case. Debtor filed opposition to the Motions (ECF No. 956). Two law firms representing talc claimants filed joinders to the Motions (ECF Nos. 1003 and 1092). A&I, TCC I, and TCC II (collectively, the "Movants") filed separate replies (ECF Nos. 1354, 1357 and 1358, respectively). The Canadian Class Action Plaintiffs opposed the Motions (ECF No. 1432). The Court approved a briefing schedule that allowed for the filing of sur-replies by Debtor and Movants (ECF Nos. 1444 and 1457, respectively). On February 14, 2022, the Court commenced a five-day trial to address the Motions and the related Preliminary Injunction Motion in the pending Adversary Proceeding (ECF No. 2 in Adv. Pro. No. 21-03032). Both sides made oral argument and introduced fact and expert witnesses. Specifically, the Court considered testimony from the following fact witnesses:

- John H. Kim, Chief Legal Officer of LTL Management LLC
- Adam Lisman, Vice President and Assistant Corporate Controller of Johnson & Johnson

- Thibaut Mongon, Executive Vice President and Worldwide Chair of Johnson & Johnson Consumer Health
- Michelle Ryan, former Treasurer of Johnson & Johnson (via recorded deposition testimony)
- Michelle Wang Goodridge, President of U.S. Self-Care with Johnson & Johnson Consumer Health and President of Johnson & Johnson Consumer Inc.
- Robert O. Wuesthoff, President of LTL Management, LLC and President of Royalty A&M LLC

The Court also heard testimony from five expert witnesses including:

- Gregory K. Bell, PhD, Group Vice President of Charles River Associates for Debtor
- John R. Castellano, Managing Director at Alix Partners for Debtor
- Charles H. Mullin, PhD, Managing Partner at Bates White Economic Consulting for Debtor
- Saul E. Burian, Managing Director at Houlihan Lokey for Movants
- Matthew Diaz, Senior Managing Director at FTI Consulting, Inc. for Movants

To the extent the Court finds the expert testimony helpful, reference has been made in this opinion to the applicable report or testimony. In rendering its decision, the Court also has reviewed declarations submitted by Rebecca J. Love, D.D.S., a member of TCC I, and Kristie Doyle, a member of the TCC II. Finally, the Court has considered brief statements offered by the United States Trustee and counsel for the Canadian Class Action Plaintiffs on the final day of trial, February 18, 2022.

II. Discussion

A. Overview

By way of brief overview, the Movants and other talc claimants, in their own words, view their tasks as a moral and legal imperative to vigorously oppose the efforts of **both** J&J and Old JJCI to utilize the bankruptcy system as a litigation tactic to address their talc-related litigation liabilities through this Debtor. Movants point to the fact that LTL was created within hours before the chapter 11 filing, as a special purpose vehicle, with the stated purpose of filing chapter 11 to employ the bankruptcy's automatic stay and asbestos resolution schemes for the benefit of its solvent operating parent and affiliated entities, as well as certain third parties ("Protected Parties"), without such entities filing for chapter 11.[6] Movants further note that Debtor has no business purpose, no employees apart from those seconded by J&J, and that LTL's board, management and employees all work for J&J and owe 100% fealty to J&J. Movants assert that Debtor has no trade creditors, lenders, bondholders, customers, suppliers, vendors, landlords, tax creditors, etc., and, in general, the chapter 11 process offers nothing of value to this estate and its creditors. Moreover, Movants contend that Debtor's creation through the pre-petition restructuring mechanism—the divisional merger under the Texas Business Corporation Act widely referred to as the "Texas Two-Step" ("2021 Corporate Restructuring")—was intended to force talc claimants to face delay and to secure a "bankruptcy discount"; in Movants' words, "an obvious legal maneuver to impose an unfavorable settlement dynamic on talc victims." *TCC I Reply Mem.* 3, ECF No. 1357.

Not unexpectedly, Debtor takes a far more positive view of the chapter 11 foundation and its purposes: to produce an equitable resolution of both current and future talc claims by means of a settlement trust, established pursuant to § 105 or § 524(g), that can promptly, efficiently, and fairly compensate claimants. Indeed, from the very outset of the case, Debtor acknowledges through John Kim's First Day Declaration that the 2021 Corporate Restructuring was implemented to enable Debtor to fully resolve talc-related claims though a chapter 11 reorganization, without subjecting the entire enterprise to a bankruptcy proceeding. Debtor makes no effort to conceal its

[6] In the Committees' words, the bankruptcy lacks a proper purpose because LTL is a "dummy" corporation with "no business, no operations, no employees, no funded debt," limited "assets," and no need for a "fresh start." *Comm. Mot.* ¶¶ 4-5, 41, ECF No. 632.

reservations regarding redress through the tort system, which Debtor views as creating inefficiencies, inequities, and delay. Debtor characterizes the jury system as a lottery in which a few plaintiffs have obtained recoveries ranging from tens of millions to multiple billions in dollars, while others have been denied recoveries completely. Unsurprisingly, Debtor also disputes the negative portrayal of the intent and impact of the restructuring, noting that neither Debtor, nor any of its affiliated entities have escaped liability and also emphasizing that all of the assets and funding sources extant pre-restructuring, remain available through this proceeding. Debtor highlights that the Funding Agreement, which provides funding up to at least the fair market value of Old JJCI (pegged by Debtor's management at approximately $60 billion) serves to eliminate any prejudice to creditors and overcome fraudulent transfer challenges.

B. Applicable Legal Standard

The Third Circuit has held that "a Chapter 11 petition is subject to dismissal for 'cause' under 11 U.S.C. § 1112(b) unless it is filed in good faith." *In re SGL Carbon Corp.*, 200 F.3d 154, 162 (3d Cir. 1999). At its most fundamental level, the good faith requirement ensures that the Bankruptcy Code's careful balancing of interests is not undermined by petitioners whose aims are antithetical to the basic purposes of bankruptcy:

> [A good faith standard] furthers the balancing process between the interests of debtors and creditors which characterizes so many provisions of the bankruptcy laws and is necessary to legitimize the delay and costs imposed upon parties to a bankruptcy. Requirement [sic] of good faith prevents abuse of the bankruptcy process by debtors whose overriding motive is to delay creditors without benefitting them in any way . . . .

SGL Carbon, 200 F.3d at 161–62 (quoting *Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1072 (5th Cir. 1986)); *see also Carolin Corp.*

v. *Miller*, 886 F.2d 693, 698 (4th Cir. 1989) (holding that the good faith requirement is "indispensable to proper accomplishment of the basic purposes of Chapter 11 protection"). Once the movant establishes that there is an issue regarding good faith,[7] the debtor bears the burden of proving that a petition was filed in good faith. *NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (In re Integrated Telecom Express, Inc.)*, 384 F.3d 108, 118 (3d Cir. 2004); *In re GVS Portfolio I B, LLC*, No. 21-10690 (CSS), 2021 WL 2285285, at *5 (Bankr. D. Del. June 4, 2021) (quoting *Tamecki v. Frank (In re Tamecki)*, 229 F.3d 205, 208 (3d Cir. 2000) ("[O]nce a debtor's good faith is appropriately put at issue, it is the burden of the debtor to produce evidence of good faith.")); *In re Cloudeeva, Inc.*, No. 14-24874, 2014 WL 6461514, at *4 (Bankr. D.N.J. Nov. 18, 2014). The debtor bears the burden of proving good faith by a preponderance of the evidence. *In re Vascular Access Centers, L.P.*, 611 B.R. 742, 761 (Bankr. E.D. Pa. 2020).

The good faith inquiry is based on "'the totality of facts and circumstances.'" *In re Integrated Telecom*, 384 F.3d at 118 (quoting *In re SGL Carbon*, 200 F.3d at 162). In determining whether a chapter 11 petition was filed in good faith, the court must undertake a "fact intensive inquiry" to determine where the petition "falls along the spectrum ranging from the clearly acceptable to the patently abusive." *Id.*; *see also Perlin v. Hitachi Cap. Am. Corp.*, 497 F.3d 364,

[7] Debtor contends that a movant must first establish a *prima facie* case of "bad faith" before the burden shifts to the Debtor and cites to *In re Walden Ridge Dev. LLC*, 292 B.R. 58, 62 (Bankr. D. N.J. 2003). While this case, and others in fact so hold, this line of cases traces this proposition all the way back to *Matter of Century City, Inc.*, 8 B.R. 25 (Bankr. D.N.J. 1980), in which Judge DeVito simply noted that unlike chapter X of the Bankruptcy Act of 1898, the Bankruptcy Code does not explicitly require filings to be undertaken in good faith, and thus required the movant to make a *prima facie* showing of lack of good faith. The bulk of the case law in this Circuit has evolved in the past 42 years without employing this *prima facie* showing requirement. Notwithstanding, even if the Court were to do so, Movants have raised the issue of Debtor's good faith sufficiently to shift the burden upon Debtor. *See In re Mottilla*, 306 B.R. 782, 789 (Bankr. M.D. Pa. 2004) ("After scrutinizing the *Tamecki* decision, I can only conclude that the Circuit requires a movant to produce relatively little evidence to place a debtor's good faith at issue.").

372 (3d Cir. 2007). The focus of the inquiry is whether the petitioner sought "to achieve objectives outside the legitimate scope of the bankruptcy laws." *In re SGL Carbon Corp.*, 200 F.3d at 165 (internal quotations omitted). The question of a debtor's good faith "depends on an amalgam of factors and not upon a specific fact." *Id.* (quoting *Idaho Dep't of Lands v. Arnold* (*In re Arnold*), 806 F.2d 937, 939 (9th Cir. 1986)). "[T]he courts may consider any factors which evidence 'an intent to abuse the judicial process and the purposes of the reorganization provisions.'" *Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly, Ltd.*), 849 F.2d 1393, 1394 (11th Cir. 1988) (quoting *Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.)*, 749 F.2d 670, 674 (11th Cir. 1984)); *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293, 297–98 (Bankr. D. Del. 2011); *see also In re Schaffer*, 597 B.R. 777, 791 (Bankr. E.D. Pa. 2019), *aff'd sub nom. Matter of Schaffer*, 606 B.R. 228 (E.D. Pa. 2019), *aff'd sub nom. In re Schaffer*, No. 19-3664, 2020 WL 2529371 (3d Cir. Jan. 24, 2020).

All parties acknowledge that the general focus must be "(1) whether the petition serves a valid bankruptcy purpose and (2) whether the petition is filed merely to obtain a tactical litigation advantage." *15375 Mem'l Corp. v. BEPCO, L.P. (In re 15375 Mem'l Corp.)*, 589 F.3d 605, 618 (3d Cir. 2009) (citing *In re SGL Carbon*, 200 F.3d 154,165 (3d Cir. 1995)). "[T]he 'good faith' filing requirement encompasses several, distinct equitable limitations that courts have placed on Chapter 11 filings . . . to deter filings that seek to achieve objectives outside the legitimate scope of the bankruptcy laws." *SGL Carbon,* 200 F.3d at 165 (quoting *In re Marsch,* 36 F.3d 825, 828 (9th Cir. 1994)). In evaluating the legitimacy of Debtor's bankruptcy filing, this Court must also examine a far more significant issue: which judicial system—the state/federal court trial system, or a trust vehicle established under a chapter 11 reorganization plan structured and approved by the United States Bankruptcy Court—serves best the interests of this bankruptcy estate, comprised primarily of present and future tort claimants with serious financial and physical injuries.[8] It goes without saying that this and related inquiries have been the subject of academic, judicial, and policy debates for years. In ruling today, however, this Court considers only the facts and applicable law relevant to this case, and this case only, and there is no expectation that this decision will be the final word on the matters.

As will be discussed below, the Court is unwilling to dismiss this case as a bad faith filing. The Court employs the standards cited above and followed by other courts within the Third Circuit. On aside, the Court acknowledges there is a much more stringent standard for dismissal of a case for lacking good faith in the Fourth Circuit, which would have governed a decision by Judge Whitley in North Carolina. The Court cannot help but ponder how a bankruptcy filing, which took place in North Carolina and most likely satisfied the good faith standards under the applicable law in that jurisdiction, suddenly morphs post-petition into a bad faith filing simply because the case travels 400 miles up I-95 to Trenton, New Jersey. Notwithstanding, the Court rules today that the chapter 11 filing also satisfies the standards this Court must apply under Third Circuit precedent.

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[8] While Movants may take issue with the Court's decision to assess the merits of the competing judicial systems as part of the totality of circumstances underlying the chapter 11 filing, these issues are likewise relevant as to whether § 1112(b)(2) provides an alternative to dismissal. "[E]ven if 'cause' exists, § 1112(b)(2) precludes dismissal or conversion if 'unusual circumstances' exist such that that conversion or dismissal of the case is not in the best interests of the creditors or the bankruptcy estate and there is a reasonable likelihood that a chapter 11 plan will be confirmed within either a reasonable time or applicable statutory deadlines." *In re: 1121 Pier Village LLC, et al.*, No. 21-11466 (ELF), 2022 WL 102622 (Bankr. E.D. Pa. Jan. 11, 2022). As discussed *infra*, the Court finds that Debtor has pursued the chapter 11 filing in good faith. Even if this were not the case, the Court holds that the interests of current tort creditors and the absence of viable protections for future tort claimants outside of bankruptcy would constitute such "unusual circumstances" as to preclude either dismissal or conversion of the case.

1. Valid Bankruptcy Purpose Underlying LTL Management LLC's Decision to File Chapter 11

To be filed in good faith, a chapter 11 petition must be supported by "a valid reorganizational purpose." *In re SGL Carbon*, 200 F.3d at 165–66. When a company "seek[s] the protections of bankruptcy when faced with pending litigation that pose[s] a serious threat to [a] compan[y's] long term viability," a valid reorganizational purpose exists only if the company is experiencing "serious financial and/or managerial difficulties at the time of filing . . . to establish the good faith of its present petition." *In re SGL Carbon*, 200 F.3d at 164. As the Supreme Court has explained, the two main functions of the bankruptcy law are (1) "preserving going concerns" and (2) "maximizing property available to satisfy creditors." *In re Integrated Telecom Express, Inc.*, 384 F.3d 119 (quoting *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453, 119 S. Ct. 1411, 143 L.Ed.2d 607 (1999)). "If **neither** of these purposes can be demonstrated, the petition will be dismissed." *In re Am. Cap. Equip., LLC*, 296 F. App'x 270, 274 (3d Cir. 2008) (citation omitted) (emphasis added). In their oral and written arguments, Movants urge the Court to restrict its examination to the valid business purpose held by the Debtor, LTL, as opposed to the reorganizational needs of Old JJCI. The Court certainly agrees that it is the **Debtor's** good faith at issue. Yet, even the Movants' experts testified that the 2021 Corporate Restructuring and the ensuing bankruptcy filing should be viewed by this Court as "a single, pre-planned, integrated transaction" comprised of interdependent steps. *See Burian Report* at 8; *Expert Report of Matthew Diaz* ("*Diaz Report*") at 19. This Court must undertake an analysis that considers the totality of the circumstances and consider the financial risks and burdens facing both Old JJCI and Debtor.

While the parties may debate whether as a result of the 2021 Corporate Restructuring, LTL continues as a "going concern," this Court has little trouble finding that the chapter 11 filing serves to maximize the property available to satisfy creditors by employing the tools available under the Bankruptcy Code to ensure that all present and future tort claimants will share distributions through the court-administered claims assessment process. Movants' challenge to the manner the estate is to be maximized does not alter the fact that a successful reorganization and implementation of a settlement trust will dramatically reduce costs and ensure balanced recoveries for present and future claimants. *See, e.g.*, *In re Am. Cap. Equip., LLC*, 296 F. App'x at 274 ("As the District Court explained, while Appellants make a number of arguments that Debtors' plan does not maximize the value of the estate, what these arguments actually take issue with is 'how the value was maximized.' What is clear is that under Debtors' plan, both the asbestos claimants and the unsecured creditors will be able to share in the assets of the estate").

From the outset, J&J and Debtor have been candid and transparent about employing Debtor's chapter 11 filing as a vehicle to address the company's growing talc-related liability exposure and costs in defending the tens of thousands of pending ovarian cancer claims and hundreds of mesothelioma cases, as well as future claims. As Movants' own experts have acknowledged, the use of the Texas divisional merger statute and subsequent filing by the newly formed LTL constituted a single integrated transaction designed to allow "New JJCI to continue to operate Johnson & Johnson's Consumer Health business in the United States without interruption and provide LTL with the opportunity to pursue process to resolve current and future [cl]aims in an equitable and efficient manner." *Debtor's Exhibit* D-56.

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Let's be clear, the filing of a chapter 11 case with the expressed aim of addressing the present and future liabilities associated with ongoing global personal injury claims to preserve corporate value is unquestionably a proper purpose under the Bankruptcy Code. *See, e.g., In re Bestwall LLC*, 605 B.R. 43, 49 (Bankr. W.D.N.C. 2019) ("Attempting to resolve asbestos claims through 11 U.S.C. § 524(g) is a valid reorganizational purpose, and filing for Chapter 11, especially in the context of an asbestos or mass tort case, need not be due to insolvency);[9] *In re SGL Carbon*, 200 F.3d at 163-64, 169 (distinguishing confined nature of litigation in *SGL Carbon* with efforts to resolve thousands of mass tort claims) (citing ALAN N. RESNICK, *Bankruptcy as a Vehicle for Resolving Enterprise–Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2050–51 (June 2000*)); In re Muralo, Co. Inc.*, 301 B.R. 690, 706 (Bankr. D.N.J. 2003) (finding debtor's "sudden high-risk exposure to thousands of seemingly random and unmanageable asbestos . . . cases" a "significant factor evidencing the good faith of Debtors' filings"). At the time of filing, Debtor—as did its immediate predecessor—faced nearly 40,000 pending tort claims, with thousands of additional claims expected annually for decades to come. *Bell Report* at 10. As of the petition date, Debtor also anticipated billions of dollars in talc-related liability and defense costs. *Id.* Indeed, in the first nine months of 2021, more than 12,300 new lawsuits were filed. *Id.* Additionally, there were pending (although contested) indemnification obligations owing to talc suppliers Imerys Talc America, Inc. and Cyprus Mines Corporation estimated at anywhere between $25 billion to $118.2 billion in damages. *Bell Report* at 12. These anticipated liabilities

[9] Movants contend that the Court should not rely upon *Bestwall* since that court was considering dismissal under the far more stringent *Carolin* standard of "objective futility." However, a determination as to the existence of a "valid business purpose" is separate and apart from the futility of a debtor's reorganization efforts and the court's opinion retains relevance.

are not merely speculative, given the history of actual defense spending and verdicts rendered to date. Since June of 2018, there have been 13 mesothelioma verdicts awarding $320.6 million in punitive damages and $155.2 million in compensatory damages for a total of $475.8 million. *See Diaz Report* at 13. By this Court's math, that averages to approximately $36.6 million per claim. With approximately 430 mesothelioma claims filed as of the chapter 11 petition date, one could argue that the Debtor's financial exposure exceeded $15 billion, not including the tens of thousands of ovarian cancer claims and all future cancer claims. Debtor's efforts to address the financially draining mass tort exposure through a bankruptcy is wholly consistent with the aims of the Bankruptcy Code.

The Court is cognizant of the Third Circuit's admonition, as pointed out by Movants, that "a desire to take advantage of a particular provision in the Bankruptcy Code, standing alone . . . does not . . . establish[] *good* faith." *In re Integrated Telecom*, 384 F.3d at 127-128 ("Just as a desire to take advantage of the protections of the Code cannot establish *bad* faith as a matter of law, that desire cannot establish *good* faith as a matter of law. Given the truism that every bankruptcy petition seeks some advantage offered in the Code, any other rule would eviscerate any limitation that the good faith requirement places on Chapter 11 filings."). However, Debtor here has demonstrated an intent to make use of the Bankruptcy Code as a whole, apart from any single Code section, to address its financial needs. There is no question as to the import and value to Debtor of implementing an asbestos trust under § 524(g). Nonetheless, this tool does not operate in a vacuum. Rather, the Debtor seeks to take advantage of the centrality of the bankruptcy forum, the breathing spell available under § 362, the efficiencies found in the claims allowance and estimation processes, and most significantly the opportunity to negotiate a global resolution to torrents of talc-related litigation as to present and future cancer victims. Moreover, the creation of a settlement trust is not wholly dependent upon § 524(g)—numerous non-asbestos mass tort cases have established trust mechanisms under confirmed plans bottomed on other Code provisions.

All Code sections are not equal in import or impact. In *Integrated Telecom,* a nonoperating liquidating debtor desired to take advantage of the § 502(b)(6) cap on the landlord's claim and argued that this purpose, in and of itself, established good faith. *See In re Integrated Telecom*, 384 F.3d 108. *Integrated* involved an effort to file a chapter 11 to reduce a singular type of claim for an isolated creditor. In contrast, Congress added 11 U.S.C. § 524(g) to the Bankruptcy Code to "help asbestos victims receive maximum value" from bankrupt entities. 140 Cong. Rec. S14,461 (Sept. 12, 1994) (statement of Sen. Heflin); *see also In re Am. Cap. Equip., LLC*, 688 F.3d 145, 159 (3rd Cir. 2012) ("[T]he [bankrupt] company remains viable . . . [and] continues to generate assets to pay claims today and into the future. In essence, the reorganized company becomes the goose that lays the golden egg by remaining a viable operation and maximizing the trust's assets to pay claims." (alterations in original)); *In re ACandS, Inc.* 311 B.R. 36, 42 (Bankr. D. Del. 2004). Section 524(g) was meant to "strengthen . . . trust/injunction mechanisms," 140 Cong. Rec. 20, 27, 692 (1994), and, to the extent possible, account for "the interests of future claimants," H.R. Rep. No. 103–835, 3349 (1994). Quite simply, this Court will not equate the use of this provision with merely an effort to cap a landlord's rent.

Determining whether Debtor is pursuing a valid bankruptcy purpose through this chapter 11 proceeding also requires the Court to examine a far more difficult issue—whether there is available to Debtor and the tort claimants a more beneficial and equitable path toward resolving Debtor's ongoing talc-related liabilities. For the reasons which follow, this Court holds a strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case—ensuring a meaningful, timely, and equitable recovery.

There is no question that, over time, our bankruptcy courts have witnessed serious abuses and inefficiencies, striking at the heart of the integrity of our bankruptcy courts. For instance, the approval of overly broad nonconsensual third-party releases, and the propriety/necessity for twenty-four hour accelerated bankruptcy cases have drawn deserved scrutiny. Likewise, the selection of case venue, as in the matter at hand, has warranted critical attention and debate.[10] In point of fact, there has been a deluge of critical commentary in recent months by academics, commentators, and even policymakers[11] challenging the shortfalls of the bankruptcy system and calling for reform. Some have even employed such distasteful, click-generating insidious phrases as "morally corrupt" or "lawless" in reference to the bankruptcy courts. No one can deny that there are situations in which tools and strategies have been abused and warrant critical review. Unfortunately, however, these commentators choose to focus on the limited failings of the system, as opposed to its innumerable successes. Every one of the Court's 370 plus colleagues on the

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[10] This case is venued now where it should be. The appropriateness of the original filing in North Carolina can be debated, but that discussion should not color the primary inquiry as to whether the case at this point should proceed in the bankruptcy court.

[11] By way of example, upon direct and cross examination, Mr. Kim was shown correspondence dated November 10, 2021, from certain members of Congress taking issue with the Debtor's approach in this bankruptcy proceeding. As these policymakers have not had the benefit of reading the briefs, examining the evidence, or listening to oral arguments, the correspondence holds no weight. As is well-established, Congress speaks with one voice through enacted legislation *Cf.* MICHAEL B. W. SINCLAIR, *Guide to Statutory Interpretation* 103 (2000) ("[O]ur legislatures speak only through their statutes; statutes are their only voice. . . .")

bankruptcy bench can point to successful case outcomes where large and small businesses are reorganized, productive business relationships are maintained, jobs preserved and, most importantly, meaningful returns distributed to creditors—all in situations where outside of the bankruptcy system there would be fewer if any identifiable benefits, and the parties left to expensive and time-consuming litigation. This holds especially true for mass tort situations, including asbestos bankruptcies, in which § 524(g) trusts and comparable non-asbestos trust vehicles have been established to ensure meaningful, timely recoveries for present and future suffering parties and their families.

While this Court recognizes and appreciates the passion and commitment of the Committee members and every one of the attorneys advocating for the interests of the injured cosmetic talc claimants in this case, the Court simply cannot accept the premise that continued litigation in state and federal courts serves best the interest of their constituency. Many of these cases, both in the United States and abroad, have been pending for a half dozen or more years and remain years away from trial dates, not to mention the substantial delays they face in the inevitable appeals process. Notably, since 2014, there have been only 49 trials that have proceeded to verdict. True, in this same period, there have been approximately 6,800 cases which have settled outside of court. *Movants' Exhibit* 161. This number is dwarfed, nonetheless, by the projected 10,000 new cases to be filed each year going forward. *See Expert Report of Charles H. Mullin, PhD* ("*Mullin Report*") at 5. As noted in her *amici curiae* brief, Professor Maria Glover acknowledges there is no perfect solution to the problems with mass tort litigation: "But no mechanism for handling the thorny challenges of mass torts is perfect, including bankruptcy. Indeed, it is the nature of mass torts to present different combinations of challenges, and those challenges follow mass torts wherever they go." *Memorandum of Law of Amici Curiae by Certain Complex Litigation Law Professors* ("*Glover Brief*") 25, ECF No. 1410.

For instance, a class action is not usually suitable for mass tort cases, since there typically exists too much variation concerning claimants' injuries, illnesses, and related losses. In the 1990s, the United States Supreme Court issued two decisions that effectively terminated the use of class actions, at least for product liability cases. In *Georgine v. Amchem Prods., Inc.*, 521 U.S. 591, 138 L.Ed.2d 689 (1996), an asbestos case, the Supreme Court held that class actions under FED. R. CIV. P. 23 could not be used to manage mass tort cases. The cases were too dissimilar, and there were also some "future" plaintiffs, individuals exposed to asbestos, but not yet manifesting disease. Likewise, in *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 144 L.Ed. 715 (1999), the Supreme Court shut the door with respect to class actions for mass tort cases involving a "limited fund," where the parties attempted to structure the settlement as a mandatory class—that is, without opt-out rights for class members—on the theory that a "limited fund" existed. The Supreme Court took issue with the settlement class in *Ortiz* for failing to assure the necessary level of cohesiveness of interests among absent class members, the representative plaintiffs, and class counsel to justify class treatment. The Court held that the class failed to provide structural protections against the likely conflicts of interests among class members. *Ortiz*, 527 U.S. at 856-57. The attempt to describe the litigation as a limited fund also received minimal sympathy. In the Court's view, a limited fund class had to demonstrate both necessity and equitable distribution. *See id.* at 850–53 (admonishing lower courts for accepting, without investigation, the litigants' attempt to create a limited fund by discounting the value of assets available for payment to class members).

Significantly, as Debtor points out, the *Ortiz* Court highlighted the difference between due process concerns in representative suits (*e.g.* class actions) versus bankruptcy cases. *Id.* at 846; *see also Debtor's Omnibus Response to the Amicus Briefs* 20-21, ECF No. 1554. The Supreme Court rejected the use of class actions under FED. R. CIV. P. 23 to aggregate unliquidated tort claims under a limited fund rationale and, in examining commentary to the Rule, observed that if such action were allowed, "in mass torts, (b)(1)(B) 'limited fund' classes would emerge as the functional equivalent to bankruptcy by embracing 'funds' created by the litigation itself[.]" *Ortiz*, 527 U.S. at 843 (quoting HENRY PAUL MONAGHAN, *Antisuit Injunctions and Preclusion Against Absent Nonresident Class Members*, 98 COLUM. L. REV. 1148, 1164 (1998). Thus, in *Ortiz*, the Supreme Court recognizes bankruptcy as a sound and appropriate approach to addressing mass tort claims. *Id.*

As further noted by Professor Troy A. McKenzie:

> The Court's strict formalism in *Amchem* and *Ortiz* also derived from an unhidden skepticism about the use of the Federal Rules of Civil Procedure as license to undertake essentially legislative reforms. The question presented in *Amchem*, as Justice Ginsburg phrased it, was "the *legitimacy under Rule 23* of the Federal Rules of Civil Procedure of a class action certification sought to achieve global settlement of current and future asbestos claims." The unspoken assumption in both cases, then, was that methods of global resolution that did not invoke the Federal Rules of Civil Procedure could escape the rigid strictures placed on the class action by the Court.

TROY A. MCKENZIE, *Toward a Bankruptcy Model for Non-Class Aggregate Litigation*, 87 N.Y.U. L. Rev. 960, 977 (2012) (emphasis in original).

Addressing mass torts through a legislative scheme enacted by Congress within the bankruptcy system does not run afoul of the concerns expressed above and provides a judicially accepted means of aggregating and resolving mass tort claims. There is no authority to the contrary ruling that use of § 105 or § 524(g) settlement trusts contravene *Amchem* and *Ortiz*. Moreover, there is no evidence before this Court that Debtor or its predecessor, Old JJCI, manufactured a limited fund by undervaluing or limiting assets. Rather, the Court finds that any such limited fund is the product of overwhelming potential talc liabilities, which far exceed Debtor's (and Old JJCI's) capacity to satisfy through current available assets.

The multi-district litigation ("MDL") poses its own set of significant challenges and inefficiencies. Here in New Jersey, for instance, the MDL being handled by Chief Judge Wolfson —which does not include mesothelioma cases, the Canadian class actions, state court proceedings, or the claims of future tort victims—will at best produce a handful of bellwether trials later in 2022, offering some insight into the strength of the cases, but will also necessarily return nearly 40,000 cases to federal courts across the country to await pre-trial proceedings and eventual trials and appeals. Notwithstanding the pre-trial work undertaken through the MDL, the fact remains that plaintiffs and defendants will be forced to relitigate causation, and damages, and apportion liability among defendants in every case, which will be both costs prohibitive and "burden the tort system with unnecessarily drawn-out litigation." *Mullin Report* at 9.

Again, in her *amici curiae* submission, Professor Glover touts the "flexibility and adaptiveness" of MDL in facilitating settlements and global resolutions by experienced MDL judges. *Glover Brief* at 24. The Court has no doubt that talented federal judges have produced significant settlements though MDL devices. To be sure, this Court knows of no better jurist at bringing about settlements than Chief Judge Wolfson. Yet, in nearly six years, there has been no progress toward a global resolution through the current MDL. The Court is unaware of any meaningful settlement talks apart from the near global settlement in the *Imerys* bankruptcy.

The fact remains that since 2014—over seven years ago—only 49 trials have gone to verdict, and many of those remain on appeal or have been remanded to retry. Given the pace of the litigations to date, as well as the mounting escalation in the number of new actions being brought monthly,[12] the vast majority suffering from illness in the existing backlog of cases will not see a penny in recovery for years. The tort system has struggled to meet the needs of present claimants in a timely and fair manner.[13] The system is ill-equipped to provide for future claimants. The Court has no reason to believe this will differ for the talc plaintiffs here.

This Court is neither blind nor deaf to the stated preferences of plaintiffs who seek to remain in the tort system and have their cases tried before a jury. The tort claimants have not chosen the bankruptcy forum. Indeed, creditors rarely choose to have their rights vindicated in the bankruptcy courts, but our Constitution and the laws passed by Congress countenance such a result. Undeniably, there have been sizable multi-million and multi-billion dollar verdicts in favor of handful of plaintiffs who were fortunate to have their claims brought in front of a jury. Movants

[12] New ovarian cancer filings have been accruing at more than 10,000 claims per year. *Mullin Report* at 5.

[13] *See Amchem Prod., Inc. v. Windsor*, 521 U.S. 591, 598 (1997) ("[D]ockets in both federal and state courts continue to grow; long delays are routine; trials are too long; the same issues are litigated over and over; transaction costs exceed the victims' recovery by nearly two to one; exhaustion of assets threatens and distorts the process; and future claimants may lose altogether.") (quoting *Report of The Judicial Conference Ad Hoc Committee on Asbestos Litigation* 2-3 (Mar. 1991)).

contend that the loss of jury trial rights would violate claimants' Seventh Amendment jury rights. Nonetheless, there have been numerous asbestos trusts implemented under § 524(g) which provide tort victims with choices between receiving guaranteed compensation under the trusts, or alternatively pursuing recovery against the trusts through jury trials.[14] The trust distribution procedures ("TDP") and plans, however, will usually place timing restrictions and caps on compensatory and punitive damage recoveries. These limitations are critical to the process since one of Congress's primary intentions in creating § 524(g) was to ensure uniform treatment of all claimants. *In re W.R. Grace & Co.*, 475 B.R. 34, 171 (D. Del. 2012), *aff'd sub nom. In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013), and *aff'd,* 532 F. App'x 264 (3d Cir. 2013), and *aff'd,* 729 F.3d 311 (3d Cir. 2013), and *aff'd sub nom. In re WR Grace & Co.*, 729 F.3d 332 (3d Cir. 2013). If the talc claimants were not subject to such a cap on jury verdicts and judgments, they would be receiving preferential treatment in comparison to other similarly situated claimants.

[14] By way of example, § 7.6 of the Trust Distribution Procedures in the *Duro Dyne National Corp.* bankruptcy case provides:

> 7.6 Suits in the Tort System. If the holder of a disputed claim disagrees with the Asbestos Trust's determination regarding the Disease Level of the claim or the claimant's exposure history, and if the holder has first submitted the claim to non-binding arbitration as provided in Section 5.8 above, the holder may file a lawsuit against the Asbestos Trust in the Claimant's Jurisdiction as defined in Section 8.3 below. Any such lawsuit must be filed by the claimant in his or her own right and name and not as a member or representative of a class, and no such lawsuit may be consolidated with any other lawsuit. All defenses (including, with respect to the Asbestos Trust, all defenses which could have been asserted by a Debtor) shall be available to both sides at trial; however, the Asbestos Trust may waive any defense and/or concede any issue of fact or law. If the claimant was alive at the time the initial pre-petition complaint was filed or on the date the proof of claim form was filed with the Asbestos Trust, the case shall be treated as a personal injury case with all personal injury damages to be considered even if the claimant has died during the pendency of the claim.

Trust Distribution Procedures 43, *Exhibit F to Third Amended Plan*, ECF No. 1-2 in Case No. 19-cv-15433 (also available at ECF No. 784-3 in Bankr. Case No. 18-27963).

Critically important is that § 524(g) ensures that present claimants do not exhaust the debtor's assets before future claimants have even manifested injuries. *Id.* The Seventh Amendment jury rights of talc plaintiffs would remain intact under a properly drafted and approved plan and TDP, and no case cited to the Court provides otherwise.

This Court also has factored into its decision the substantial risks facing the talc claimants in the tort system. There have been countless plaintiffs denied any recovery and many of the plaintiffs' verdicts have been reversed ultimately on appeal.[15] "The results of the 49 [t]alc [l]itigation cases to proceed to trial are inconsistent in terms of liability and damages awards. Defendants prevailed in 18 cases; plaintiffs prevailed in 17 cases; eight cases resulted in mistrials; and six cases settled during trial." *Bell Report* at 14. It is inarguable that continued litigation of talc claims in the state and federal tort system comes with a meaningful risk of recovery. Debtor points to prior multiple litigation successes by J&J and Old JJCI over the years by securing dismissals of roughly 1,300 ovarian cancer cases and over 250 mesothelioma cases without payment and trying sixteen cases to defense verdicts. *See Kim Decl.* ¶ 38. ECF No. 5. Old JJCI secured reversal of numerous plaintiff verdicts. *Id.* Of equal concern to this Court is the capacity for the state and federal courts to protect future claimants, whose claims may surface in the next half century given the acknowledged latency period for the types of cancer at issue. The needs of these victims are wholly ignored by the current rush to secure judgments against Debtor in the

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[15] *See Hrg. Tr.* 34:11-12, Oct. 20, 2021, ECF No. 178 ("Old JJCI . . . ultimately prevailed in most of the talc cases it tried."); *Hrg. Tr.* 15:16-17, Dec. 15, 2021, ECF No. 846 ("[T]he company was prevailing in the majority of cases . . . ."); *Hrg. Tr.* 75:8-11, Jan. 11, 2022, ECF No. 1118 ("And most of the cases ended up with a defense verdict, and even where there's a plaintiff verdict most of them are reversed on appeal.").

federal and state courts. In the eyes of this Court, the tort system produces an uneven, slow-paced race to the courthouse, with winners and losers. Present and future talc claimants should not have to bear the sluggish pace and substantial risk if there exists another viable option.

The Court's comments are not intended to dismiss or discredit the inarguable benefits of our tort system and the essential work of our plaintiffs' bar in bringing about corporate transparency and vindicating the rights of those victims who are ill-equipped to pursue their rights against large corporate defendants. In this vein, we can all point to concrete illustrations where such litigation has been responsible for necessary safety reforms and health measures. What the Court regards as folly is the contention that the tort system offers the **only fair and just pathway** of redress and that other alternatives should simply fall by the wayside. It is manifestly evident that Congress did not share this narrow view in developing the structure of asbestos trusts under §524(g). There is nothing to fear in the migration of tort litigation out of the tort system and into the bankruptcy system.[16] Rather, this Court regards the chapter 11 process as a meaningful opportunity for justice, which can produce comprehensive, equitable, and timely recoveries for injured parties. The bankruptcy courts offer a unique opportunity to compel the participation of all parties in interest (insurers, retailers, distributors, claimants, as well as Debtor and its affiliates) in a single forum with an aim of reaching a viable and fair settlement. As the Third Circuit noted in *In re Federal-Mogul Global, Inc.*:

> Bankruptcy has proven an attractive alternative to the tort system for corporations [facing mass tort claims] because it permits a global resolution and discharge of

[16] *But cf.* BRUBAKER, RALPH, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy* (November 9, 2021). The Yale Law Journal Forum, forthcoming, University of Illinois College of Law Legal Studies Research Paper No. 22-01, Available at SSRN: https://ssrn.com/abstract=3960117.

> present and future liability, while claimant's interests are protected by the bankruptcy court's power to use future earnings to compensate similarly situated tort claimants equitably.

684 F.3d 355, 359 (3d 2012). Indeed, the Third Circuit has taken notice that the asbestos bankruptcy trusts achieved Congress's expressed aims in best serving the interests current and future asbestos victims,[17] as well as corporations saddled with such liabilities:

> Furthermore, the trusts appear to have fulfilled Congress's expectation that they would serve the interests of both current and future asbestos claimants and corporations saddled with asbestos liability. In particular, observers have noted the trusts' effectiveness in remedying some of the intractable pathologies of asbestos litigation, especially given the continued lack of a viable alternative providing a just and comprehensive resolution. Empirical research suggests the trusts considerably reduce transaction costs and attorneys' fees over comparable rates in the tort system.

In re Federal-Mogul Glob., Inc., 684 F.3d at 362 (citing studies).

The Court acknowledges that Movants have raised a challenging and interesting issue as to whether Debtor can take advantage of a §524(g) trust: "[B]ecause LTL has never been named as a defendant in a talc case, then a channeling injunction and Section 524(g) trust will be unavailable under the plain language of the statute." *TCC II Reply Mem.* at 19 n.11, ECF No. 1358 (citing 11 U.S.C. § 524(g)(2)(B)(i)(I), which dictates that the injunction, together with the trust, must "assume the liabilities of a debtor which at the time of entry of the order for relief *has been named as a defendant* in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or

[17] The legislative history of § 524(g) is clear that Congress enacted the statute to assist any company facing liability that involves asbestos. H.R. REP. 103-835, 41, 1994 U.S.C.C.A.N. 3340, 3350 ("The asbestos trust/injunction mechanism established in the bill is available for use by any asbestos company facing a similarly overwhelming liability.").

asbestos-containing products") (emphasis added). The causes of action held by the talc plaintiffs are owing by Debtor as successor in interest to Old JJCI and, consequently, Debtor substitutes for Old JCCI in all federal actions as a matter of law. *See* FED. R. CIV. P. 25(c). At closing during the hearing, Debtor's counsel apprised the Court and all parties that Debtor in fact has been named in pending suits. Notwithstanding, as we have seen in other non-asbestos mass tort cases, referenced below, chapter 11 can still offer the opportunity to reach consensus on a global resolution of present and future claims without express resort to § 524(g).

In recent weeks and months, we have seen comprehensive and productive mediated settlements, producing hundreds of millions of dollars in funding of settlement trusts. Indeed, we need look only at the USA Gymnastics settlement approaching $400 million, the proposed Mallinckrodt $1.7 billion trust and the Boy Scouts proposed settlement nearing $3 billion as examples. Likewise, settlement trusts are in some stage of negotiation in over thirty Catholic Church diocese cases across the country. The Court places these positive results against a backdrop of dozens of successful asbestos trust cases created over the years pursuant to § 524(g), which continue to fund payments to asbestos victims. Claims reconciliation through these bankruptcy trusts place reduced evidentiary and causation burdens on the injured and their families, and resolution of claims and payments to victims can be achieved at a far more expeditious pace than through uncertain litigation in the tort system. A trust would establish a far simpler and streamlined process—both for present and future cosmetic talc claimants—than currently available in the tort system.[18] As noted by the court in *In re Bestwall LLC*, 606 B.R. at 257: "[A] section 524(g) trust will provide all claimants—including future claimants who have yet to institute litigation—with an efficient means through which to equitably resolve their claims."

Through adopted procedures, these trusts establish fixed criteria and common parameters for payments to claimants, ensuring a level playing field for all present and future victims, taking into consideration the significance of preserving all due process rights. *See In re W.R. Grace & Co.*, 729 F.3d 311, 324 (3d Cir. 2013) ("Therefore, as long as a court correctly determines that § 524(g)'s requirements are satisfied, present and future claims can be channeled to a § 524(g) trust without violating due process."). In recent years, state attorneys general and the United States Justice Department have undertaken numerous investigations of existing trust funding and trust distribution procedures and have brought issues before courts aimed at safeguarding the availability of funding for future claimants. In sum, the bankruptcy system, through use of a §524(g) trust, will "provide all claimants—including future claimants who have yet to institute litigation—with an efficient means through which to equitably resolve their claims." *In re Bestwall LLC*, 606 B.R. at 257. A settlement trust, with proper oversight and funding, can best serve the needs of Debtor and talc claimants alike.

[18] "A plan of reorganization can implement a trust with administrative procedures to resolve claims with far lower transaction costs [attorneys' fees] and in a timelier manner for both the claimants and Debtor than continued litigation in the tort system." *Mullin Report* at 5, 12.

Throughout their submissions and oral argument, Movants have decried Debtor's (and its affiliated entities') efforts to "cap" the liabilities owing the injured parties.[19] Likewise, there have been emotive contentions that the chapter 11 process offers Debtor—as well as J&J and other affiliates—an unfair advantage, or upper hand in protecting assets and escaping liabilities and exposure. The Court does not share these views. Frankly, it is unsurprising that J&J and Old JJCI management would seek to limit exposure to present and future claims. Their fiduciary obligations and corporate responsibilities demand such actions. Nonetheless, merely seeking to limit liabilities, standing alone, does not demonstrate "bad faith" for purposes of filing under chapter 11. If that were so, nary a debtor would meet the "good faith' requirements. Rather, the Court finds this chapter 11 is being used, not to escape liability, but to bring about accountability and certainty.

The record before the Court does not reflect assets that have been ring-fenced, concealed, or removed. Neither J&J nor New JJCI (nor any J&J affiliate for that matter) are to be released from liability, or their assets placed out of reach of creditors, absent a negotiated settlement under a plan in which J&J's and New JJCI's roles and funding contributions warrant a release as a matter of both law and fact. True, a handful of claimants who have secured judgments may be delayed by the bankruptcy process, but this Court must act to ensure justice for all the nearly 40,000 current claimants and undetermined future injured parties (and families) who face years in litigation. Also, it is nonsensical to accept the notion that J&J and Old JJCI would bear the brunt of public and judicial scrutiny, as well as the time and costs to implement this integrated transaction, simply to

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[19] *See, e.g.*, *A&I Reply Mem.* 23, ECF No. 1354 ("J&J created LTL to file for bankruptcy not only to "cap" the talc liabilities of Old JJCI that had been imposed on the Debtor, but also to 'cap' the talc liabilities *of J&J* and shield it from any talc litigation and any more judgments in favor of talc victims.").

stall claimants or walk away from its financial commitments under the Funding Agreement. Moreover, remedial creditor actions addressing the pre-petition divisive merger and restructuring remain available for creditors to pursue, if necessary. It is appropriate to note that the true leverage remains where Congress allocated such leverage, with the tort claimants who must approve of any plan employing a § 524(g) trust by a 75% super majority.[20] In filing this chapter 11, Debtor faces a risk that good-faith negotiations will not produce the consensus necessary to confirm a plan; notwithstanding, the Court hopes and expects the parties to undertake a sensible, pragmatic and reasonable approach to negotiations.

[20] As noted by Judge Beyer in *In re Bestwall, LLC*, 606 B.R. 243, 251 (Bankr. W.D.N.C. 2019), "claimants will be afforded due process in this case as a result of the requirements of the Bankruptcy Code and, in particular, section 524(g). Section 524(g) contemplates the active participation and support of the Committee, requires the affirmative vote of at least 75% of asbestos claimants in connection with confirmation of a plan seeking the benefits of that section (*see* 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb)), and calls for approval of the plan of reorganization by both this Court and the District Court (*see* 11 U.S.C. § 524(g)(3)(A))."

2. Debtor's Financial Distress

Debtor is the successor to Old JCCI and has been allocated its predecessor's talc-based liabilities, including verdicts, settlements, and defense costs, "as reflected in Old JJCI's general ledger." *Debtor's Sur-Reply* 9, ECF No. 1444. As testified in detail by Mr. Adam Lisman, Assistant J&J Controller, at both his deposition and during trial, the talc-related expenses were charged to Old JJCI because it had legal responsibility for them. *Deposition Tr. of Adam Lisaman Lisman Dep. Tr.* 117:1-3, Oct. 30, 2021, *Ex. H to Toroborg Decl.*, ECF No. 1444-9 ("[T]hese are talc product liability costs that JJCI was ultimately responsible for, which is why it is showing up as a [sic]expense on their account.").[21] One cannot distinguish between the financial burdens facing Old JCCI and Debtor. At issue in this case is Old JJCI's talc liability (and the financial distress that liability caused), now the legal responsibility of Debtor. Absent a global settlement, neither entity would be able to defend or economically resolve the current and future talc-related claims. As Debtor's expert, Dr. Gregory Bell testified, and as reflected in J&J's public filings, talc-related litigation was the "primary driver" that caused J&J's entire Consumer Health segment "to drop from a $2.1 billion profit (14.8 percent of sales) in 2019 to a $1.1 billion loss (-7.6 percent of sales) in 2020." *Bell Report* at 4; *see also id.* at 6 ("This current and potential future financial drain imposed by the Talc Litigation . . . was threatening Old JJCI's ability to sustain the marketing, distribution, and R&D expenditures needed to compete in the U.S. market . . . placing Old JJCI at a significant competitive disadvantage.").

This chapter 11 followed denial of review by the U.S. Supreme Court of a multi-billion dollar award in the *Ingham* litigation, as well as other more recent verdicts for hundreds of millions of dollars. There was also a break-down of a potential multi-billion dollar global settlement in the *Imerys* bankruptcy. The evidence before the Court establishes that at the time of the chapter 11 filing, this Debtor, LTL, had contingent liabilities in the billions of dollars and likely would be expending annually sums ranging $100-200 million in its defense of the tens of thousands of talc personal injury cases for decades to come.[22] The evidence confirms that the talc litigation payments and expenses forced Old JJCI into a loss position in 2020. *Bell Report* at 4-5. Indeed, to date, the talc-related litigation charges have eradicated all profits earned by Old JJCI from sales of talc-based consumer products, since inception, by more than four times over and have displaced more than 140% of the cash generated from the sales. *Bell Report* at 14. As highlighted in Debtor's Reply Memorandum, even plaintiffs' attorneys have recognized the substantial exposure facing Debtor (as successor to Old JJCI):

> Mr. Klein: "If the last seven jury awards in mesothelioma trials are any indication, and I submit to Your Honor that they are, then my Committee's constituents' claims are worth ten[s] of billions of dollars." [transcript citations omitted]
>
> Mr. Finch: "You know, Mr. Rice resolved the tobacco litigation 20 some years ago for $250 billion. I happen to think that the, the dollar figure here has to be a lot closer to 250 billion than the 2 billion that Johnson & Johnson has put on the table." [transcript citations omitted]

Debtor's Sur-Reply at 8, n.12, 13, ECF No. 1444 (citing transcripts of hearings held on Jan. 19, 2022 and Nov. 4, 2021 (*Toroborg Decl. Ex. E, F*, ECF No. 1444-6, 1444-7)).

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[21] In the accompanying Memorandum Opinion Declaring That the Automatic Stay Applies to Certain Actions Against Non-Debtors and Preliminarily Enjoining Such Actions, dated February 28, 2022, the Court analyzes in greater detail the bona fides of J&J's 1979 transfer of assets to and assumption of liabilities by Old JJCI's predecessor, which serves as the basis for the latter's legal responsibility for all talc-related liabilities.

[22] "$1 billion in defense costs over the prior five years; $3.5 billion in verdicts and settlements over that same timeframe; billions more in indemnification claims from Imerys; and (given latency) the immense costs of decades more of the same." *Debtor's Obj.* at 8. "It would cost $190 billion in defense costs just to try the *current* claims." *Id.*

Claimants repeatedly have called to the Court's attention the market capitalization ($450 billion) and stellar credit-rating of Debtor's indirect parent, J&J. Nonetheless, apart from voluntarily undertaking such an obligation or a judicial finding as to alter ego status, J&J (like all parent corporations) have no legal duty to satisfy the claims against its wholly-owned or affiliated subsidiaries. *See, e.g., Travelers Indem. Co. v. Cephalon, Inc.*, 32 F. Supp. 3d 538, 556 (E.D. Pa. 2014), *aff'd*, 620 F. App'x 82 (3d Cir. 2015) (a parent company is not liable for the actions of its subsidiaries unless the parent company itself has engaged in wrongdoing, or exercises control over the subsidiary entity).

It is true that Debtor, under the Funding Agreement, could compel J&J to deplete its available cash (amounting to nearly 7% of its entire market cap) or pursue a forced liquidation of New JJCI to tap into its enterprise value of $61 billion. Needless to say, such actions would have a horrific impact on these companies, with attendant commercial disruptions and economic harm to thousands of employees, customers, vendors, and shareholders, and threaten their continued viability. The Court is at a loss to understand, why—merely because Debtor contractually has the right to exhaust its funding options—the Debtor is not to be regarded as being in "financial distress."

It is of no moment that the Debtor, by virtue of the Funding Agreement, was not insolvent on the date of the chapter 11 filing. "As a statutory matter, it is clear that the bankruptcy law does not require that a bankruptcy debtor be insolvent, either in the balance sheet sense (more liabilities than assets) or in the liquidity sense (unable to pay the debtor's debts as they come due), to file a chapter 11 case or proceed to the confirmation of a plan of reorganization." *Marshall v. Marshall*

(In re Marshall), 721 F.3d 1032, 1052 (9th Cir. 2013). Prior to the chapter 11 filing, J&J and Old JJCI incurred compensatory damages awards in ovarian cancer cases which ranged from $5 million to $70 million, while punitive damage awards ranged from $50 million to $347 million. Likewise, in mesothelioma cases, there were compensatory damages awards ranging from $2.5 million to $40 million, while punitive damages ranged from $100,000 to $300 million. As acknowledged by all parties, in the *Ingham* case, a jury awarded $4.14 billion in punitive damages, one of the largest personal injury verdicts ever seen in the United States, ultimately reversed in part and reduced on appeal to $2.24 billion.[23] Even without a calculator or abacus, one can multiply multi-million dollar or multi-billion dollar verdicts by tens of thousands of existing claims, let alone future claims, and see that the continued viability of all J&J companies is imperiled.

As Dr. Bell testified at trial,

> Old JJCI was not positioned to continue making substantial Talc Litigation payments from working capital or other readily marketable assets. . . . As a consequence, it is apparent that Old JJCI had no significant excess net current assets available for the satisfaction of future Talc Litigation payments. In addition, Old JJCI had no other assets that were readily marketable in order to satisfy liabilities associated with the Talc litigation, which could be substantial.

Bell Report at 19-21, 32. At the time of filing, the prospects of continued monthly $10-20 million defense expenditures, with rapidly increasing numbers of new claims being filed, warranted seeking action in this Court. By comparison, the administrative burdens and costs to oversee the trust distributions under a § 524(g) trust represent a small fraction of the funds being expended currently to litigate these cases through the trial and appellate courts.

[23] *Debtor's Informational Br.* at 119-20.

Several years ago, Judge Laurie Selber Silverstein noted in *In re Rent-A-Wreck of America, Inc.*, 580 B.R. 364 (Bankr. D. Del. 2018), that a valid business purpose assumes an entity in distress. Well, such distress is patently apparent in the case at bar. *Id.* at 375. The Debtor has estimated that the costs to try a single ovarian cancer claim ranges between \$2 million to \$5 million. Defending just the over 38,000 pending ovarian cancer claims through trial would cost up to \$190 billion. In addition, Old JJCI and J&J are facing billions of dollars in indemnification claims from their talc supplier, Imerys Talc America, Inc. and two of its affiliates, Imerys Talc Vermont, Inc. and Imerys Talc Canada, Inc. (collectively, "Imerys").[24]

No public or private company can sustain operations and remain viable in the long term with juries poised to render nine and ten figure judgments, and with such litigation anticipated to last decades going forward. The Court must also factor in the negative impact of ongoing regulatory investigations by state attorneys general. The Third Circuit in *In re SGL Carbon* noted that there exists a "need for early access to bankruptcy relief to allow a debtor to rehabilitate its business before it is faced with a hopeless situation." 200 F.3d at 163; *see also In re Johns-Manville*, 36 B.R. 727, 736 (Bankr. S.D.N.Y 1984) (holding debtor "should not be required to wait until the economic situation is beyond repair in order to file a reorganization petition," and noting that the "'Congressional purpose' in enacting the Code was to encourage resort to the bankruptcy process"). While the Third Circuit requires "some" degree of financial distress, *see In re*

[24] "In its bankruptcy case, Imerys has contended that it has claims against Old JJCI and J&J for indemnification and joint insurance proceeds," claims allegedly in the billions of dollars. *Kim Decl.* ¶ 55, ECF No. 5. Similarly, Cyprus Mines Corporation and its parent company, which had owned certain Imerys talc mines, filed an adversary proceeding in the Imerys bankruptcy against Old JJCI, J&J, Imerys Talc America, Inc., and Imerys Talc Vermont, Inc. seeking a declaration of indemnity under certain contractual agreements. Cyprus Mines Corporation has since filed its own bankruptcy case. *Id.* at ¶ 56.

Integrated, *supra*, the Bankruptcy Code does not "require any **particular** degree of financial distress as a condition precedent to a petition seeking relief." *In re Gen. Growth Props., Inc.*, 409 B.R. 43, 61 (Bankr. S.D.N.Y. 2009) (quoting *United States v. Huebner*, 48 F.3d 376, 379 (9th Cir. 1994) (emphasis added)). Old JJCI need not have waited until its viable business operations were threatened past the breaking point. Movants ask the Court to require the highest level of distress,[25] for which there is no precedent.

At the hearing, Movants attempted to make the case that J&J would have continued to fund all talc-related obligations of Old JJCI without any bankruptcy filing. This was merely supposition, offered without evidentiary support. The focus then shifted to Old JJCI's rising profits, year after year, of J&J's Consumer Health Sector, allegedly undermining any claim of financial distress. Movants' expert, Saul E. Burian, testified, on both direct and cross examination, that none of the entities (LTL, J&J, Old JJCI or New JJCI) needed to file bankruptcy. *Burian Report* at 34-39. To be sure, Mr. Burian highlighted that *after taking out payments and charges relative to the talc litigation*, the sales and adjusted income before tax for J&J's Total Consumer Health sector have grown steadily since 2016; pointedly, the loss experienced in 2020 by Old JJCI is attributable primarily to the one-off payment of the *Ingham* judgment. *Id.* Movants also call to the Court's attention Debtor's access to funding through the Funding Agreement:

> Here, the totality of facts and circumstances conclusively show that LTL was not in serious financial distress when it filed its bankruptcy petition. To the contrary, prior to the bankruptcy, J&J entered into a Funding Agreement with LTL pursuant

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[25] " Because those tort claims were not a **terminal threat** to the company, as detailed above, LTL's intent plainly was to use the bankruptcy system to gain advantages that J&J and Old JJCI were unable to obtain in the tort system." *TCC II Reply Mem.* 28, ECF No. 1358 (emphasis added).

> to which it and New JJCI agreed to fund LTL's current and future talc liabilities up to the value of New JJCI—roughly $61 billion.

TCC II Reply Mem. 8, ECF No. 1358. As a result, Movants contend that "LTL had the ability to require that J&J and New JJCI fund up to $61 billion to satisfy talc liabilities." *Id.* at 9. Similarly, Movants insist that LTL was not in serious financial distress because it could "have relied on the Funding Agreement to [settle its liabilities] before filing for bankruptcy, because at the moment of the divisive merger, J&J had approximately $31 billion in cash on its balance sheet, and a half trillion-dollar market cap." *Id.* at 11, n.7.

Movants appear to suggest that due to Old JJCI's pre-petition sales revenues, as well as Debtor's financial capacity (primarily derivative from funding provided by J&J and New JJCI), this Court cannot find that Debtor suffered from financial distress at the time of filing. This suggestion, as a corollary, would mean that neither J&J nor Old JJCI (which had an even greater asset base than New JJCI) could have filed for chapter 11 in good faith. Yet, this is wholly inconsistent with Movants oft repeated contention:

> If the Debtor and/or J&J wanted the Court to focus on the financial condition of Old JJCI in evaluating the good faith of this proceeding, ***Old JJCI should have filed for bankruptcy.*** It did not. . . . J&J or Old JJCI could have chosen what it perceived to be the difficult path of obtaining the benefits and complying with the burdens of Chapter 11.

TCC II Reply Mem. at 23, ECF No. 1358 (emphasis in original).

More significantly, the Court is troubled by Movants' conflicting positions as to whether any chapter 11 filing had to be undertaken at all, as claimants submit that J&J and Old JJCI could have satisfied the extant claims without resorting to the bankruptcy court. On the one hand, Movants minimize Debtor's true talc-related financial exposure by pointing out that over 6,800 ovarian cancer and mesothelioma claims have been settled since 2017 for under $1 billion. *Movants' Ex.* 161. Similarly, during trial, Movants presented video testimony of two Directors at S&P Global, a rating agency, as well as supporting documentary evidence (contemporaneous notes and emails) reflecting the understanding of these witnesses that J&J allegedly viewed their overall talc-related liabilities at no greater than $7 billion. These understandings were reached after communications with J&J personnel. In sum, Movants press that J&J could have managed its talc-related liabilities without resort to the bankruptcy court.

Yet, on the other hand, Movants' counsel compelled Mr. Kim to acknowledge on cross examination that plaintiffs have prevailed in the last seven mesothelioma trials, for verdicts totaling over $360 million. *Diaz Report* at 13. These verdicts average to over $50 million for each mesothelioma claim and hardly can be characterized as manageable. Movants also highlighted significant events in the timeline which point toward greater talc exposure for Debtor:

- October 2019: FDA finds asbestos in Johnson's Baby Powder
- June 2020: Missouri Court of Appeals affirms *Ingham*
- April 21, 2021: Health Canada confirms its 2018 finding of a significant association, indicative of a causal effect, between exposure to talc and ovarian cancer
- May/June 2021: Settlement in *Imerys* falls apart
- June 2021: U.S. Supreme Court denies *certiorari* in the *Ingham* case

TCC I Closing at 19. Simply put, there is a clear inconsistency in the message to the Court: either JJCI was facing increased unmanageable financial risk from the talc litigation, warranting bankruptcy consideration, or it was not. At the end of the day, this Court concludes that the weight of evidence supports a finding that J&J and Old JJCI were in fact facing a torrent of significant talc-related liabilities for years to come. The evidence at trial, including the testimony of S&P Global witnesses Arthur Wong and David Kaplan, raise doubts about the intentions underlying the communications to S&P Global—were they truly projections of amounts necessary to resolve current and future talc liabilities, or estimates of anticipated short-term reserves or bankruptcy settlements? What is not in doubt are a series of events which pointed to the need for bankruptcy consideration: the $4.16 billion *Ingham* verdict and ultimate denial of appellate review, the shift by claimants to multi-billion dollar damage demands, as well as the failure to reach an accord in *Imerys*. These were triggering events that changed the landscape for future talc settlements and litigation. Neither the settlements nor verdicts which predated these events could thereafter serve as dependable guideposts for expectations going forward.

3. Debtor's Chapter 11 Filing Was Not Undertaken to Secure an Unfair Tactical Advantage

As noted, in addition to gauging whether a chapter 11 filing serves a valid bankruptcy purpose, courts must also consider "whether the petition is filed merely to obtain a tactical litigation advantage." *In re Integrated Telecom Express, Inc.*, 384 F.3d at 120; *SGL Carbon*, 200 F.3d at 165. In this regard, the thrust of Movants' challenge to Debtor's filing appears bottomed on the 2021 Corporate Restructuring and the use of the Texas divisional merger statute to create a special purpose vehicle in the hours before the filing to accomplish J&J's goals. Pertinently, Movants contend that the 2021 Corporate Restructuring "hindered," "delayed," and "prejudiced" talc claimants—by "blocking talc creditors from obtaining access" to "Old JJCI's substantial business assets" and "remov[ing] Old JJCI's business assets and operations from the reach of its talc creditors." *Original TCC's Mot. to Dismiss* ¶¶ 2-4, 41, 50, ECF No. 632; *A&I's Mot. to Dismiss* ¶¶ 4, 55-63, ECF No. 766. Yet, notwithstanding the barrage of academic and media criticism leveled at the use of the divisional merger provisions under the Texas Business

Organizations Code, the Court concludes that there have been no improprieties or failures to comply with the Texas statute's requirements for implementation, and that the interests of present and future talc litigation creditors have not been prejudiced.

Debtor was incorporated and domiciled in Texas prior to effectuating the 2021 Corporate Restructuring, albeit only days before implementation. The Texas statute "applies to all business entities, regardless of when such entities were formed." *Phillips v. United Heritage Corp.*, 319 S.W.3d 156, 163 n.5 (Tex. Ct. App. 2010). The Texas Business Organizations Code establishes the procedures that an entity must follow to effect a divisional merger, including development of a plan of merger (specifying, among other things, the allocation of assets and liabilities) and a filing with the Secretary of State. *See* Tex. Bus. Orgs. Code Ann. §§ 10.001(b), 10.002, 10.003, 10.151. Moreover, under Texas's Business Organizations Code, upon a divisional merger in which the dividing entity does not survive, "all liabilities and obligations" of the dividing entity automatically "are allocated to one or more of the . . . new organizations in the manner provided by the plan of merger." Tex. Bus. Orgs. Code Ann. § 10.008(a)(2), (3). So, where the dividing entity does not survive (such as Old JJCI), and the plan of merger allocates a particular liability or obligation to a single new entity, that designated new entity is exclusively liable for that obligation. Except as otherwise provided, "no other [entity] created under the plan of merger is liable for the debt or other obligation." *Id.* § 10.008(a)(4). The record establishes conclusively that Old JJCI complied with all requirements under Texas law.

Movants posit that the 2021 Corporate Restructuring left Debtor undercapitalized from the outset and placed the contingent talc creditors at greater risk.[26] Indeed, Movants have raised several challenges as to the efficacy of the Funding Agreement, including that: (1) J&J and New JJCI may refuse to make payments under the Funding Agreement; (2) the Funding Agreement substitutes the assets of valuable operating businesses with "an amorphous, artificially capped contract right, the value of which would take years to adjudicate;" and (3) enforcement of the agreement rests with the Debtor, which is under the control of both Payors under the Funding Agreement. *Original TCC's Mot. to Dismiss* ¶ 23, ECF No. 632. Accordingly, Movants contend that "[t]alc claimants have thus been intentionally rendered worse off than they were prior to the divisional merger, an outcome prohibited by the statute." *Id.*

The divisional merger under the Texas statute, in the absence of any subsequent bankruptcy filing by LTL, may possibly have prejudiced creditors by requiring them to await LTL's draw upon the Funding Agreement; however, that did not occur and is not the situation presented. Rather, a bankruptcy filing for the newly created, smaller entity housing the talc liabilities was a critical component of the 2021 Corporate Restructuring from the outset. As noted above, it is uncontested that the restructuring was intended as a single integrated transaction. Indeed, no one contests that J&J and Old JJCI looked to the Bankruptcy Code for a way to globally address all talc-related claims. With Debtor's chapter 11 filing, this Court now has jurisdiction and oversight over the bankruptcy estate, which controls LTL's rights under the Funding Agreement, and can ensure that Debtor pursues its available rights against J&J and New JJCI. It is inexplicable

[26] The Court previously raised the inconsistency of Movants' argument, given the repeated contention that neither Old JJCI nor the Debtor was in financial distress at the time of the filing.

that Movants would want to dismiss this proceeding and lose such leverage and access to an immediate enforcement vehicle. The Court is unpersuaded that the tort claimants have been placed in a worse position due to either the 2021 Corporate Restructuring or implementation of the Funding Agreement.

The Funding Agreement between Debtor, on the one hand, and J&J and New JJCI (on a joint and several basis) on the other, is not intended to—and is unlikely to—impair the ability of talc claimants to recover on their claims. *See Kim Decl.* ¶ 21, ECF No. 5 ("A key objective of the restructuring was to make certain that the Debtor has the same, if not greater, ability to fund the costs of defending and resolving present and future talc-related claims as Old JJCI did prior to the restructuring.") In this regard, under the Funding Agreement, all creditors, including talc claimants, maintain the ability to enforce any liquidated and fixed claims against LTL, with the added benefit of having both J&J and New JJCI backstop such obligations, up to the fair market value of Old JJCI as a floor amount, along with any additional value in New JJCI.[27] Thus, as a result of the 2021 Corporate Restructuring, Debtor would have the funding available to satisfy present and future claims against Old JJCI, with the added contractual right to look to J&J and New JJCI as primary obligors without having to establish independent liability. Moreover, with

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[27] Without any corresponding repayment obligation, the Funding Agreement obligates New JJCI and J&J, on a joint and several basis, to provide funding, up to the full value of New JJCI, to pay for costs and expenses of the Debtor incurred in the normal course of its business (a) at any time when there is no bankruptcy case and (b) during the pendency of any chapter 11 case, including the costs of administering the chapter 11 case, in both situations to the extent that any cash distributions received by the Debtor from Royalty A&M are insufficient to pay such costs and expenses. *Declaration of John K. Kim in Support of First Day Pleadings* ¶ 27, ECF No. 5. In addition, the Funding Agreement requires New JJCI and J&J to, up to the full value of New JJCI, fund amounts necessary (a) to satisfy the Debtor's talc-related liabilities at any time when there is no bankruptcy case and (b) in the event of a chapter 11 filing, to provide the funding for a trust, in both situations to the extent that any cash distributions received by the Debtor from Royalty A&M are insufficient to pay such costs and expenses and further, in the case of the funding of a trust, the Debtor's other assets are insufficient to provide that funding. *Id.*

the bankruptcy filing, the bankruptcy estate succeeds to all rights held by Debtor, with the oversight and jurisdiction of this Court as needed for enforcement. Significantly, the resources under the Funding Agreement will be available upon confirmation of a plan—whether or not the plan is acceptable to J&J or New JJCI, and whether or not the plan offers payors protections under § 524(g).

This Court agrees with Judge Beyer in *In re Bestwall LLC,* in analyzing a comparable funding agreement facing similar challenges:

> The Court disagrees with the [c]ommittee's argument [that the divisional merger 'enabled Old GP to replace the assets against which asbestos creditors had a claim with a much smaller subset of assets'] for several reasons. First, because of the [f]unding [a]greement, the [d]ebtor's ability to pay valid Bestwall [a]sbestos [c]laims after the 2017 [c]orporate [r]estructuring is identical to Old GP's ability to pay before the restructuring.

606 B.R. at 252. Debtor, in argument and its submissions, points out that for over thirty years, Texas law has permitted divisional mergers that exclusively allocate liabilities (and assets) to a new entity created by the transaction, *see* CURTIS W. HUFF, *The New Texas Business Corporation Act Merger Provisions*, 21 St. Mary's L.J. 109, 110 (1989), and that several other states have since enacted similar statutes, *see, e.g.*, 15 PA. CONS. STAT. § 361; ARIZ. REV. STAT. ANN. § 29-2601; DEL. CODE ANN. tit. 6, § 18-217(b)-(c). Debtor further underscores that corporate transactions similar to the 2021 Corporate Restructuring were effectuated pre-bankruptcy filing in several other mass tort bankruptcies—even apart from the other similarly structured filings currently pending in the Western District of North Carolina.[28] Indeed, the Court has come to learn that in *G-I Holdings*,

[28] *See, e.g.*, *In re Garlock Sealing Tech., LLC,* 10-31607 (Bankr. W.D.N.C. 2017); *In re Mid Valley, Inc.*, No. 03-25592 (Bankr. W.D. Pa. 2003); *In re Babcock & Wilcox Co.* No. 00-10992-10995 (Bankr. E.D. La, 2002).

Inc. (Case No. 01-30135 (RG)), a case which graced our court's hallways here in New Jersey for nearly a decade, was filed by a successor-in-interest entity which assumed liability for over 100,000 then pending asbestos-related lawsuits. While all of these cases may indeed have factual distinctions from the case at bar, the important takeaway is that the 2021 Corporate Restructuring was not such a novel ploy and the attention it has received is likely attributable more to the significant financial capacity of J&J, the controversial venue effort, and the timing of the bankruptcy filing given the uproar surrounding the *Purdue Pharma* confirmation battle. None of these factors, however, bear upon on this Court's resolution of the pending Motions.

Movants point to the indisputable fact that the current Debtor had no liabilities (and thus no need for a bankruptcy filing) until the divisional merger was completed hours before the filing. The Court fully understands the refrain that if J&J or New JJCI are to obtain the benefits under the Bankruptcy Code, they should file their own chapter 11 cases and bear the burdens under the Bankruptcy Code. As noted in Movants' Reply Memorandum:

> Under the law, J&J and New JJCI must shoulder burdens commensurate to such benefits: "Since a discharge is an extreme remedy, stripping a creditor of claims against its will, it is a privilege reserved for those entities which file a petition under the bankruptcy code and abide by its rules. Simply put, 'the enjoyment of the benefits afforded by the code is contingent on the acceptance of its burdens.'" *In re Arrowmill Dev't Corp.*, 211 B.R. 497, 503 (Bankr. D.N.J. 1997) (citation omitted). J&J and New JJCI thus must file for bankruptcy for this kind of benefits package. *See id.* at 506.

TCC I Reply Mem. at 10, ECF No. 1357. While that argument has facial appeal, it falters when the Court reviews and weighs the harm such filings would cause to Debtor, its affiliates, the bankruptcy estate, all creditors and claimants, and non-insider third parties. Filings by these companies would create behemoth bankruptcies, extraordinary administrative costs and burdens, significant delays and unmanageable dockets. One need only look at the conflict list in this case—revealing pages and pages of domestic and global affiliated entities and related parties—to confirm that such filings would pose massive disruptions to operations, supply chains, vendor and employee relationships, ongoing scientific research, and banking and retail relationships—just to name a few impacted areas. The administrative and professional fees and costs associated with such filings would likely dwarf the hundreds of millions of dollars paid in mega cases previously filed—and for what end? Even if Old JJCI had itself filed for bankruptcy, the talc actions would still be subject to the automatic stay, the assets available to pay those claims would be no greater, and the sole issue in the case would still be the resolution of the talc liabilities.

Let me be clear, this is not a case of too big to fail… rather, this is a case of too much value to be wasted, which value could be better used to achieve some semblance of justice for existing and future talc victims. The Court is not addressing the needs of a failing company engaged in a forced liquidation. Instead, the J&J corporate enterprise is a profitable global supplier of health, consumer products and pharmaceuticals that employs over 130,000 individuals globally, whose families are dependent upon continued successful operations. Why is it necessary to place at risk the livelihoods of employees, suppliers, distributors, vendors, landlords, retailers—just to name a few innocent third parties—due to the dramatically increased costs and risks associated with all chapter 11 filings, when there is no palpable benefits to those suffering and their families? Clearly, the added hundreds of millions of dollars that would be spent on professional fees alone would be better directed to a settlement trust for the benefit of the cancer victims. As acknowledged by other courts, bankruptcy filings by J&J, Old JJCI, or New JJCI would pose potential negative consequences, without offering a positive change in direction or pathway to success in this case.[29]

And what are the important burdens of bankruptcy that J&J, Old JJCI and New JJCI have avoided through use of the Texas divisional merger statute? The Bankruptcy Code requires full transparency of all assets, liabilities and financial conduct through scheduling and reporting. Moreover, the Code mandates accountability for all assets and expenditures. Likewise, the Code requires judicial oversight over all non-ordinary course of business conduct. Finally, the Code burdens a debtor with the need to reach a consensus with its creditor base though the plan process and voting requirements. Given what will be required to confirm a plan in this case, as well as the attention this case is receiving from the public, media, government regulators, policy makers—let alone the Court, the United States Trustee and the dozens of attorneys involved—the Court is disinclined to view any of these entities as escaping the scrutiny or burdens.

There is no question that a fair resolution of this chapter 11 proceeding will require extraordinarily large contributions by the J&J corporate family, and likely insurers, toward a settlement fund. The sooner we get there, the better all around. Grossly multiplying the costs and complexity of this proceeding will not help the process. The J&J corporate family will not attain the benefits sought in this proceeding unless and until the parties can reach a court-approved global resolution under a confirmed plan of reorganization. This dynamic does not change whether Debtor, as a special purpose vehicle, filed the chapter 11 or the J&J family filed independent

[29] *See In re Aldrich Pump, LLC,* 2021 WL 3729335, at *8 (acknowledging the "serious negative consequences" of a hypothetical bankruptcy filing of Old IRNJ and Old Trane); *In re DBMP LLC*, 2021 WL 3552350, at *8 (acknowledging adverse effects of hypothetical bankruptcy filing of Old CertainTeed).

chapter 11 cases. The potential loss in market value, the disruptions to operations, and the excessive administrative costs associated with independent chapter 11 filings justify the business decision to employ the divisional merger statute as a means of entering the bankruptcy system.

The decision to seek resolution of the present and future talc claims within the bankruptcy system, through a § 524(g) asbestos settlement trust in lieu of continued state court litigation, is consistent with congressional objectives dating back to implementation of the § 524 asbestos provisions, which codified the approach taken in *In re Johns-Manville.* Congress has not made significant modifications to the statute, so we must assume that such mass tort resolutions—at least as to asbestos claims—are consistent with public policy. Notwithstanding, Movants and the plaintiffs' committees in the cases pending in North Carolina are vigorously challenging the chapter 11 process. As noted previously, Congress placed the tort claimants in a strong position by implementing a 75% super majority class voting requirement to confirm a plan with a § 524(g) trust. This leverage comes with responsibility, however, to engage in good faith and pursue the best interests of the collective class. In exchange, this Court will endeavor to ensure that those who are suffering currently, and in the future, have their day in court—this Court—and receive fair compensation under a comprehensive and transparent distribution scheme.

As to whether the divisional merger or the desired implementation of a § 524(g) trust should be regarded as an abusive or unfair "litigation strategy" warranting dismissal of the case for bad faith, this Court is tasked to define the permissible parameters of a debtor's pre-petition litigation strategy. In doing so, this Court takes into account the totality of circumstances, such as litigation posture outside the bankruptcy court, the subjective intent of the debtor and management, the degree of financial distress facing the debtor, the pressures from nonmoving creditors, pre-petition litigation conduct, the nature of the creditor body and the extent of assets, the structure and formation of the debtor, and—most importantly in this Court's view—the debtor's reorganizational purpose and exit strategy. Here, Debtor did not undertake the corporate restructuring and bankruptcy filing as litigation tactics designed **solely** to gain a litigation advantage or hinder a plaintiff in any of the thousands of pending tort actions. Rather, Debtor seeks to employ the tools provided by Congress under the Bankruptcy Code (the automatic stay and §105 or § 524(g) trust) to attain a bankruptcy resolution of its mass tort liabilities. Without more, merely availing itself of chapter 11 tools does not constitute an improper litigation tactic. *See In re Am. Cap. Equip., LLC*, 296 F. App'x. 270, 274 (3d Cir. 2008) (finding no intent to confer "a particular litigation advantage to Debtors, over and above the advantages that a typical debtor may properly obtain by availing himself of the bankruptcy system").

A finding that there exists an abusive litigation strategy, warranting dismissal of the case, is made most often in such obvious circumstances as a filing intended to simply delay the inevitable entry of judgment, to forestall collection efforts to allow the transfer of assets, a filing without any real prospects of confirming a plan or reorganizing, or where there is pointed effort to exploit the Bankruptcy Code—to name just a few examples. Certainly, this case differs from the above scenarios. The Claimants cite to *In re Integrated Telecom Express, Inc.*, 384 F.3d 108 (3d Cir. 2004), and *In re 15375 Memorial Corp.*, 589 F.3d 605 (3d Cir. 2009), for the proposition that a desire to use a particular provision in the Bankruptcy Code is "by itself" insufficient to establish good faith.[30] *Comm. Mot. to Dismiss* ¶ 48, ECF No. 632; *Arnold & Itkin Mot. to Dismiss.* ¶¶ 51-52, ECF No. 766. Yet, Claimants fail to explain how Debtor's filing effectuated any "tactical litigation advantage" in any of the tens of thousands of talc claims pending as of the Petition Date. It is evident from the record that Debtor filed this case to resolve the potentially crippling costs and financial drain associated with defending—over the next several decades—tens of thousands (if not hundreds of thousands) of personal injury claims with a multi-billion dollar exposure to Debtor and nondebtor affiliates.[31] Indeed, as this Court has emphasized throughout this Opinion, far from a means to "hinder and delay talc claimants," a global resolution of these claims though the bankruptcy may indeed accelerate payment to cancer victims and their families.

With respect to the use of the now infamous "Texas Two-Step," the Court finds nothing inherently unlawful or improper with application of the Texas divisional merger scheme in a manner which would facilitate a chapter 11 filing for one of the resulting new entities. This Court does not find that the rights of the talc claimants and holders of future demands are materially affected by the divisional merger. Certainly, I can say with some confidence, that the legislature

[30] The Court finds many of the other cases cited by Movants to be inapposite, in that they involve efforts by a debtor to hinder, delay or disrupt a pending two-party disputes, as opposed to the circumstances present in this matter. *See Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 829 (9th Cir. 1994) (finding debtor with clear ability to pay judgment filed solely to avoid paying a judgment or posting appeal bond); *In re Ravick Corp.*, 106 B.R. 834, 851 (Bankr. D.N.J. 1989) (finding debtor sought to upend previous decision of trial court ordering specific performance against debtor); *Argus Grp. 1700, Inc. v. Steinman (In re Argus Grp.)*, 206 B.R. 757, 759-60 (E.D. Pa. 1997) (finding financially health debtor filed bankruptcy three days after state appellate court vacated earlier order staying proceeding); *Furness v. Lilienfield*, 35 B.R. 1006, 1007-08 (D. Md. 1983) (finding debtor filed bankruptcy on the eve of trial after repeated delays and multiple unsuccessful attempts to postpone trial).

[31] It is uncontested that during the twenty-one months (January 1, 2020 through September 30, 2021) preceding the petition date, Old JJCI expended roughly $3.6 billion of litigation expenses relating to the Talc Claims—34% of the company's sales, resulting in a pre-tax loss of nearly a billion dollars ($893.4 million) in the 21 months leading up to the petition date. *See JJCI Income Statements* (for the periods Jan. 1, 2020 to Dec. 31, 2020 and Jan. 1, 2021 to Sept. 30, 2021), *Torborg Decl. Exhibits C, D*, ECF No. 956-4.

which passed the statute into law probably did not foresee its current popular use. Notwithstanding, the statute makes clear the legislative intent that there be a neutral impact upon creditors. If current use of the divisional merger scheme as a foundation for chapter 11 filings conflicts with Texas' legislative scheme and goals, it can be repealed or modified. Until such time that there is legislative action, I am not prepared to rule that use of the statute as undertaken in this case, standing alone, evidences bad faith.

Argument has been put forward by Movants, other parties in interest, and the drafters of the *amici curie* brief that allowing this case to proceed will inevitably "open the floodgates" to similar machinations and chapter 11 filings by other companies defending against mass tort claims. Given the Court's view that the establishment of a settlement trust within the bankruptcy system offers a preferred approach to best serve the interests of injured tort claimants and their families, maybe the gates indeed should be opened. Nonetheless, for most companies, the complexity, necessary capital structure, and financial commitments required to lawfully implement a corporate restructuring as done in this case, will limit the utility of the "Texas Two-Step." Not many debtors facing financial hardships have an independent funding source willing and capable of satisfying the business's outstanding indebtedness. Moreover, the Court notes that in the fifteen years since having been appointed to the bankruptcy bench, there have been roughly 60 asbestos case filings under chapter 11 across the country, and under 100 filings since the very first case in 1982—hardly a flood. There have been, of course, dozens of additional mass tort cases not involving asbestos, primarily filings by a handful of pharmaceutical companies, manufacturers and several dozen catholic dioceses. With respect to the latter, the Court doubts very much that the dioceses will be utilizing the Texas Business Code to restructure in advance of filing under the Bankruptcy Code. Quite simply, the Court does not anticipate the forecasted parade of horribles.

4. Application of Equitable Considerations

Movants urge the Court to exercise its equitable powers in dismissing this proceeding:

> Bankruptcy courts are courts of equity. *See, e.g., Young v. United States*, 535 U.S. 43, 50–51 (2002) (explaining that bankruptcy courts "appl[y] the principles and rules of equity jurisprudence") (citation omitted); *United States v. Energy Res. Co.*, 495 U.S. 545, 549 (1990) ("[B]ankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.") (citation omitted); *United States v. Energy Res. Co.*, 495 U.S. 545, 549 (1990) ("[B]ankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships."); *Pepper v. Litton*, 308 U.S. 295, 304 (1939) ("for many purposes 'courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity'" (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934))). . . . A bankruptcy court can exercise its equitable powers "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Pepper*, 308 U.S. at 305.

TCC II Reply Mem. at 33, ECF No. 1358. The Court is unsure how this argument aides Movants' position. Indeed, the last quote above from the *Pepper* opinion suggests—and the Court agrees—that form should not supplant substance. Such is the very reason the Court is disinclined to dismiss this case based on Debtor's 2021 corporate reorganization efforts. At the risk of being labeled didactic, the Court observes that notwithstanding the ubiquitous acceptance by courts and attorneys, bankruptcy courts are not courts of equity. Rather, bankruptcy courts exercise authority granted by statute and may address both legal and equitable claims. *See* HON. MARICA S. KREIGER, *"The Bankruptcy Court is a Court of Equity": What does that Mean?,* 50 S.C.L. REV. 275 (1999).

True, for purposes of jurisdiction and authority, the Bankruptcy Act of 1898[32] granted the district courts exclusive bankruptcy jurisdiction at law and equity. A comparable grant of equitable jurisdiction is wholly absent in the Bankruptcy Code or Judicial Code. Bankruptcy courts are specialized courts with limited jurisdiction that apply statutory law. Included within these statutory powers is § 105(a) of the Bankruptcy Code which empowers this Court to "[i]ssue any order, process or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. 11 U.S.C. § 105(a). Pursuant to this provision, the Court has certain authority to fashion any order or decree that is in the interest of preserving or protecting the value of a debtor's assets. *See e.g., In re Morristown & Erie Railroad Co.*, 885 F.2d 98, 100 (3d Cir. 1990) (noting that § 105(a) of the Bankruptcy Code is a powerful and versatile tool).

In permitting this case to proceed going forward, this Court stands prepared to employ its limited equitable authority under § 105(a) to facilitate and assist Debtor and all tort claimants to achieve a fair and just result, consistent with the social policies and objectives intended by Congress in enacting the Bankruptcy Code. As noted by the late District Judge Jack B. Weinstein, the use of equitable concepts is particularly appropriate to address the social needs involved with mass tort cases:

> Once the province of common law courts and judges, mass tort cases now forced the courts to adopt an equitable posture. Courts of equity traditionally have taken into account the equities-the concrete issues of fact and fairness of the particular situation-in fashioning remedies. In the mass tort context these include: (1) fairly and expeditiously compensating numerous victims, and (2) deterring wrongful conduct where possible; while (3) preventing over deterrence in mass torts from shutting down industry or removing needed products from the market, (4) keeping the courts from becoming paralyzed by tens or even hundreds of thousands of

[32] Bankruptcy Act of 1898, ch. 541, 30 Stat. 545 (1898).

> repetitive personal injury cases, and (5) reducing transactional costs of compensation.

JACK B. WEINSTEIN & EILEEN B. HERSHENOV, *The Effect of Equity on Mass Tort Law,* 991 U. ILL. While class actions offer no pathway for redress with personal injury mass tort litigation and MDL's have been employed in the past with only limited success, and neither address the needs of future claimants, the use of the tools found within the Bankruptcy Code may well be the key here to fashion the remedies envisioned by Judge Weinstein.

III. Conclusion

For the reasons discussed, the Court denies the Motions in their entirety. The Court is aware that its decision today will be met with much angst and concern. Nonetheless, the matter before the Court is so much more than an academic exercise or public policy debate. These issues impact real lives. This Court lives with the distress in the voice of Vincent Hill, a mesothelioma plaintiff, when he testified about wanting his day in court and the need to care for his family. Sadly, Mr. Hill passed away recently and his death reaffirms for this Court the horrible truth that many of these cancer victims will not live to see their cases through the trial and appellate systems, but certainly deserve the comfort in knowing that their families' financial needs will be addressed timely. The Court remains steadfast in its belief that justice will best be served by expeditiously providing critical compensation through a court-supervised, fair, and less costly settlement trust arrangement.

During closing arguments, the U.S. Trustee suggested that if the case were not dismissed, the Court should consider the appointment of a chapter 11 trustee. This same argument was raised by counsel for the Canadian Class Plaintiffs. In apparent response, Debtor offered to consent to

(1) the appointment of an examiner to investigate and (2) derivative standing for the Original TCC to pursue any valid claims for possible avoidance actions or other claims relative to the 2021 Corporate Restructuring. The record does not support a finding of Debtor's pre-petition or post-petition malfeasance, or other cause warranting the appointment of a chapter 11 trustee and the attendant costs. The Court, nonetheless, agrees that there is a need for independent scrutiny of possible claims while the case progresses through the appointment of a Future Talc Claims Representative, mediation and towards the plan formulation process. The Court will take up these issues at the upcoming March 8, 2022, omnibus hearing. The Court will enter an order consistent with this Opinion.

Michael B. Kaplan, Chief Judge
U.S. Bankruptcy Court
District of New Jersey

Dated: February 25, 2022

Nos. 22-2003(L), 22-2004, 22-2005, 22-2006,
22-2007, 22-2008, 22-2009, 22-2010, 22-2011

**IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

In re: LTL Management LLC

On Appeal from the United States Bankruptcy Court
for the District of New Jersey

BRIEF FOR ANDREW R. VARA, UNITED STATES TRUSTEE, AS AMICUS CURIAE IN SUPPORT OF APPELLANTS AND SUPPORTING REVERSAL

Of Counsel:

RAMONA D. ELLIOTT
Deputy Director and General Counsel

P. MATTHEW SUTKO
Associate General Counsel

SUMI SAKATA
JOHN P. SHEAHAN
Trial Attorneys
U.S. Department of Justice
Executive Office for United States Trustees
441 G Street NW, Suite 6150
Washington, DC 20530

BRIAN M. BOYNTON
Principal Deputy Assistant Attorney General

PHILIP R. SELLINGER
United States Attorney

MARK B. STERN
SEAN R. JANDA
Attorneys, Appellate Staff
Civil Division, Room 7260
U.S. Department of Justice
950 Pennsylvania Avenue NW
Washington, DC 20530
(202) 514-3388

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INTEREST OF THE UNITED STATES TRUSTEE

The United States Trustee files this brief under Federal Rule of Appellate Procedure 29(a).

The Attorney General appoints United States Trustees to supervise the administration of bankruptcy cases and trustees. 28 U.S.C. §§ 581-589a. They "serve as bankruptcy watch-dogs to prevent fraud, dishonesty, and overreaching in the bankruptcy arena." H.R. Rep. No. 95-595, at 88 (1977). To this end, Congress has provided that "[t]he United States trustee may raise and may appear and be heard on any issue in any case or proceeding." 11 U.S.C. § 307. 28 U.S.C. § 586(a)(8) specifically authorizes United States Trustees to seek the conversion and dismissal of chapter 11 cases under 11 U.S.C. § 1112(b).

In this case, a solvent company facing substantial tort liability used what is referred to as a "divisional merger" to insulate its valuable ongoing business assets in one successor company while saddling a different successor company with that tort liability. That latter company then immediately filed for chapter 11 bankruptcy relief, sought to enjoin the ongoing tort litigation against not only the debtor but also its parent company and other nondebtor affiliates, and stated a goal to eliminate the civil liability of those affiliates through releases in the debtor's bankruptcy plan. The misuse of the bankruptcy system is an issue of substantial importance to the United States Trustee, who often files motions for conversion or dismissal under § 1112(b).

INTRODUCTION AND SUMMARY

Johnson & Johnson (J&J) and its related entities sold a talc-based baby powder product for decades; there are now approximately 38,000 pending tort claims contending that the product caused ovarian cancer or mesothelioma. Last year, Johnson & Johnson Consumer Inc. (Old JJCI), the corporate subsidiary that had held all of the assets and liabilities relating to the baby powder product for decades, underwent a transaction under Texas corporate law known as a "divisional merger." Through that transaction, Old JJCI was divided into two companies. One of the companies was a new subsidiary—also called Johnson & Johnson Consumer Inc. (New JJCI)—that was assigned almost all of Old JJCI's non-talc assets and liabilities. That corporation is currently worth approximately $61 billion. The other company was LTL Management LLC (LTL), which was assigned all of Old JJCI's talc-related liabilities and very few assets.

During its brief existence, LTL has had no substantial ongoing business operations, no employees other than those seconded from other J&J affiliates, and no reason for existing other than to file for bankruptcy. And indeed, two days after its creation, LTL did exactly that, filing a voluntary petition for chapter 11 bankruptcy relief. The stated purpose of this corporate restructuring and subsequent bankruptcy filing was to enable the J&J corporate enterprise to resolve all of its talc-related tort liabilities in a single bankruptcy proceeding—with the stated aim of confirming a plan of reorganization that would create a trust for talc claimants' benefit and would preclude them from pursuing their claims against not only LTL but also J&J and other nondebtor corporate affiliates that have not filed for bankruptcy.

LTL's bankruptcy filing was not in good faith and should be dismissed for cause under 11 U.S.C. § 1112(b). As this Court has explained, chapter 11 petitioners receive considerable benefits at the expense of creditors, including "the automatic stay, the exclusive right to propose a reorganization plan, [and] the discharge of debts." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 129 (3d Cir. 2004) (quotation omitted). Congress has determined that those benefits are appropriate in circumstances where bankruptcy relief will benefit creditors as a group, such as where a "financially troubled petitioner[] seek[s] a chance to remain in business," *id.* (quotation omitted), or where the prospect of near term insolvency threatens a race to the courthouse pitting creditors against each other or a "fire sale" harming all creditors, *id.* at 121 (quotation omitted). At the same time, those benefits mean that bankruptcy "presents an inviting safe harbor for" solvent companies that face large potential tort liability, "creat[ing] the possibility of abuse which must be guarded against to protect the integrity of the bankruptcy system and the rights of all involved in such proceedings." *In re SGL Carbon Corp.*, 200 F.3d 154, 169 (3d Cir. 1999).

To guard against such abuse, a bankruptcy court must dismiss a chapter 11 petition "unless it is filed in good faith," *SGL Carbon*, 200 F.3d at 162, a standard that focuses generally on "(1) whether the petition serves a valid bankruptcy purpose, *e.g.*, by preserving a going concern or maximizing the value of the debtor's estate, and (2) whether the petition is filed merely to obtain a tactical litigation advantage," *Integrated Telecom*, 384 F.3d at 119-20.

In this case, LTL's petition fails the good faith test in all respects. Because LTL has no substantial ongoing business operations, its petition cannot preserve any going concern. Because LTL is not facing any substantial prospect of short-term financial distress, the petition cannot maximize the value of its estate. And because LTL's petition was self-evidently filed in large part as an attempt to extend the benefits of bankruptcy to nondebtor corporate affiliates, it cannot further a valid bankruptcy purpose. That conclusion is confirmed by the pre-petition corporate restructuring that was undertaken for the purpose of enabling the company to misuse the Code by making its bankruptcy filing a weapon against tort claimants rather than a good-faith means of reorganization.

STATEMENT OF THE ISSUE

The issue presented is whether LTL's chapter 11 petition should be dismissed for cause under 11 U.S.C. § 1112(b) as not having been filed in good faith.

STATEMENT OF THE CASE

A. Statutory Background

1. Bankruptcy is the "subject of the relations between a[] . . . debtor[] and his creditors, extending to his and their relief." *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 513-14 (1938) (quotation omitted). To standardize an "expansive (and sometimes unruly) area of law," *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639,

649 (2012), Congress enacted the Bankruptcy Code under the Bankruptcy Clause of the U.S. Constitution, which vests Congress with power to "adjust[] . . . a failing debtor's obligations," *Railway Labor Execs.' Ass'n v. Gibbons*, 455 U.S. 457, 466 (1982) (quotation omitted).

In enacting the Code, Congress was particularly concerned with "protect[ing] creditors in general," seeking to prevent "an insolvent debtor from selectively paying off the claims of certain favored creditors at the expense of others" and to temper the "inevitable temptation among creditors to compete fiercely over the debtor's limited funds." H.R. Rep. No. 103-835, at 33 (1994). Congress thus designed a bankruptcy system "to enforce a distribution of the debtor's assets in an orderly manner in which the claims of all creditors are considered fairly, in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor." *Id.* In addition, Congress intended the bankruptcy system to "provide honest debtors who have fallen on hard times the opportunity for a fresh start." *Id.* at 32.

To achieve both of those objectives, the Code implements a comprehensive scheme that establishes a highly reticulated mechanism for the equitable adjustment of the debtor-creditor relationship. In particular, Congress has designed a basic bankruptcy *quid pro quo* that imposes a host of duties—including requiring debtors to comply with extensive disclosure and reporting obligations, generally requiring them to devote the value of all but certain statutorily exempt assets to the estate, and specifying how the estate's assets must be distributed to creditors—that debtors must satisfy to receive relief.

2. In general, a company may file a bankruptcy petition under either chapter 7 or chapter 11 of the Code. In a chapter 7 bankruptcy, the company's pre-petition assets are liquidated and distributed to creditors according to specific rules of priority established in the Code. 11 U.S.C. § 701 *et seq.* A chapter 7 bankruptcy is typically undertaken in circumstances where the debtor's business cannot be rehabilitated.

By contrast, a chapter 11 bankruptcy typically results in a "plan" that specifies how each class of creditors' claims will be treated in exchange for a discharge of debts to the extent provided by the Code. *See* 11 U.S.C. § 1101 *et seq.* A chapter 11 plan can either provide for the reorganization and ongoing operation of the debtor's business or a liquidation and distribution to creditors in accordance with the Code's priority scheme. At a high level, chapter 11 reflects Congress's recognition that a debtor may suffer from temporary financial distress but may nevertheless be able to preserve its business as a going concern if it can resolve that distress. The successful implementation of a plan under chapter 11 and preservation of the debtor's business will often benefit creditors, because a company will usually be worth more as a going concern than as a bare set of assets.

3. A debtor's right to adjust its debts through chapter 11 is, however, subject to several important limitations. To ensure that creditors are not prejudiced by a debtor's choice to file under chapter 11 rather than chapter 7, Congress has provided that a

plan may generally be confirmed only if each creditor receives at least as much as it would receive in a chapter 7 liquidation or consents to less favorable treatment. *See* 11 U.S.C. § 1129(a)(7), (b)(1).

Congress has also instituted mechanisms to protect creditors at the outset of a chapter 11 case. As particularly relevant here, Congress has provided that, generally speaking, "on request of a party in interest, and after notice and a hearing, the court shall convert a case under [chapter 11] to a case under chapter 7 or dismiss a case under [chapter 11], whichever is in the best interests of creditors and the estate, for cause." 11 U.S.C. § 1112(b). Under this provision, a "Chapter 11 petition is subject to dismissal for 'cause' . . . unless it is filed in good faith." *In re SGL Carbon Corp.*, 200 F.3d 154, 162 (3d Cir. 1999). Notably, § 1112(b) speaks in mandatory language, providing that the bankruptcy court "shall" convert or dismiss the case upon a finding of cause, in contrast to other provisions of the Code that provide a discretionary authority to convert or dismiss. *See* 11 U.S.C. §§ 1208(c)-(d), 1307(c)-(d).

"At its most fundamental level, the good faith requirement ensures that the Bankruptcy Code's careful balancing of interests is not undermined by petitioners whose aims are antithetical to the basic purposes of bankruptcy . . . ." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 119 (3d Cir. 2004). As is explained above, the underlying purposes of the bankruptcy system are to ensure that creditors are treated fairly and that they receive maximum value on their claims; at the same time, the bankruptcy system necessarily imposes costs on creditors by, for example, preventing them from continuing to pursue their claims outside of bankruptcy during the bankruptcy case. *See* 11 U.S.C. § 362. The good-faith standard thus "furthers the balancing process between the interests of debtors and creditors which characterizes so many provisions of the bankruptcy laws and is necessary to legitimize the delay and costs imposed upon parties to a bankruptcy." *SGL Carbon*, 200 F.3d at 161 (quotation omitted). The determination whether a petition was filed in good faith focuses on "(1) whether the petition serves a valid bankruptcy purpose, *e.g.*, by preserving a going concern or maximizing the value of the debtor's estate, and (2) whether the petition is filed merely to obtain a tactical litigation advantage." *Integrated Telecom*, 384 F.3d at 119-20.

B. Factual and Procedural Background

1. Johnson & Johnson (J&J) is a New Jersey company, first incorporated in 1887, that is a "profitable global supplier of health[and] consumer products and pharmaceuticals." J.A. 2, 47. In 1894, J&J began selling a talc-based baby powder product; through a series of corporate transactions beginning in the 1970s, the assets and liabilities related to that product were assigned to Johnson & Johnson Consumer Inc. (Old JJCI), a subsidiary of J&J, which continued to sell the product until 2020 (when its sale was discontinued in the United States and Canada). J.A. 2-4.

In recent years, J&J and Old JJCI have faced a large, and escalating, number of lawsuits claiming that their talc-based baby powder contained asbestos and fibrous talc; that certain applications of talc powder can increase the risk of, or cause, ovarian cancer; and that exposure to asbestos-containing talcum powder can cause mesothelioma. J.A. 3. These lawsuits together threatened J&J and Old JJCI with significant liability: one case involving 22 plaintiffs recently resulted in a $2.25 billion final judgment assessed against J&J and Old JJCI, and there are approximately 38,000 claims currently pending. J.A. 4; *see also* Decl. of John K. Kim ¶ 39, J.A. 458.

Nevertheless, J&J and Old JJCI have repeatedly suggested, even following the $2.25 billion verdict, that the talc-related litigation has not created a significant risk of near-term insolvency for either company. For example, J&J has indicated that, in a worst-case scenario, total talc-related liabilities may reach $7 to $7.5 billion—but J&J had liquidity of over $41 billion last year. *See* J.A. 3427, 4670, 4766-67, 4782. And in its 2020 10-K filing, J&J publicly reported that it "anticipates that operating cash flows, the ability to raise funds from external sources, borrowing capacity from existing committed credit facilities and access to the commercial paper markets will continue to provide sufficient resources to fund operating needs, including the talc litigation." Trial Ex. 398, at 30, Form 10-K for the Fiscal Year Ended January 3, 2021, Johnson & Johnson.

2. On October 12, 2021, Old JJCI underwent a "labyrinthine" set of corporate transactions that gave rise to this bankruptcy case. J.A. 4-5. Of particular importance, Old JJCI engaged in a "divisional merger" under Texas corporate law, through which Old JJCI ceased to exist and its assets and liabilities were divided between two new

companies—LTL Management LLC (LTL) and a new Johnson & Johnson Consumer Inc. (New JJCI)—that were formed in its place. *See* J.A. 5.

Through that merger, LTL received all of Old JJCI's talc-related assets and liabilities, along with approximately $6 million in cash and a royalty revenue stream estimated to generate approximately $50 million annually. *See* Kim Decl. ¶¶ 24-26, J.A. 453-54. In addition, LTL received rights under a Funding Agreement that generally obligates New JJCI and J&J to fund, up to the greater value of New JJCI or Old JJCI (and to the extent that LTL's royalty stream or other assets are insufficient), various LTL costs and expenses and—in the event of an LTL chapter 11 bankruptcy—any trust for the benefit of existing and future claimants created under a reorganization plan confirmed by a final, nonappealable order of the bankruptcy court. *See* Kim Decl. ¶ 27, J.A. 454; J.A. 5-6. All other assets and liabilities of Old JJCI were allocated to New JJCI, which is valued at approximately $61 billion. Kim Decl. ¶ 25, J.A. 453; J.A. 35. Shortly after its creation, LTL relocated from Texas to North Carolina and "entered into a secondment agreement pursuant to which J&J Services has agreed to second to [LTL] certain of its employees . . . on a full-time basis to manage [LTL's] business." Kim Decl. ¶¶ 16, 29, J.A. 448, 455.

Two days after the divisional merger, LTL filed a voluntary petition for chapter 11 relief in the Western District of North Carolina. The stated purpose of the corporate restructuring and subsequent bankruptcy filing was "to enable [LTL] to globally resolve talc-related claims through a chapter 11 reorganization without subjecting the entire Old JJCI enterprise to a bankruptcy proceeding." Kim Decl. ¶ 21, J.A. 450. Although only LTL filed for bankruptcy, it has explained that its "goal in this case is to negotiate, obtain approval of and ultimately consummate a plan of reorganization that would, among other things, . . . provide for the issuance of an injunction that will permanently protect" not just LTL but also "its affiliates and certain other parties from further talc-related claims." Kim Decl. ¶ 59, J.A. 463-64.

3. After the petition was filed in North Carolina, it was transferred to the District of New Jersey, which is where J&J is headquartered and where LTL's employees—all of whom are seconded from other corporate affiliates—work. *See In re LTL Mgmt. LLC*, No. 21-30589, 2021 WL 5343945, at *1 (Bankr. W.D.N.C. Nov. 16, 2021). Following the transfer, multiple groups representing talc claimants moved to dismiss LTL's bankruptcy petition for cause under § 1112(b) as not having been filed in good faith.

The bankruptcy court held a five-day trial on the motions to dismiss (and a related motion for a preliminary injunction). *See* J.A. 7-8. It then denied the motions. First, the court concluded that LTL's petition was "supported by a valid reorganizational purpose" because "the chapter 11 filing serves to maximize the property available to satisfy creditors." J.A. 14-32 (quotation omitted). Second, the court concluded that LTL was in significant financial distress, finding that it "had contingent liabilities in the billions of dollars and likely would be expending annually sums ranging $100-200 million" were it forced to defend against the talc claims. And although the Funding Agreement obligates J&J and New JJCI to cover LTL's expenses up to approximately $61 billion, the court stated that actually requiring J&J and New JJCI to meet that obligation "would have a horrific impact on these companies." J.A. 33-41. Third, the court concluded that the chapter 11 filing was not undertaken only to secure a tactical litigation advantage but was instead undertaken—following a legal divisional merger under state corporate law—to allow for the more efficient and equitable resolution of claims through an LTL-specific bankruptcy rather than through a JJCI bankruptcy or through tort litigation. J.A. 41-52.

A number of movants filed notices of appeal, and the bankruptcy court certified its decision for direct review in this Court under 28 U.S.C. § 158(d)(2). *See* J.A. 135-39. This Court then granted, over debtor's opposition, the claimants' petitions for permission to appeal. *See* Order, *In re LTL Mgmt. LLC*, No. 22-8015 (3d Cir. May 11, 2022), ECF No. 12-1. These consolidated appeals followed.

ARGUMENT

A petition under chapter 11 is "subject to dismissal under 11 U.S.C. § 1112(b) unless filed in good faith, and the burden is on the bankruptcy petitioner to establish that its petition has been filed in good faith." *In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir. 2004). Although the bankruptcy court's underlying factual findings are subject to review for clear error, the determination of whether the "facts of a case support the conclusion of good faith" is "subject to plenary review because it is, essentially, a conclusion of law." *In re 15375 Mem'l Corp. v. Bepco, L.P.*, 589 F.3d

605, 616 (3d Cir. 2009). In this case, the totality of the facts and circumstances demonstrate that LTL's petition was not filed in good faith.

A. LTL's Petition Does Not Serve a Valid Bankruptcy Purpose

A bankruptcy court must dismiss a chapter 11 petition "unless it is filed in good faith." *In re SGL Carbon Corp.*, 200 F.3d 154, 162 (3d Cir. 1999). In applying that standard, a court considers "(1) whether the petition serves a valid bankruptcy purpose, *e.g.*, by preserving a going concern or maximizing the value of the debtor's estate, and (2) whether the petition is filed merely to obtain a tactical litigation advantage." *Integrated Telecom*, 384 F.3d at 119-20.

LTL's petition fails the good faith test in every respect. Because LTL was created for the sole purpose of filing for bankruptcy, it has no substantial ongoing business operations that might be protected by a bankruptcy filing. Similarly, because LTL faces no substantial prospect of short-term insolvency, the petition cannot maximize the value of its estate. And because LTL's petition was filed in principal part to extend the benefits of bankruptcy to nondebtor corporate affiliates, it does not further a valid bankruptcy purpose.

A central purpose of chapter 11 is to allow a distressed business to "preserv[e] going concerns" while navigating financial hardship. *Integrated Telecom*, 384 F.3d at 119 (quoting *Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453 (1999)). As an entity created as a vehicle to file for bankruptcy, LTL has no substantial going concerns to preserve. Other than various items linked to Old JJCI's talc-related assets and liabilities, LTL's only assets are an equity interest in a single royalty revenue stream and rights under the Funding Agreement. *See* Kim Decl. ¶ 26, J.A. 453-54. Its only employees are employees of other J&J affiliates that have been seconded to LTL. *See In re LTL Mgmt. LLC*, No. 21-30589, 2021 WL 5343945, at *1 (Bankr. W.D.N.C. Nov. 16, 2021). Because LTL has "no going concerns to preserve—no employees, offices, or business other than the handling of litigation," *Bepco*, 589 F.3d at 619—the petition cannot substantially further the fundamental reorganization purpose of chapter 11.

In some cases, even where there is no substantial need to preserve going concerns, a chapter 11 petition may still serve a valid bankruptcy purpose to the extent that it enables the debtor the "maximiz[e] the value of [its] estate" for the benefit of creditors. *Integrated Telecom*, 384 F.3d at 119-20. As this Court has explained, "[a]t its most basic level, the Bankruptcy Code maximizes value by alleviating the problem of financial distress." *Id.* at 121. In short, in the absence of the successful preservation of the debtor's business, the Code ensures at least an "orderly liquidation [that] is likely to produce more value—or to avoid more loss—than [a] piecemeal liquidation" and avoids the problem "that the system of individual creditor remedies may be bad for the creditors as a group when there are not enough assets to go around." *Id.* at 120-21 (quotations and emphasis omitted).

Achieving these benefits, however, requires that a debtor be facing the prospect of financial distress: without such distress, there is no prospect of a fire-sale liquidation or of pitting creditors against each other to fight over a limited pot. As a result, invoking this purpose of the Code to demonstrate "good faith necessarily requires some degree of financial distress on the part of a debtor." *Integrated Telecom*, 384 F.3d at 121. Thus, courts "have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11." *SGL Carbon*, 200 F.3d at 166.

LTL does not face any immediate financial distress. Under the Funding Agreement, the company has access to up to approximately $61 billion to fund ongoing litigation costs and tort judgments. As explained above, J&J and Old JJCI repeatedly suggested that the total expected cost of the talc-related tort litigation was far lower than that number, and, in any event, there certainly was no impending danger of LTL being unable to fulfill its obligations.

Finally, the avowed purpose of LTL's bankruptcy filing is not to protect creditors but to protect corporate affiliates that are not themselves in bankruptcy. As LTL itself explained, the corporate restructuring and bankruptcy petition were implemented "to enable [LTL] to globally resolve talc-related claims through a chapter 11 reorganization without subjecting the entire Old JJCI enterprise to a bankruptcy proceeding," and LTL's "goal in this case is to . . . consummate a plan of reorganization that would[] . . . provide for the issuance of an injunction that will permanently protect [LTL], its affiliates and certain other parties from further talc-related claims." Kim Decl. ¶¶ 21, 59, J.A. 450, 463-64. But the purpose of the Code is to provide a mechanism for the adjustment of the debtor-creditor relationship, not to permit nondebtors—who do not themselves shoulder the obligations of bankruptcy—to benefit from the Code's protections. *Cf.* 11 U.S.C. § 524(e) (providing that a discharge in bankruptcy generally "does not affect the liability of any" nondebtor for that debt). LTL's filing—designed primarily (if not exclusively) to benefit nondebtor corporate affiliates—does not serve a valid bankruptcy purpose. *See Bepco*, 589 F.3d at 624-25.

The absence of good faith is underscored by the absence of evidence that LTL made an independent decision to seek bankruptcy protection, much less to do so for any purpose other than to protect corporate affiliates. LTL's first-day filings suggest—consistent with the two-day gap between LTL's creation and its bankruptcy petition—that the decision to have LTL file for bankruptcy was made by J&J or Old JJCI before LTL's creation. *See* Kim Decl. ¶ 21, J.A. 450. And LTL itself is controlled entirely by employees seconded from other J&J affiliates, who may not be fully beholden to LTL's interests. This Court has recognized bad faith in similar circumstances, where the debtor was directed by a representative who "was primarily concerned with protecting [nondebtor affiliates], not the Debtors." *Bepco*, 589 F.3d at 624 (emphasis omitted); *see also id.* at 624-25 (explaining that it weighed in favor of bad faith that "the Debtors' decision to file for bankruptcy was not their own; [a corporate affiliate] was ultimately in control of whether the Debtors filed").

B. The Pre-Petition Corporate Restructuring Underscores the Extent to Which LTL's Petition Was Not Filed in Good Faith

The pre-petition corporate restructuring underscores the absence of good faith. Through that restructuring, Old JJCI spun off its talc-related liabilities into a separate entity with minimal assets other than its rights under the Funding Agreement. That entity then filed a chapter 11 petition to benefit not only the debtor but also its nondebtor corporate affiliates. Those corporate maneuvers have resulted in a bankruptcy that "circumvent[s] the Code's procedural safeguards," *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 986 (2017), and undermines the "Code's careful balancing of interests," *Integrated Telecom*, 384 F.3d at 119, which provides additional cause to dismiss the petition.

The corporate restructuring and subsequent bankruptcy petition undermine the basic *quid pro quo* contemplated by the Code. To benefit from bankruptcy, a debtor is required to shoulder a host of obligations. A chapter 11 debtor must make extensive disclosures of its creditors, assets and liabilities, income and expenditures, and the nature of its financial affairs. It must then, under the supervision of the bankruptcy court, agree to, and obtain confirmation of, a plan of reorganization that meets a variety of substantive requirements to ensure that the plan is feasible, treats all of the creditors' claims equitably, and generally leaves each class of creditors no worse off than it would be if the debtor were liquidated. Furthermore, the equity owners of the debtor generally cannot retain their interest or receive a distribution on account of their ownership until all creditors have been paid in full. *In re Telegroup, Inc.*, 281 F.3d 133, 139 (3d Cir. 2002). Only if a debtor can successfully consummate such a plan does it receive a discharge of its debts that "releases [the] debtor from personal liability with respect to any discharged debt by voiding any past or future judgments on the debt." *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440, 447 (2004).

In this case, because only LTL has filed a bankruptcy petition, only LTL has agreed to take on the obligations and duties that the Code requires. Neither New JJCI nor J&J has made the extensive financial disclosures required for a debtor, and neither has submitted itself to the supervision of the bankruptcy court to obtain relief under a feasible and equitable plan of reorganization. At the same time, because of the corporate restructuring that left LTL with few assets other than its rights under the Funding Agreement (which themselves have no liquidation value), LTL can meet creditor demands only to the extent that those demands are covered by that agreement. As reflected in LTL's first-day filings, the corporate enterprise's apparent strategy is to have J&J and New JJCI fund a settlement trust for talc claimants as part of an LTL plan of reorganization and, in exchange, to seek an injunction from the bankruptcy court preventing claimants from continuing to pursue those claims against nondebtors J&J and New JJCI. And LTL has already sought automatic stay relief not only for its own benefit but also for the benefit of its corporate affiliates.

In short, through the corporate restructuring and subsequent bankruptcy filing, J&J and New JJCI seek to garner the fundamental benefits of bankruptcy—a stay that prevents talc claimants from pursuing litigation in the forum of their choice and the ability to reach a single, overarching resolution of all the talc-related tort claims (even over some claimants' potential objections)—without themselves shouldering its attendant obligations, undermining the framework established by the Code.[1]

In addition, through its eve-of-bankruptcy transactions, J&J essentially chose which subset of its assets would be exposed to the bankruptcy case and which subset of its creditors would be forced to deal with the delay and uncertainty of the bankruptcy process. That undermines the Code's priority scheme, "which ordinarily determines the order in which the bankruptcy court will distribute assets of the estate" and which provides that equity holders "receive nothing until all previously listed creditors have been paid in full." *Jevic*, 137 S. Ct. at 979. That scheme "constitutes a basic underpinning of business bankruptcy law" and "has long been considered fundamental to the Bankruptcy Code's operation." *Id.* at 983-84.

Carving out that single class of tort creditors also provides additional evidence that LTL's petition was "filed merely for tactical advantage" in ongoing litigation.

[1] Only one provision of the Code, 11 U.S.C. § 524(g), contemplates permitting a bankruptcy court to extinguish third-party claims against a nondebtor. That provision permits bankruptcy courts to enjoin third parties from pursuing certain asbestos-related claims against a limited set of non-debtors where several stringent requirements are satisfied. *See id.* Here, although it is possible that some of the talc claimants' tort claims might be subject to that provision, LTL has not yet demonstrated that most or all of the claims would be or that it will comply with the stringent requirements articulated in that provision. And in any event, the possibility that LTL's nondebtor affiliates could permissibly obtain some relief under § 524(g) does not cure the many bad-faith aspects of LTL's filing.

SGL Carbon, 200 F.3d at 165. In *SGL Carbon*, for example, the debtor filed for bankruptcy after it was named as a defendant in a large antitrust suit, apparently because it believed that bankruptcy would provide a preferable venue for resolving the antitrust claims. In evaluating a motion to dismiss the petition, this Court examined the proposed reorganization plan, which provided for all creditors to "be paid in full in cash" except antitrust judgment creditors—who would be "required to accept limited-time credits to purchase SGL Carbon's products." *Id.* at 167. This Court explained that the "plan's differing treatment of creditors suggests SGL Carbon's petition was not filed to reorganize the company but rather to put pressure on antitrust plaintiffs to accept the company's settlement terms." *Id.*

Although J&J and its affiliates have pursued different tactics in this case, the fundamental result is the same. J&J and New JJCI continue to satisfy their obligations to all of the enterprise's creditors outside of bankruptcy, with the single exception of the talc-related tort claimants. Those creditors, and those creditors alone, have now had their claims subjected to the burdens of bankruptcy. Thus, through the corporate restructuring, the J&J affiliates have essentially managed to achieve what SGL Carbon sought: they have put pressure on talc claimants—and no other creditors—to take a bankruptcy-induced discount on their claims.

Finally, the corporate restructuring and immediate bankruptcy filing are, at the least, in substantial tension with the Code's fraudulent transfer provisions. Under those provisions, a trustee is given the power to avoid any transfer of assets from or obligations to the debtor if the transfer was made within two years of the petition filing date and various actual or constructive fraud conditions are satisfied (including if the transfer was made "with actual intent to hinder, delay, or defraud any entity to which the debtor was or became" indebted or if the debtor "received less than a reasonably equivalent value in exchange" and "became insolvent as a result"). 11 U.S.C. § 548. This avoidance power "help[s] implement the core principles of bankruptcy" by allowing the trustee to "set aside transfers that unfairly or improperly deplete assets" of the estate to the detriment of creditors. *Merit Mgmt. Grp. v. FTI Consulting, Inc.*, 138 S. Ct. 883, 888 (2018) (alterations and quotation omitted).

If Old JJCI had simply transferred nearly all of its assets to a different J&J affiliate and then filed a bankruptcy petition two days later in an attempt to resolve its talc-based liabilities, that transfer almost certainly would have been avoidable in a fraudulent transfer action and the transferred assets would have been available to creditors. Although the question of whether J&J or other affiliates will ultimately be liable for a fraudulent transfer remains unresolved in this case, the divisional merger technique employed here appears designed to, at the least, hinder these fundamental creditor protections. The resulting bankruptcy petition does not constitute a good faith filing.

C. The Bankruptcy Court's Contrary Conclusion Is Unpersuasive

The bankruptcy court failed to come to grips with the fundamental concerns raised by the petition.

First, the bankruptcy court stated that "the chapter 11 filing serves to maximize the property available to satisfy creditors," on the ground that the bankruptcy system produces more efficient and equitable outcomes than tort litigation. J.A. 14-32; *see* J.A. 18-19 ("[T]his Court holds a strong conviction that the bankruptcy court is the optimal venue for redressing the harms of both present and future talc claimants in this case . . . .").

This Court has made clear, however, that bankruptcy is not intended as a general vehicle for efficient resolution of mass tort claims but is instead designed to address the specific circumstance of a potentially insolvent debtor. Thus, a good-faith petition must do more than attempt to leverage the perceived efficiencies of bankruptcy over other litigation; it "must seek to create or preserve some value that would otherwise be lost—not merely distributed to a different stakeholder—outside of bankruptcy." *Integrated Telecom*, 384 F.3d at 129. Because there was no apparent risk of LTL (or, before LTL's formation, Old JJCI or J&J) becoming insolvent or unable to satisfy tort judgments in the foreseeable future, the bankruptcy process does not preserve value by avoiding a race to judgment or intracreditor fighting over a limited pot. *See Bepco*, 589 F.3d at 620 (explaining that "the centralization of claims and the consolidation of litigations into a single forum" is not a sufficient good-faith basis for a petition because the distribution problem "bankruptcy is designed to handle" is the problem where "the system of individual creditor remedies harms the creditors as a group and there are not enough assets to go around").

This Court has emphasized that, "[r]ather than pursuing a valid bankruptcy purpose," a bare desire to resolve tort claims more efficiently than is possible in the tort system "suggest[s] that [the debtor] filed for Chapter 11 in part to gain a litigation advantage over [plaintiffs], a use of Chapter 11 that [was] emphatically rejected in *SGL Carbon*." *Integrated Telecom*, 384 F.3d at 125. Insofar as LTL is simply attempting to leverage bankruptcy to resolve the pending tort claims, that purpose further confirms that the petition is no more than an attempt "to distribute value directly from a creditor to a company's shareholders"—a paradigmatic example of a bad-faith filing. *Id.* at 129.

The bankruptcy court's reasoning is also at odds with Congress's judgment regarding the appropriate mechanisms for resolving mass claims. Congress has not determined to impose the bankruptcy system on all mass tort claimants, even when there is no prospect of a defendant's near-term insolvency. Instead, Congress has created other mechanisms to facilitate the efficient and equitable mass resolution of claims, including federal multidistrict litigation procedures, *see* 28 U.S.C. § 1407. Indeed, at the time of LTL's bankruptcy petition, approximately 90% of the pending ovarian cancer claims were proceeding in a multidistrict litigation. *See* Kim Decl. ¶ 42, J.A. 459. Regardless of any "strong conviction" that Congress's judgment about which mechanisms are appropriate in which circumstances is wrong, a desire to circumvent that judgment cannot constitute the good faith required to support a bankruptcy petition.

Second, the bankruptcy court concluded that LTL was in financial distress, finding that it "had contingent liabilities in the billions of dollars and likely would be expending annually sums ranging $100-200 million" were it forced to defend against the talc claims. J.A. 33-41. But that conclusion fails to account for LTL's rights under the Funding Agreement, which would enable LTL to receive at least approximately $61 billion in funding to cover both litigation and judgment-related costs from J&J and New JJCI. Nowhere did the bankruptcy court suggest that LTL's talc-related costs would likely approach or exceed $61 billion, much less that they might do so in the near term.

Indeed, the court recognized the significance of the Funding Agreement, but it declared that requiring J&J and New JJCI to meet their full obligations under the agreement "would have a horrific impact on these companies." J.A. 35. It stated that the "Court is at a loss to understand, why—merely because [LTL] contractually has the right to exhaust its funding options—[LTL] is not to be regarded as being in" distress. *Id.* The court's statement highlights its assumption that the LTL bankruptcy case is the appropriate way to globally resolve all claims against its affiliates, who are not themselves in bankruptcy. But as explained, such a goal is not a valid bankruptcy purpose supporting a good-faith petition.

Finally, the bankruptcy court briefly suggested that even if LTL's petition were filed in bad faith, it would refuse to dismiss the case under 11 U.S.C. § 1112(b)(2), which creates a narrow exception to the section's mandatory dismissal command. J.A. 13 n.8. That provision states that a court should not convert or dismiss a case under § 1112(b) if "unusual circumstances establish[] that converting or dismissing the case is not in the best interests of creditors and the estate" and if, among other requirements, the "grounds for converting or dismissing the case include an act or omission of the debtor" for which there is a "reasonable justification" and which "will be cured within a reasonable period of time." 11 U.S.C. § 1112(b)(2).

The suggestion that § 1112(b)(2) might preclude dismissal in this case is without merit. At the least, LTL could not meet the requirements of § 1112(b)(2) because there could never be a reasonable justification for filing a petition in bad faith, nor could such a bad-faith filing ever be cured.

CONCLUSION

For the foregoing reasons, the order of the bankruptcy court should be reversed.

Respectfully submitted,

BRIAN M. BOYNTON
Principal Deputy Assistant Attorney General

PHILIP R. SELLINGER
United States Attorney

MARK B. STERN

s/ Sean R. Janda
SEAN R. JANDA
Attorneys, Appellate Staff
Civil Division, Room 7260
U.S. Department of Justice
950 Pennsylvania Avenue NW
Washington, DC 20530
(202) 514-3388
sean.r.janda@usdoj.gov

Of Counsel:

RAMONA D. ELLIOTT
Deputy Director and General Counsel

P. MATTHEW SUTKO
Associate General Counsel

SUMI SAKATA
JOHN P. SHEAHAN
Trial Attorneys
U.S. Department of Justice
Executive Office for United States Trustees
441 G Street NW, Suite 6150
Washington, DC 20530

June 2022

United States Court of Appeals
for the
Third Circuit

Case No. 22-2003

In re: LTL MANAGEMENT LLC,

Debtor,

*OFFICIAL COMMITTEE OF TALC CLAIMANTS,

Appellant.

*(Amended per Court's Order dated 06/10/2022)

DIRECT APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY IN CH. 11 NO. 21-30589 AND ADV. PRO. NO. 21-03032

BRIEF OF CERTAIN BANKRUPTCY LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF DEBTOR-APPELLEE

DANIEL S. SHAMAH
O'MELVENY & MYERS LLP
Seven Times Square
New York, New York 10036
(212) 326-2000

PETER FRIEDMAN
O'MELVENY & MYERS LLP
1625 Eye Street, NW
Washington, DC 20006
(202) 383-5300

LAURA L. SMITH
EMMA L. PERSSON
O'MELVENY & MYERS LLP
2501 North Harwood Street,
Suite 1700
Dallas, Texas 75201
(972) 360-1900

Counsel for Amici Curiae

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INTEREST OF *AMICI CURIAE*[1]

The amici curiae, whose names and affiliations are set forth in the attached Appendix, are nationally-recognized professors of law (collectively, the "Law Professors") who teach courses and seminars in corporate governance, business law, and bankruptcy law and reorganization. The Law Professors have published numerous articles and treatises on the subject of business reorganizations and mass tort bankruptcies, provided testimony to Congress on various bankruptcy matters, and maintain a professional interest in ensuring that this Court is appropriately informed about how the bankruptcy framework is uniquely suited to address the issues affecting mass tort plaintiffs and defendants. The Law Professors' vast experience and authorship in this area of law are critically relevant to the above-referenced appeal. The Law Professors submit this brief to explain that the circumstances surrounding the filing of this bankruptcy case do not reflect a lack of good faith, and that the Bankruptcy Court did not err in denying Appellants' motion to dismiss the case.

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[1] All parties have consented to the filing of this brief. Pursuant to Federal Rule of Appellate Procedure 29, Amici state that no counsel for a party authored this brief in whole or in part. No person other than Amici or their counsel made a monetary contribution to its preparation or submission.

INTRODUCTION AND SUMMARY OF ARGUMENT

Mass torts create a unique scale of harm and liabilities, and fairly addressing them poses substantial challenges to the U.S. legal system, particularly when the universe of all potential plaintiffs cannot be identified at a given point in time.[2] Litigation in state and federal courts of general jurisdiction (including multi-district litigation) has encountered various resolution obstacles, including (i) high transaction costs, (ii) protracted proceedings that extend for years, (iii) the inability to offer comprehensive settlement of all claims, (iv) failure to protect future claimants, and (v) insufficient means to protect parties from open-ended liability.[3] In contrast, for the past five decades, the United States Bankruptcy Code and bankruptcy courts have provided plaintiffs with substantial claims and debtors with finite resources an efficient and expeditious process to resolve their differences and create meaningful settlement funds for both current and future mass tort claimants.[4] The bankruptcy process offers a comprehensive response to collective action

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[2] *See* Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. ___ (forthcoming 2022), available at https://ssrn.com/abstract=3649611.

[3] *See id.*

[4] *See, e.g., In re Mallinckrodt PLC*, 639 B.R. 837, 850 (Bankr. D. Del. 2022); *In re PG&E Corp., 617 B.R. 671, 673* (Bankr. N.D. Cal. 2020); *In re Owens Corning*, No. 00-3837, 2006 Bankr. LEXIS 2856, at *1 (Bankr. D. Del. Oct. 19, 2006); *In re A. H. Robins Co.*, 88 B.R. 742, 747 (E.D. Va. 1988); *In re Dow Corning Corp.*, 211 B.R. 545, 562 n.16 (Bankr. E.D. Mich. 1997); *In re Johns-Manville Corp.*, 68 B.R. 618, 627 (Bankr. S.D.N.Y. 1986).

problems that often preclude resolution of complex disputes. Mass tort cases present the most daunting collective action problems and often times require the unique tools that only the bankruptcy process provides.[5]

Recent debate about mass tort restructurings overlooks this history and the ways in which the bankruptcy system can facilitate consensual and beneficial outcomes in many mass tort cases.[6] Moreover, bankruptcy allows similarly situated plaintiffs to receive similar recoveries. The bankruptcy process ensures that claims arising out of the same nucleus of facts do not receive wildly divergent recoveries—a result customarily seen when mass tort cases are resolved through other non-bankruptcy venues, including jury trials in disparate jurisdictions.[7] Recent debate about these cases further overlooks simple process objectives. The primary objectives in resolving mass tort cases should be to (a) provide plaintiffs a fair and reasonable recovery under the circumstances and (b) attain that recovery on the

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[5] *See* Samir D. Parikh, *Scarlet-Lettered Bankruptcy: A Public Benefit Proposal for Mass Tort Villains*, 117 NW. U. L. REV. ___ (forthcoming 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4005503.

[6] *See* Samir Parikh, *Bankruptcy is Optimal Venue for Mass Tort Cases*, LAW360 (Feb. 28, 2022), https://www.law360.com/articles/1468363/bankruptcy-is-optimal-venue-for-mass-tort-cases.

[7] *See generally, e.g., In re WR Grace & Co.*, 729 F.3d 332, 343 (3d Cir. 2013) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."); *Begier v. IRS*, 496 U.S. 53, 58 (1990) (same).

shortest possible timeline.[8] The prospect of a meaningful and prompt resolution instead of endless courtroom delays can be transformative to current victims facing staggering health care costs.[9] The Hon. Michael Kaplan of the Bankruptcy Court properly addressed these important objectives in denying dismissal of the Debtor's bankruptcy case.

In seeking dismissal of this bankruptcy case, the Official Committee of Talc Claimants (the "TCC") challenged the bankruptcy filing of the Debtor, a subsidiary of Johnson & Johnson ("J&J") created through a divisional merger, which allocated roughly tens of billions of alleged talc liabilities to the Debtor in exchange for a funding agreement that gave the Debtor access to up to $60 billion in value for the potential benefit of creditors.[10] In finding that the divisional merger followed by a chapter 11 petition did not constitute a bad faith filing, Judge Kaplan noted that "the Debtor seeks to employ the tools provided by Congress under the Bankruptcy Code (the imposition of the automatic stay and the channeling injunctions provided by § 105 and § 524(g)) to attain a bankruptcy resolution of its mass tort liabilities."[11] Resolution of tort liabilities through a bankruptcy filing constitutes a valid

[8] *See* Parikh, *supra* note 6.
[9] Samir Parikh, *Mass Exploitation*, 170 U. PA. L. REV. ONLINE 53, 65 (Feb. 2022).
[10] *See In re LTL Mgmt., LLC*, 637 B.R. 396, 404 (Bankr. D.N.J. 2022).
[11] *Id.* at 426.

bankruptcy purpose by facilitating "the participation of all parties in interest . . . in a single forum with an aim of reaching a viable and fair settlement."[12] Judge Kaplan further noted that, "[the] Debtor filed this case to resolve the potentially crippling costs and financial drain associated with defending—over the next several decades—tens of thousands (if not hundreds of thousands) of personal injury claims with a multi-billion dollar exposure to Debtor and non-debtor affiliates."[13] As opposed to "hinder[ing] and delay[ing] talc claimants," Judge Kaplan concluded that "a global resolution of these claims though the bankruptcy may indeed accelerate payment to cancer victims and their families."[14]

The Law Professors submit that the totality of the circumstances in this case demonstrates the Debtor's bankruptcy filing should not be dismissed as a bad faith filing. Third Circuit precedent *required* Judge Kaplan to evaluate the totality of circumstances to consider what would happen if the bankruptcy case was dismissed.[15] Judge Kaplan correctly focused on tools available to both the Debtor and creditors under the Bankruptcy Code, and why those tools make the bankruptcy system the optimal venue for resolving competing creditors' claims to a potentially

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[12] *Id.* at 414.
[13] *Id.* at 427.
[14] *Id.*
[15] *Mem'l Corp. v. BEPCO, LP (In re 15375 Mem'l Corp.)*, 589 F.3d 605, 618 (3d Cir. 2009).

finite set of assets. Here, the Law Professors submit, as Judge Kaplan held, that dismissal of the bankruptcy case would likely lead to worse outcomes for stakeholders in the Debtor's estate. Indeed, any *per se* rule that provides a debtor who undertakes a divisional merger and next files for bankruptcy protection does so in bad faith is fundamentally at odds with the Third Circuit's totality-of-the circumstances test to determine a good faith bankruptcy filing.

In this vein, and as further discussed herein, the fact that a debtor has undertaken a divisive merger prior to filing for bankruptcy should not – by itself – support a dismissal for a bad faith filing. Divisive mergers have been undertaken for decades and are codified into law in many states. There is nothing inherently illegal, inequitable, or fundamentally improper about the technique. Naturally, any technique can be abused, but the fact that a technique *could possibly* be abused should not preclude parties from pursuing a legitimate execution.[16]

A divisive merger and its accompanying agreements can provide a debtor and its creditors access to the same – or even greater – financial resources enjoyed outside of bankruptcy. And the bankruptcy process can significantly reduce administrative and legal costs and remove various barriers to resolution. The benefits to the creditor collective are clear. Further, a divisive merger that actually defrauds

[16] *See* Parikh, *supra* note 6.

or otherwise disadvantages creditors can be addressed through the well-developed remedies available under the Bankruptcy Code by a jurist extremely experienced in adjudicating these types of claims. The argument that dismissal must be required if a divisive merger precedes a bankruptcy filing is misguided. This Court should undertake a more qualitative assessment focused on whether the Debtor has met the applicable good faith standard in availing itself of the bankruptcy system to resolve its mass tort liability. Hyperbole should not cloud the debate.

ARGUMENT

I. THE DEBTOR'S USE OF THE BANKRUPTCY PROCESS PROVIDES BENEFITS TO ALL STAKEHOLDERS COMPARED TO CONTINUING MASS TORT LITIGATION OUTSIDE OF BANKRUPTCY.

Bankruptcy courts in the Third Circuit engage in a fact-intensive inquiry into the totality of the circumstances to determine whether a debtor has filed a bankruptcy petition in good faith.[17] In this case, the Debtor's bankruptcy filing advanced two legitimate bankruptcy purposes, both of which are consistent with public policy: (i) equality of distribution and (ii) preventing a race to the courthouse. Indeed, federal bankruptcy courts are the optimal venue for addressing unique problems created by cases that involve both present and future mass tort claims. Without bankruptcy

[17] *Mem'l Corp.*, 589 F.3d at 618.

resolution, the uncertainty of future liability could prevent otherwise viable companies from productively carrying on their businesses and undertaking projects or asset sales that could create value and facilitate a cooperative resolution.[18]

Appellants miss the mark by focusing on one of the means (a divisional merger) used in preparing for a bankruptcy filing instead of the ultimate purpose of a bankruptcy filing.[19] When used appropriately, a divisional merger preceding a bankruptcy filing can provide a mechanism to resolve mass tort claims, and isolate – but by no means eliminate – the mass tort liability for resolution independent of the other operations of the business.[20]

For that reason, a corporation may undertake a divisive merger prior to filing for bankruptcy to assist in liability management and offer legally recognized protections to all stakeholders, including creditors, employees and shareholders. This act, in and of itself, should not constitute a basis to dismiss a case as a bad faith filing. In fact, such a result would be unprecedented. Divisive mergers have been

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[18] Anthony Casey and Joshua Macey, *[Texas Two-Step and the Future of Mass Tort Bankruptcy Series] A Qualified Defense of Divisional Mergers*, Harvard Law School Bankruptcy Round Table (June 28, 2022), https://blogs.harvard.edu/bankruptcyroundtable/2022/06/28/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-a-qualified-defense-of-divisional-mergers/.
[19] *Id.*
[20] *Id.*

undertaken for decades, and are legal in several states including Texas, Arizona, Pennsylvania, and Delaware. The Law Professors are unaware of any bright-line rule mandating dismissal of a bankruptcy case based on a *prima facie* lawful corporate transaction the debtor executed prepetition. A rule that denies divisive-merger entities access to federal bankruptcy courts would be a radical step in the wrong direction, with no legal or practical justification.

a. *Bankruptcy Offers Powerful Tools for Mass Tort Claimants.*

Dating back to the *Johns-Manville* asbestos bankruptcy in the 1980s, chapter 11's uniquely powerful tools have offered "a structured system to manage multiple liabilities and ha[ve] provided a forum for companies with massive liabilities to attempt to do so."[21] Permitting the Debtor to use these tools and continue in bankruptcy would thus be consistent with this precedent and best ensure all present and future tort claimants share in distributions equally through a court-administered claims process. These tools include, among others: centralization of claims, the automatic stay, the broad reach of bankruptcy jurisdiction, claims estimation, extensive disclosure requirements, appointment of a future claims representative with fiduciary duties, and the chapter 11 plan process.[22] Bankruptcy offers a

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[21] Report of the National Bankruptcy Review Commission 315 (Oct. 20, 1997).
[22] *See* Parikh, *supra* note 2 at pages 29-31.

comprehensive response to collective action problems that often preclude resolution of complex disputes. Mass tort cases present the most daunting collective action problems and often times require the unique tools that only the bankruptcy process provides.

First, bankruptcy provides mechanisms to centralize tort claims to allow an efficient, uniform, and evenhanded approach to the assessment and resolution of all claims against a debtor.[23]

Second, section 362's automatic stay halts the litigation tsunami that squanders resources that should ultimately go to victims.[24] It likewise provides a debtor (and potentially other affiliated entities) with a necessary breathing spell to afford it the opportunity to strategically implement its reorganization process and propose a corresponding plan.[25]

Third, the bankruptcy court's wide-ranging jurisdiction under 28 U.S.C. § 1334 allows for the aggregation of state and federal claims held by both current and future claimholders. Further, bankruptcy courts enjoy jurisdiction over claims

[23] *See In re Federal–Mogul Global Inc.*, 684 F.3d 355, 359 (3d Cir. 2012) ("Bankruptcy has proven an attractive alternative to the tort system for corporations because it permits a global resolution and discharge of current and future liability, while claimants' interests are protected by the bankruptcy court's power to use future earnings to compensate similarly situated tort claimants equitably.").

[24] *See* Parikh, *supra* note 6.

[25] *See generally In re Amatex Corp.*, 107 B.R. 856, 870 (E.D. Pa. 1989).

against, among, or between third parties that may increase available assets for the debtor's creditors.[26]

Fourth, Bankruptcy Code section 502(c) authorizes a bankruptcy court – either alone or together with a district court – to estimate the value of contingent claims subject to pending litigation against a debtor, often within a matter of months.[27]

Fifth, Bankruptcy Code section 1109(b) authorizes a bankruptcy court to appoint a representative with fiduciary duties to protect the interests of future claimants as "parties in interest."[28]

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[26] *See In re Badogna*, 331 F. App'x 962, 965 (3d Cir. 2009) ("Bankruptcy courts have jurisdiction to adjudicate claims 'arising under' Title 11 or 'arising in' a Title 11 bankruptcy case (collectively, 'core' claims), as well as those 'related to' a bankruptcy case.").

[27] *See In re Stone Webster, Inc.*, 279 B.R. 748, 809 (Bankr. D. Del. 2002) ("The purpose of an estimation proceeding is to avoid delays that may arise from waiting to fix the value of contingent claims."); *see also In re Choice ATM Enters.*, 2015 Bankr. LEXIS 689, at *17 (Bankr. N.D. Tex. Mar. 4, 2015) ("Section 502(c) and its legislative history make clear that Congress intended bankruptcy courts to handle disputes . . . in an expedited manner to accomplish the goals of preserving going-concern value for the benefit of not just debtors, but their creditors as well."); *see also, e.g., In re POC Props., LLC*, 580 B.R. 504, 508 (Bankr. E.D. Wis. 2017) (bankruptcy court estimated claims for purposes of distribution under the chapter 11 plan); *Denke v. PNC Bank, N.A (In re Denke)*, 524 B.R. 644, 654 (Bankr. E.D. Va. 2015) (bankruptcy court estimated unsecured deficiency claims).

[28] *See In re Johns-Manville Corp.*, 36 B.R. 743, 749 (Bankr. S.D.N.Y. 1984) ("Future claimants are undeniably parties in interest to these reorganization proceedings pursuant to the broad, flexible definition of that term. . . . The drafting of 'party in

Finally, a debtor's treatment of a particular class of claims is delineated in a plan of reorganization, which is accompanied by a court-approved disclosure statement and voted on by all allowed claim holders. Such a plan would include current tort claimants and other creditors, and is subject to input from a future claimants representative and oversight from statutory committees, the United States Trustee, and the bankruptcy court.[29]

In sum, the bankruptcy process reduces transaction costs by centralizing litigation, offering the means – including mediation and claim estimation – to achieve an expedited global settlement, and enjoying the statutory flexibility to efficiently resolve claims held by both current and future claimants. Instead of potentially waiting a decade for a recovery, mass tort creditors may be able to vote on a settlement offer within 18 months.[30] To this end, this bankruptcy case's

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interest' as an elastic concept was designed for just this kind of situation."); *In re Imerys Talc America*, Case No. 19-10289 (LSS), (Bankr. D. Del. 2019) [Docket No. 503 at 10] (a future claimants' representative's "loyalties must lie with the demand holders for whom he acts as a fiduciary, that is—the future claimants"); *see also Jones v. Chemetron Corp.*, 212 F.3d 199, 209–10 (3d Cir. 2000) (recognizing that future claimants "may require some voice" in the reorganization process and therefore qualify as "parties in interest" under section 1109(b) of the Bankruptcy Code).

[29] *See generally, e.g., In re Armstrong World Industries, Inc.*, 348 B.R. 136, 205 (D. Del. 2006).

[30] *See* 11 U.S.C. § 1121(b), (d) (providing a debtor has the exclusive right to propose a chapter 11 plan for the first 120 days, which may be extended by the bankruptcy court "for cause" up to the statutory maximum period of 18 months).

objectives are entirely consistent with those sought by other mass tort bankruptcies: to provide plaintiffs a fair, equitable, and expedited recovery for their meritorious claims, and offer a defendant with potentially limited funds[31] a single and efficient forum for resolution.

b. *The Propriety of Any Given Divisive Merger Can Be Assessed Under Applicable Law in a Bankruptcy Case.*

Parties' arguments that any bankruptcy case filed following a divisive merger constitutes *per se* bad faith mandating dismissal disregard the holistic nature of the bad-faith inquiry and overlook the myriad legal tools bankruptcy courts have to assess the merits of any divisive merger. A bankruptcy court can evaluate the merits of challenges to divisive mergers under both state and federal fraudulent transfer law,[32] through veil-piercing, or other equitable remedies such as substantive

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[31] In this case, even before the divisional merger, there were limited funds available to pay creditors. While J&J as an enterprise may have significant resources, as a matter of general corporate law, a parent entity is not liable if alleged tortious conduct can only be traced to agents of a subsidiary. *See generally Min Wu v. Jafco Foods, Inc.*, No. BER-L-7317-20, at *5 (N.J. Super. Feb. 25, 2022) ("Even a parent corporation is not routinely liable for the torts of the subsidiary.").

[32] *See, e.g., DBMP LLC v. Those Parties Listed on Appendix A to Complaint (In re DBMP LLC)*, Nos. 20-30080, 20-03004, 2021 Bankr. LEXIS 2194, at *59-60 (Bankr. W.D.N.C. Aug. 10, 2021) (denying asbestos claimants' lift stay motion, which the Court commented was "the functional equivalent" of a motion to dismiss and further noting that " . . . [W]hile there have been many arguments made suggesting that the Divisional merger was a fraudulent transfer, etc. at present, there is no pending action in this case that challenges the transaction . . . . Instead, [the

consolidation.[33] There are well-developed bodies of law in all these areas that bankruptcy courts are experienced in applying. These issues, however, are irrelevant for purposes of assessing good faith at the outset of a chapter 11 mass tort bankruptcy. A bright-line rule that a prepetition divisive merger necessitates dismissal of an entire bankruptcy case is inappropriate.

II. THE ALTERNATIVES TO BANKRUPTCY ARE INEFFICIENT AND OFTEN RESULT IN WORSE OUTCOMES FOR KEY CREDITORS.

A divisive merger and its accompanying agreements can provide a debtor and its creditors access to the same – or even greater – financial resources enjoyed outside of bankruptcy.[34] Further, as noted above, the bankruptcy process can significantly reduce administrative and legal costs and remove barriers to resolution. The ultimate result is a forum that can be optimal for resolving many mass tort cases.

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asbestos claimants] seek dismissal of the case, but indirectly."); *In re Bestwall LLC*, 605 B.R. 43, 50-51 (Bankr. W.D.N.C. 2019) (denying the motion to dismiss the bankruptcy case filed by the Official Committee of Asbestos Claimants upon noting that the case was not "objectively futile," and further finding that the court would "ultimately have to rule on Bestwall's good faith, albeit in a different context, at confirmation.").

[33] *See In re Owens Corning*, 419 F.3d 195, 199 (3d Cir. 2005) (noting substantive consolidation is an "equitable remedy" in which bankruptcy courts may substantively consolidate the assets and liabilities affiliated entities, but declining to impose such remedy in the instant case).

[34] *See generally In re LTL Mgmt., LLC*, 637 B.R. at 423 ("With Debtor's chapter 11 filing, this Court now has jurisdiction and oversight over the bankruptcy estate, which controls LTL's rights under the Funding Agreement, and can ensure that Debtor pursues its available rights against J&J and New JJCI.").

Proponents of the view that a divisive merger bankruptcy filing is *per se* in bad faith typically champion bankruptcy alternatives, *e.g.*, class certification and multi-district litigation ("MDL"), as preferred substitutes for the bankruptcy process. But while class-action litigation and the MDL process have their place, they suffer from numerous drawbacks that generally render them inferior alternatives to bankruptcy, especially for cases involving future mass tort claims.

a. Class Certification Under Federal Rule of Civil Procedure 23.

Although class certification under Federal Rule of Civil Procedure 23 is an oft-praised resource for resolving large pools of claims involving unified causation elements, the procedure cannot be used for many mass tort cases.[35] Specifically, Rule 23 class certification is not available for personal injury, mass tort cases that present too many individual issues surrounding causation and damages. In *Amchem Products v. Windsor*, 521 U.S. 591, 597 (1997) and *Ortiz v. Fibreboard Corp.*, 527 U.S. 823, 821 (1999), the Supreme Court limited the class action resolution option for the vast majority of mass tort cases, holding that proposed asbestos claimant classes did not satisfy the requirements of common issue predominance and adequacy of representation, and that the mandatory settlement class was not certifiable on a limited

[35] *See* Parikh, *supra* note 6.

fund theory under Federal Civil Procedure Rule 23(b)(1)(B).[36] Since then, federal courts have reached a consensus: Most personal injury, mass tort cases present too many individual issues surrounding causation and damages to satisfy Rule 23's predominance and superiority requirements.[37] Moreover, from a practical standpoint, class certification is not a viable tool for resolving all claims against a defendant unless a settling defendant allows some form of future claims to return to the tort system. Mass torts present unique latency issues. Tortious conduct has occurred but a plaintiff's injury may not manifest for decades. In this regard, future plaintiffs cannot have a role in a purported class action; they cannot opt out because future plaintiffs have no notice of class settlements, and the Supreme Court has held that courts cannot bind future plaintiffs to class settlements in light of due process.[38] In contrast, the bankruptcy

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[36] *Id.*

[37] *Id.*

[38] *Ortiz*, 527 U.S. at 846 ("[A] mandatory settlement-only class action with . . . future claimants compromises their Seventh Amendment rights without their consent." Moreover, they "implicate the due process 'principle . . . that one is not bound by a judgment in personam in a litigation in which he is not designated as a party or to which he has not been made a party by service of process.'"); *see also* Sergio Campos and Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, 91 FORDHAM L. REV. ___ (*forthcoming* 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4088836.

system, as discussed above, has been used to resolve mass tort liabilities, including future claims, since the 1980s.

b. The MDL Process.

The MDL process under 28 U.S.C. § 1407 has distorted outcomes for parties involved in mass tort disputes.[39] While the MDL process produces success stories, like Volkswagen's "clean diesel" litigation,[40] the process has now evolved in ways that can undermine effective resolution of mass tort cases, especially ones involving future mass tort claims and where liability is disputed.

First, the overwhelming majority of victims in MDL cases do not receive their day in court. According to the 2018 statistics, approximately 156,511 MDL actions were pending in front of 48 transferee district courts as of September 30, 2018.[41] From 1968 through September 30, 2018, transferee courts had received and resolved approximately 516,593 cases.[42] Of these civil actions, only 16,728 were remanded for trial.[43] In other words, only 3% of transferred cases escaped MDL capture; 97%

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[39] *Id.*

[40] *Volkswagen "Clean Diesel" Marketing, Sales Practices, and Product Liability Litigation*, 15-MD-2672-CRB (JSC).

[41] *See* Parikh, *supra* note 2, at 26 (citing U.S. JUDICIAL PANEL ON MULTIDISTRICT LITIG., MDL STATISTICS REPORT– DISTRIBUTION OF PENDING MDL DOCKETS BY ACTIONS PENDING 6 (2018)).

[42] *Id.*

[43] *Id.*

of transferred cases are resolved in MDL courts by dispositive motion or settlement.[44]

Second, unlike the bankruptcy process, there are no statutory requirements that an MDL court review or assess the integrity of a settlement process or any settlement reached by the parties, leading to a lack of judicial oversight. There is also a lack of transparency, as confidentiality agreements invariably prevent publication or an assessment of settlement details. In contrast, bankruptcy settlements are subject to judicial approval under Bankruptcy Rule 9019, and plan settlements in mass tort cases are subject to rigorous disclosure rules as well as the confirmation requirements of Bankruptcy Code section 1129.

Third, MDLs can primarily resolve only current federal claims; state claims and claims of future victims fall outside the MDL process.[45] This stands in stark contrast to the bankruptcy court process, which can resolve ostensibly all claims against a mass tort debtor.

Fourth, the MDL process can be protracted and meandering—a significant departure from the speed with which bankruptcy cases are often resolved. [46] In *In re Patenaude*, 210 F.3d 135, 146 (3rd Cir. 1999), for example, transferred cases

[44] *Id.*
[45] *See* Parikh, *supra* note 6.
[46] *Id.*

languished before the MDL judge for seven years. The plaintiffs sought to have the cases remanded, asserting that pre-trial proceedings had been resolved years before.[47] Their objections fell on deaf ears.[48] The plaintiffs petitioned the Third Circuit for a writ of mandamus to remand their cases for trial.[49] The Third Circuit denied the writ because, in its estimation, pretrial proceedings were "ongoing" even after 7 years.[50]

Bankruptcy, by contrast, affords constituents greater flexibility and promotes accelerated resolution. Specifically, a bankruptcy judge has broad discretion to intervene and adjust the process to address various deficiencies. MDL judges do not enjoy this flexibility. Although parties can consent to conduct all proceedings before an MDL court, notably, the MDL statute prevents MDL judges from even trying a case, and compelling a settlement is the only means to effectuate any meaningful recovery for claimants.[51] Beyond giving judges more procedural discretion, the

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[47] Parikh, *supra* note 2.
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *See* 28 U.S.C. § 1407(a); *In re DePuy Orthopaedics, Inc.*, 870 F.3d 345, 348 (5th Cir. 2017) ("An MDL court can conduct pretrial proceedings but cannot try a case that it would not be able to try without its MDL status." Moreover, "[f]ederal law limits an MDL court's jurisdiction over a transferred case to pretrial proceedings and provides that once those are completed, the MDL court must remand the transferred case to the district from which it was transferred.").

bankruptcy rules limit the time in which a debtor may exclusively propose a plan of reorganization.[52] The possible termination of exclusivity incentivizes a debtor to move quickly to secure consensual resolution.

CONCLUSION

Though controversial, divisive mergers are a legal technique. A prepetition divisive merger should not – by itself – support a bad faith dismissal of a case. In denying dismissal of the Debtor's bankruptcy case, Judge Kaplan was required to undertake a qualitative assessment of the circumstances surrounding the Debtor's bankruptcy filing. In doing so, Judge Kaplan correctly concluded that dismissal of the bankruptcy case would push plaintiffs out of the optimal venue for resolving mass tort cases like the Debtor's and plunge them into a perilous alternative plagued by protracted litigation, diminished recoveries, and inequitable distributions. For these reasons and those explored above, the Bankruptcy Court's judgment should be affirmed.

[52] *See supra* note 30.

Dated: August 22, 2022

Respectfully submitted,

/s/ Peter Friedman
PETER FRIEDMAN
O'MELVENY & MYERS LLP
1625 EYE STREET, NW
WASHINGTON, DC 20006
(202) 383-5300

DANIEL S. SHAMAH
O'MELVENY & MYERS LLP
7 Times Square
New York, New York 10036
(212) 326-2000

LAURA L. SMITH
EMMA L. PERSSON
O'MELVENY & MYERS LLP
2501 North Harwood St., Suite 1700
Dallas, Texas 75201
(972) 360-1900

Counsel for Amici Curiae

APPENDIX

SAMIR PARIKH
PROFESSOR OF LAW, LEWIS & CLARK LAW SCHOOL
10101 S. Terwilliger Blvd.
Portland, Oregon 97219
(503) 768-6979

ANTHONY CASEY
DONALD M. EPHRAIM PROFESSOR OF LAW AND ECONOMICS, THE UNIVERSITY OF CHICAGO LAW SCHOOL
1111 E. 60th Street
Chicago, Illinois 60637
(773) 702-9578

JOSHUA MACEY
ASSISTANT PROFESSOR OF LAW, THE UNIVERSITY OF CHICAGO LAW SCHOOL
1111 E. 60th Street
Chicago, Illinois 60637
(773) 702-9494

EDWARD MORRISON
CHARLES EVANS GERBER PROFESSOR OF LAW, COLUMBIA LAW SCHOOL
Jerome Greene Hall
435 West 116th Street
New York, NY 10027
(212) 854-5978

. . . it did not admit to negligence, much less malice." King v. U.S. Dep't of Veterans Affairs, 728 F.3d 410, 414 (5th Cir. 2013).

Newcombe asserts that his case is distinguishable from Jones because it involved a clear and unmistakable error, also referred to as a CUE. Newcombe argues that a CUE is a special admission of error that removes the need for the court to review a benefits decision, or, alternatively, that the CUE renders the benefits determination a "mistake" rather than a "decision." In Jones, we noted that "[a CUE's] interaction with a common-law negligence claim is a question for another case." 727 F.3d at 849. This question is squarely before us now.

A CUE is a distinct kind of error with specific regulatory requirements and effects within the VA benefits appeals process. See 38 C.F.R. §§ 20.1400–20.1411.

> Clear and unmistakable error is a very specific and rare kind of error. It is the kind of error, of fact or of law, that when called to the attention of later reviewers compels the conclusion, to which reasonable minds could not differ, that the result would have been manifestly different but for the error.

Id. § 20.1403(a). When the Board of Veterans' Appeals finds that a decision contained a CUE, it revises the prior decision, and the revised decision is automatically made effective as of the date of the original decision. Id. § 20.1406(a).

Newcombe argues that, although an ordinary admission of error of the kind the VA made in Jones does not relieve the district court of the need to review a benefits determination, a CUE is a special type of admission that makes such a review unnecessary. We disagree. A CUE is distinct from a simple admission of error in that it has particular consequences within the veterans' benefits review process, but this distinction has no impact on the question of subject-matter jurisdiction. Like the admission of error in Jones, the Board's determination that the February 2015 letter contained a CUE does not constitute an admission of negligence such that the district court would no longer need to review a benefits determination in deciding Newcombe's claim.

Newcombe also argues that the Board's determination that the February 2015 letter contained a CUE renders the letter a "mistake" rather than a "decision" and, therefore, the court would not need to review a "decision" to rule on his claim. The plain language of the regulations contradicts this argument. "A decision of the Board that revises a prior Board *decision* on the grounds of clear and unmistakable error has the same effect as if the decision had been made on the date of the prior decision." Id. (emphasis added). The February 2015 letter contained a decision that the district court would need to review in ruling on Newcombe's claims. The court therefore lacked jurisdiction.

Accordingly, the order of the district court is affirmed.

IN RE: PEABODY ENERGY CORPORATION Debtor

Ad Hoc Committee of Non-Consenting Creditors Appellant

v.

Peabody Energy Corporation; Citibank, N.A.; Aurelis Capital Management, LP; Elliott Management Corporation; South Dakota Investment Council;

Panning Capital Management, LP; PointState Capital, LP; Contrarian Capital Management, LLC; Discovery Capital Management; South Dakota Retirement System; Wilmington Savings Fund Society, FSB; Official Committee of Unsecured Creditors of Peabody Energy Corporation Appellees

No. 18-1302

United States Court of Appeals, Eighth Circuit.

Submitted: April 16, 2019

Filed: August 9, 2019

Background: Ad hoc committee of nonconsenting creditors appealed order of the United States Bankruptcy Court for the Eastern District of Missouri which, following approval of private placement agreement (PPA) and related agreements by which debtors were able to secure exit financing, had confirmed, over committee's objections, the Chapter 11 plan of corporate debtor, an American coal company, and its subsidiaries. Committee's emergency motion for a stay pending appeal was denied, and debtors, which had by then reorganized, moved to dismiss appeal as equitably moot. Official committee of unsecured creditors, as well as other creditors that had supported plan, joined debtors' motion. The District Court, Audrey G. Fleissig, J., 582 B.R. 771, granted motion and dismissed appeal as equitably moot or, alternatively, affirmed the judgment of the bankruptcy court and approved the plan on the merits. Ad hoc committee appealed.

Holdings: The Court of Appeals, Melloy, Senior Circuit Judge, held that:

(1) the bankruptcy court did not err in determining that debtors' plan satisfied the Bankruptcy Code's equal-treatment rule, and

(2) the bankruptcy court did not clearly err in determining that debtors' plan was proposed in good faith.

Affirmed.

1. Bankruptcy ⟹3779

As the second reviewing court in a bankruptcy case, the Court of Appeals applies the same standard of review as the district court.

2. Bankruptcy ⟹3782, 3786

Court of Appeals reviews the bankruptcy court's legal conclusions de novo and its factual findings for clear error.

3. Bankruptcy ⟹3786

Bankruptcy court's factual finding is "clearly erroneous" when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.

See publication Words and Phrases for other judicial constructions and definitions.

4. Bankruptcy ⟹3558

Whether a reorganization plan was proposed in good faith is a factual question.

5. Bankruptcy ⟹3552

Under Chapter 11 plan of debtor-coal company and its subsidiaries, the right of qualifying creditors to participate in "Private Placement" whereby qualifying creditors could purchase preferred stock in reorganized debtors at 35% discount to the Plan Equity Value did not constitute unequal treatment for their claims in violation of the Bankruptcy Code's equal-treatment rule; opportunity to participate in Private Placement was not "treatment for" participating creditors' claims but, instead, was consideration for valuable new commitments made by these creditors, investors who promised to support plan, buy preferred stock that did not sell in the Private Placement, and "backstop" debtors' Rights Offering, in exchange for which they received the opportunity to buy preferred stock at a discount as well as premiums designed to compensate them for shouldering significant risks despite volatile nature of coal market. 11 U.S.C.A. § 1123(a)(4).

6. Bankruptcy ⚷3558

Although the term "good faith" is left undefined by the Bankruptcy Code, in the context of a Chapter 11 reorganization, a plan is considered proposed in "good faith" if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code. 11 U.S.C.A. § 1129(a)(3).

See publication Words and Phrases for other judicial constructions and definitions.

7. Bankruptcy ⚷3558

To determine whether a Chapter 11 plan has been proposed in good faith, the "totality of the circumstances" surrounding the creation of the plan must be considered. 11 U.S.C.A. § 1129(a)(3).

8. Bankruptcy ⚷3787

Because the bankruptcy judge is in the best position to assess the good faith of the parties' proposals, the Court of Appeals reviews the question of whether a Chapter 11 plan has been proposed in good faith for clear error. 11 U.S.C.A. § 1129(a)(3).

9. Bankruptcy ⚷3558

Bankruptcy court's finding that debtors' Chapter 11 plan was proposed in good faith, even though plan provided for exclusive sale of discounted preferred stock to qualifying creditors, was supported by evidence that debtors mediated with creditors to resolve major inter-creditor dispute, that debtors reached settlement with substantial input from negotiating parties, that objecting creditors could have joined had they chosen to intervene in the mediation, that settlement revolved around plan that allowed all first-lien holders to be paid off, all second-lien holders to receive approximately 52.4% of face value of their claims, and all unsecured creditors to receive approximately 22.1% of their claims' face value, that plan garnered tremendous consensus, that debtors permitted alternative plans to be proposed, all of which debtors considered with advisors and at board meetings, and that, given volatile nature of coal market and costs associated with delay, time was of the essence. 11 U.S.C.A. § 1129(a)(3).

10. Bankruptcy ⚷3558

In determining whether Chapter 11 debtors' plan was proposed in good faith, the court could not look merely at the potential virtues of objecting creditors' proposed alternative plan while ignoring the potential risks involved with that plan. 11 U.S.C.A. § 1129(a)(3).

Appeal from United States District Court for the Eastern District of Missouri - St. Louis

Counsel who presented argument on behalf of the appellant was Andrew M. Leblanc, of Washington, DC. The following attorney(s) appeared on the appellant brief; Jonathan D. Hacker, of Washington, DC., David M. Dare, of Saint Louis, MO., Gerard Uzzi, of New York, NY., Eric K. Stodola, of New York, NY., Alan J. Stone, of New York, NY., Andrew M. Leblanc, of Washington, DC.

Counsel who presented argument on behalf of the appellee Peabody Energy Corporation was Shay Dvoretzky, of Washington, DC. The following attorney(s) appeared on the appellee brief; Steven N. Cousins, of Saint Louis, MO., Shay

Dvoretzky, of Washington, DC., Robert W. Hamilton, of Columbus, OH., Heather Lennox, of Cleveland, OH., John G. Willard, of Saint Louis, MO., Matthew Corcoran, of Columbus, OH., Benjamin M. Flowers, of Columbus, OH.

Counsel who presented argument on behalf of the appellees Official Committee of Unsecured Creditors of Peabody Energy Corporation was Lena H. Hughes, of New York, NY. The following attorney(s) appeared on the appellees brief; Joseph R. Palmore, of Washington, DC., Lorenzo Marinuzzi, of New York, NY, Ryan C. Hardy, of Saint Louis, MO., Daniel J. Harris, of New York, NY., Melissa A. Hager of New York, NY.

Before SHEPHERD, MELLOY, and GRASZ, Circuit Judges.

MELLOY, Circuit Judge.

In April 2016, Peabody Energy Corporation and its affiliates (the "Debtors") filed a voluntary reorganization petition under Chapter 11 of the Bankruptcy Code. In March 2017, over the objection of the Ad Hoc Committee of Non-Consenting Creditors (the "Ad Hoc Committee"), the bankruptcy court confirmed a reorganization plan proposed by the Debtors. The Ad Hoc Committee appealed to the district court,[1] which dismissed the appeal as equitably moot. Alternatively, the district court approved the plan on the merits, holding that the plan: (1) comported with the requirement in 11 U.S.C. § 1123(a)(4) that all claims in a particular class be treated the same; and (2) was proposed in good faith. We, too, affirm on the merits.

I. Background

The Debtors are an American coal company and some of its subsidiaries. Over the middle years of this decade, a variety of factors decreased the demand for and price of American-produced coal. The decreased demand and lower prices resulted in a sharp decline in the Debtors' revenues. Impacted by these falling revenues and weighed down by what the Debtors call "substantial debt obligations," the Debtors filed for reorganization under Chapter 11.

Before filing their reorganization petition, however, a dispute arose between several of the Debtors' secured and senior-unsecured creditors (the "security-interest dispute"). The creditors disagreed over the extent to which the Debtors' assets served as collateral for the secured creditors' debts. The Debtors filed their petition and then, to resolve the security-interest dispute, commenced an adversary proceeding seeking a declaratory judgment on the matter.

Non-binding mediation followed. Negotiations in the mediation gradually expanded from resolving the security-interest dispute to formulating a reorganization plan. The negotiating parties included the Debtors and a group of seven holders of the Debtors' second-lien and senior-unsecured notes. On appeal, the parties refer to this group as the "Noteholder Co-Proponents." Members of the Ad Hoc Committee did not participate in the mediation, though they did receive notice. Eventually, the negotiating parties crafted a complex plan for reorganization as part of a global settlement. The plan was expressly conditioned on approval by the bankruptcy court.

In general, the plan that emerged from the mediation provided a way for the

1. The Honorable Audrey G. Fleissig, United States District Judge for the Eastern District of Missouri.

Debtors to raise $1.5 billion in new money to pay for distributions under the plan and fund operations following reorganization. This was to be accomplished by two sales. The first was a sale of common stock at a discount to certain classes of creditors. The second was an exclusive sale of discounted preferred stock to qualifying creditors. As will be discussed in greater detail below, creditors could qualify to buy the preferred stock by executing certain agreements that obligated them to: (1) buy a set amount of preferred stock; (2) agree to backstop (i.e., purchase shares of common and preferred stock that did not sell) both sales; and (3) support the plan in the confirmation process. The amount of preferred stock qualifying creditors could and were required to buy depended on the portion of the prebankruptcy debt they owned and also on when they became qualifying creditors (i.e., how quickly they took action to qualify). Qualifying creditors also received several premiums for executing the agreements.

More specifically, the plan included the following elements. First, the plan required the reorganized Debtors to engage in a $750 million "Rights Offering" following reorganization. The Rights Offering allowed holders of certain unsecured notes known as Class-5B claims and second-lien note holders to purchase common stock in the reorganized company at a 45% discount to the value the negotiating parties agreed the common stock should be worth (what the Ad Hoc Committee refers to as "Plan Equity Value"). The parties agree that this element of the plan is not contested.

Second, the plan required the reorganized Debtors to engage in a $750 million "Private Placement" whereby qualifying creditors could purchase preferred stock in the reorganized Debtors at a 35% discount to the Plan Equity Value. A creditor qualified to participate in the Private Placement if it: (1) held a second-lien note or Class-5B claim; (2) signed a "Private Placement Agreement" that committed the creditor to purchase a certain amount of preferred stock based on when it signed the agreement; (3) agreed to backstop the Rights Offering; and (4) agreed to support the reorganization plan throughout the confirmation process.

The negotiating parties developed an intricate three-phase system for determining who could and must buy what in the Private Placement. In Phase One, the Noteholder Co-Proponents were given the exclusive right and obligation to purchase the first 22.5% of preferred stock at the discounted price. The Noteholder Co-Proponents also had to purchase what remained of the 77.5% of preferred stock that did not sell in the next two phases. In Phase Two, the Noteholder Co-Proponents plus any creditor who took action to qualify by an initial deadline (the "Phase-Two investors") received the exclusive right and obligation to purchase the next 5% of the preferred stock at the discounted price. The Phase-Two investors were also obligated to purchase whatever remained unsold of the 72.5% of preferred stock in the next phase. Finally, in Phase Three, the Noteholder Co-Proponents, the Phase-Two investors, plus any creditor who took action to qualify after Phase Two but before the close of the sale received the exclusive right and obligation to purchase the remaining 72.5% of preferred stock at the discounted price.

The Debtors agreed to pay creditors who participated in the Private Placement certain premiums "in consideration for" their agreements. For agreeing to backstop the Rights Offering, the creditors were promised a "Backstop Commitment Premium" worth $60 million (i.e., 8% of the $750 million raised). They were also promised a "Ticking Premium" worth $18,750,000, which was to be paid monthly through a designated closing date. Corresponding commitment and ticking premiums were paid to creditors who agreed to buy their portion of the preferred stock in the Private Placement. All the premiums were paid in common stock of the reorganized Debtors.

In essence, holders of second-lien and Class-5B claims could buy a significant amount of stock in the reorganized Debtors at a discount and receive significant premiums in exchange for promptly agreeing to backstop the arrangement and support the plan. Moreover, under the plan, holders of second-lien and Class-5B claims were also entitled to recover significant portions of their claims regardless of whether they participated in the Private Placement. Holders of second-lien claims, for instance, were expected to receive an estimated 52.4% of the face value of their claims, and holders of Class-5B claims were expected to receive approximately 22.1%.

On December 22, 2016, the Debtors moved to approve a disclosure statement and set a confirmation hearing date. The next day, the Debtors moved for an order approving the Private Placement and backstop agreements and authorizing the Debtors to enter into those agreements. This started the clock ticking on when creditors had to qualify to participate in the various phases of the Private Placement—creditors had three days to qualify to participate in Phase Two, and thirty-three days to qualify to participate in Phase Three. The agreement-approval motion also asked for authorization to enter into a plan-support agreement and for approval of the Rights Offering.

Members of the Ad Hoc Committee elected not to sign the various agreements. Thus, they never qualified to participate in the Private Placement. Instead, shortly after the Debtors filed the motions just described, the Ad Hoc Committee submitted the first of several alternative-plan proposals to the Debtors and the Official Committee of Unsecured Creditors (the "Official Committee"). The proposals included an offer to backstop a $1.77 billion rights offering that would take the place of the Rights Offering and Private Placement proposed by the Debtors' plan. According to testimony and sworn statements from the Debtors' CFO, each time the Debtors received an alternative-plan proposal, they reviewed the proposal with advisors and considered it at board meetings, analyzing each proposal against the Debtors' main goals for reorganization.[2] With each proposal, the Debtors determined that the proposed alternative either: (1) would not accomplish their goals as well as the Debtors' proposed plan would; or (2) would add significant legal expenses and delay to the already expensive and lengthy reorganization process. The Official Committee independently reviewed the Ad Hoc Committee's proposals and found them to be inferior to the Debtors' proposed plan.

On January 26, 2017, the bankruptcy court held a hearing on the Debtors' motions. The bankruptcy court approved the disclosure statement and scheduled a confirmation hearing. The bankruptcy court also, over the Ad Hoc Committee's objec-

2. The Debtors have consistently declared throughout the bankruptcy proceedings that their goals for reorganization were to: (1) emerge from bankruptcy with adequate liquidity to weather the volatile business cycles inherent in the coal industry; (2) ensure that following emergence they could pay their debts on time; (3) maximize the size of their estate for the creditors' benefits; and (4) achieve the broadest consensus among creditors possible.

tions, granted the Debtors' agreement-approval motion. By the date of the confirmation hearing, all twenty classes of the Debtors' creditors had voted overwhelmingly to approve the plan and approximately 95% of the Debtors' unsecured creditors had agreed to participate in the Private Placement and make backstop commitments. The bankruptcy court held the confirmation hearing and confirmed the Debtors' proposed plan. The Ad Hoc Committee promptly appealed to the district court.

Following confirmation and the Debtors' formal emergence from bankruptcy as a reorganized company, the reorganized Debtors began consummating the plan. By April 4, 2017, the reorganized Debtors had received $1.5 billion from investors pursuant to the Rights Offering and Private Placement and had issued and distributed millions of shares of preferred and common stock in the newly reorganized company to compensate those investors. The reorganized Debtors had also received exit financing, paid over $3.5 billion in claim distributions under the plan, and completed many more plan-related transactions before the district court reviewed the case.

Against that backdrop, the district court granted a motion to dismiss filed by the Debtors. The district court held that the appeal was "equitably moot" because the plan had been substantially consummated. Alternatively, the district court affirmed the judgment of the bankruptcy court, finding that the equal-treatment requirement of 11 U.S.C. § 1123(a)(4) had been satisfied and that the Debtors had proposed the plan in good faith. The Ad Hoc Committee timely appealed.

II. Discussion

At issue before us is whether the bankruptcy court erred in determining that the Debtors' plan satisfied the equal-treatment rule and was proposed in good faith. Because we find no error, we need not address the Debtors' argument that the Ad Hoc Committee's appeal is equitably moot.

[1–3] "As the second reviewing court in a bankruptcy case, we apply the same standard of review as the district court." Melikian Enters., LLLP v. McCormick, 863 F.3d 802, 806 (8th Cir. 2017) (citation omitted). We review the bankruptcy court's legal conclusions de novo and its factual findings for clear error. Id. "A finding is clearly erroneous when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Hill v. Snyder, 919 F.3d 1081, 1084 (8th Cir. 2019) (internal quotation marks and citation omitted).

[4] Whether a reorganization plan was proposed in good faith is a factual question. See Hanson v. First Bank of S.D., N.A., 828 F.2d 1310, 1315 (8th Cir. 1987) (reviewing a bankruptcy court's finding that a plan had been proposed in good faith for clear error), partially abrogated on other grounds by Pioneer Inv. Servs. Co v. Brunswick Assocs. Ltd. P'ship, 507 U.S. 380, 387 n.3, 394, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993); see also In re Andreuccetti, 975 F.2d 413, 420 (7th Cir. 1992) (stating that a finding whether a reorganization plan was proposed in good faith "is one of fact, which we will not overturn unless it is clearly erroneous"). We have not addressed whether a determination that the equal-treatment rule has been satisfied is a factual finding subject to clear-error review or a legal conclusion subject to de novo review. At least one circuit has concluded that it is a factual finding and should not be disturbed unless clearly erroneous. See Acequia, Inc. v. Clinton (In re Acequia, Inc.), 787 F.2d 1352, 1358 & n.4 (9th Cir. 1986). We need not decide the issue here. Even assuming

the standard of review is de novo, our conclusion as to the alleged equal-treatment violation in this case would be the same.

A. Equal Treatment

[5] The Ad Hoc Committee argues that the right of qualifying creditors to participate in the Private Placement was unequal treatment for their claims, a violation of 11 U.S.C. § 1123(a)(4). Section 1123(a)(4) states that a reorganization plan 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." Neither the Supreme Court nor our Court has interpreted that provision, and the Code does not define the standard of equal treatment. See In re AOV Indus., Inc., 792 F.2d 1140, 1152 (D.C. Cir. 1986) (noting that "neither the Code nor the legislative history precisely defines the standards of equal treatment").

Cases from other circuits that have dealt with the issue, however, appear to agree that a reorganization plan may treat one set of claim holders more favorably than another so long as the treatment is not for the claim but for distinct, legitimate rights or contributions from the favored group separate from the claim. The Second Circuit, for instance, held that § 1123(a)(4) was not violated where a plan treated an equity holder better than other equity holders in the class because the equity holder: (1) had a secured claim separate from its equity interest; and (2) had "agreed to attribute" to the reorganized debtor certain "causes of action against third parties." Ahuja v. LightSquared Inc., 644 F. App'x 24, 29 (2d Cir. 2016). The Fifth Circuit concluded that a plan proponent's payments to certain members of a debtor power cooperative did not violate § 1123(a)(4) because the payments were "reimbursement for plan and litigation expenses," not payments "made in satisfaction of the [members'] claims against [the debtor]." Mabey v. Sw. Elec. Power Co. (In re Cajun Elec. Power Coop., Inc.), 150 F.3d 503, 518–19 (5th Cir. 1998). And the Ninth Circuit upheld a plan that provided preferential treatment to one of a debtor's shareholders apparently because the preferential treatment was tied to the shareholder's service to the debtor as a director and officer of the debtor, not to the shareholder's ownership interest. See Acequia, 787 F.2d at 1362–63 ("[The shareholder's] position as director and officer of the Debtor is separate from her position as an equity security holder.").

Here, the opportunity to participate in the Private Placement was not "treatment for" the participating creditors' claims. 11 U.S.C. § 1123(a)(4). It was consideration for valuable new commitments made by the participating creditors. The participating creditors were investors who promised to support the plan, buy preferred stock that did not sell in the Private Placement, and backstop the Rights Offering. In exchange, they received the opportunity to buy preferred stock at a discount as well as premiums designed to compensate them for shouldering significant risks.

The Ad Hoc Committee argues that Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999), calls for a different conclusion. We disagree. In LaSalle, the Supreme Court rejected a reorganization plan that gave a debtor's prebankruptcy equity holders the exclusive opportunity to receive ownership interests in the reorganized debtor if the equity holders would invest new money in the reorganized debtor. Id. at 437, 119 S.Ct. 1411. The plan in LaSalle had been "crammed down" under

11 U.S.C. § 1129(b) despite the objections of a senior class of the debtor's impaired creditors who claimed that the plan violated the absolute priority rule. See id. at 441–43, 119 S.Ct. 1411; see also 11 U.S.C. § 1129(b)(2)(B)(ii) (stating that in a cramdown situation "the holder of any claim or interest that is junior to the claims of [a class of unsecured claims may] not receive or retain under the [proposed] plan on account of such junior claim or interest any property"). The Court explained that the exclusive opportunity given to the equity holders was "a property interest extended 'on account of' " the equity holders' equity interests in the reorganizing debtor. LaSalle, 526 U.S. at 456, 119 S.Ct. 1411. The Court found troubling the facts that the equity holders had paid nothing for the valuable exclusive opportunity and the debtor had not considered any alternative ways of raising capital. Id. Given these facts, the Court concluded that the "very purpose of the whole transaction" must have been, "at least in part, to do old equity a favor … because of old equity's prior interest" in the debtor. Id.

LaSalle is distinguishable from this case in at least three ways. First, the Ad Hoc Committee was not excluded from any opportunity like the creditors in LaSalle were. The Ad Hoc Committee could have participated in the Private Placement at any phase had they timely taken the necessary actions to qualify.[3] Second, unlike the equity holders in LaSalle, creditors who participated in the Private Placement gave something of value up front in exchange for their right to participate: They promised to support the plan, buy preferred stock that did not sell in the Private Placement, and backstop the Rights Offering.[4] Third, unlike the debtor in LaSalle, the Debtors here considered several alternative ways to raise capital, including proposals submitted by the Ad Hoc Committee. The Debtors reviewed each alternative-plan proposal with advisors and analyzed the merits of each at board meetings.[5] With each proposal, the Debtors determined that the proposed alternative would either be less effective at accomplishing their goals than their plan, or it would cost too much in terms of time or money. Indeed, the Debtors' CFO testified at the confirmation hearing that delay was likely to cost the Debtors around $30 million per month, not includ-

3. To the extent that the Ad Hoc Committee argues that it was unable to participate in the first phase of the Private Placement, we note, as did the bankruptcy court, that the Ad Hoc Committee could have intervened in the nonbinding mediation that resulted in the formulation of the plan. See Fed. R. Bankr. P. 2018(a) ("In a case under the Code, after hearing on such notice as the court directs and for cause shown, the court may permit any interested entity to intervene generally or with respect to any specified matter.").

4. The Ad Hoc Committee focuses on the fact that under the Private Placement and backstop agreements the participants were paid handsome premiums for their agreement to buy all unsold preferred stock and backstop the Rights Offering. The right to buy the preferred stock at a discount, the Ad Hoc Committee argues, could not also have been consideration for those commitments. We disagree. The Private Placement participants did receive premiums for committing to buy the unsold preferred stock and to backstop the Rights Offering. However, the right to buy the preferred stock at a discount may also be seen as an incentive to agree to support the plan or to stop pursuing the security-interest dispute. Moreover, the right to buy at a discount and the premiums could, together, be viewed as necessary consideration for the promises to buy the unsold preferred stock and to backstop the Rights Offering, especially given the volatility of coal markets at the time and uncertainty as to the Debtors' future.

5. The Ad Hoc Committee does not challenge the Debtors' assertion that the Debtors consulted with advisors and considered the alternative-plan proposals at board meetings.

ing any litigation expenses related to resolving the security-interest dispute. Moreover, the Official Committee, acting in a fiduciary capacity, independently reviewed the Ad Hoc Committee's proposals and found them to be inferior to the Debtors' proposed plan. Because it is distinguishable, LaSalle does not convince us that § 1123(a)(4) has been violated here.

In sum, we agree with the bankruptcy court that the right to participate in the Private Placement was not "treatment for" a claim. 11 U.S.C. § 1123(a)(4). The right to participate in the Private Placement was consideration for valuable new commitments. Consequently, the plan did not violate the equal-treatment rule of § 1123(a)(4).

B. Good Faith

The second issue before us is whether the bankruptcy court erred in determining that the Debtors proposed their plan in good faith. The Ad Hoc Committee argues a lack of good faith for three reasons: (1) "the Plan failed to maximize the value of the Debtors' estate" because the preferred stock was not sold for its full value; (2) "the Plan gave certain class members additional benefits in exchange for settling class-wide disputes"—namely, the Noteholder Co-Proponents were able to buy more preferred stock in the Private Placement than other members of their class; and (3) "the Plan Proponents employed a coercive process that induced holders to vote to accept the Plan." (Emphasis omitted).

[6–8] A bankruptcy court "shall confirm a plan only if ... [t]he plan has been proposed in good faith." 11 U.S.C. § 1129(a)(3). "[T]he term 'good faith' is left undefined by the Code." Hanson, 828 F.2d at 1315. However, "[i]n the context of a chapter 11 reorganization, ... a plan is considered proposed in good faith 'if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code.'" Id. (citation omitted). To determine whether a plan has been proposed in good faith, the "totality of the circumstances" surrounding the creation of the plan must be considered. In re Madison Hotel Assocs., 749 F.2d 410, 425 (7th Cir. 1984) (quoting Jasik v. Conrad (In re Jasik), 727 F.2d 1379, 1383 (5th Cir. 1984)). Because "[t]he bankruptcy judge is in the best position to assess the good faith of the parties' proposals," id. (alteration in original) (citation omitted), we review the question of good faith for clear error, see Hanson, 828 F.2d at 1312, 1315 (articulating the standard of review).

[9] We hold that the bankruptcy court did not clearly err in finding that the Debtors proposed their plan in good faith. The record shows that the Debtors mediated with their creditors to resolve a major dispute between those creditors. The Debtors reached a settlement with substantial input from the negotiating parties. Other creditors who received notice, including members of the Ad Hoc Committee, could have joined had they chosen to intervene in the mediation. The settlement revolved around a plan that allowed all first-lien holders to be paid off, all second-lien holders to receive approximately 52.4% of the face value of their claims, and all unsecured creditors to receive approximately 22.1% of their claims' face value. The plan garnered tremendous consensus—all twenty classes of creditors voted overwhelmingly to approve the plan and approximately 95% of the Debtors' unsecured creditors agreed to participate in the Private Placement and make backstop commitments. And the Debtors permitted alternative plans to be proposed, all of which the Debtors considered with advisors and at board meetings.

[10] The Ad Hoc Committee disagrees, arguing that the plan failed to maximize value. We acknowledge that the Debtors might have made more money selling the preferred stock at full price. However, this argument ignores the point that the Debtors might not have convinced the parties to the security-interest dispute to settle or commit to any number of the other agreements if the Debtors had not offered the preferred stock at a discount. The Debtors' overall efforts to reorganize might have otherwise been thwarted had they followed the course proposed by the Ad Hoc Committee. We cannot look merely at the potential virtues of the Ad Hoc Committee's proposed alternative while ignoring the potential risks involved. See In re Madison Hotel Assocs., 749 F.2d at 425 (stating that when considering whether a plan has been proposed in good faith, the totality of the circumstances must be considered).

The Ad Hoc Committee also argues that the Noteholder Co-Proponents received a disproportionate opportunity to participate in the Private Placement. We see no merit to their concern. A sub-group of a creditor class certainly obtained favored treatment by participating in the mediation and in the offerings formulated in that mediation. However, that sub-group took on more obligations than other members of the class: They put themselves on the hook to buy more of the preferred stock if it did not sell, something that might easily have happened as the Debtors were emerging from mediation during volatile coal-market seasons.

Finally, the Ad Hoc Committee argues that the Debtors coercively solicited votes in favor of the plan. We are somewhat sympathetic to this argument. It is troubling that creditors wishing to take part in the Private Placement had to elect to do so before approval of all the agreements and the disclosure statement. We are convinced, however, by the Debtors' argument that time was of the essence given the volatile nature of the coal market. Moreover, as noted above, delay was likely to cost the Debtors around $30 million per month in addition to other litigation costs. We also find convincing an argument made by the Official Committee that, were it not for the existence of a support agreement, Private Placement parties might have had an incentive to sabotage the plan and obtain breakup fees should coal-market conditions worsen.

Thus, despite any reservation we might have regarding the good faith question, we have not been left with a "definite and firm conviction that a mistake has been committed." Hill, 919 F.3d at 1084 (citation omitted). We therefore do not disturb the bankruptcy court's factual finding that the Debtors proposed their plan in good faith.

III. Conclusion

We affirm the judgment of the district court on the merits.

UNITED STATES of America, Plaintiff - Appellee,

v.

David RUELAS-CARBAJAL, Defendant - Appellant.

No. 18-2454

United States Court of Appeals, Eighth Circuit.

Submitted: May 17, 2019

Filed: August 9, 2019

Background: Defendant was convicted in the United States District Court for the

2018 WL 11435661
Only the Westlaw citation is currently available.
United States Bankruptcy Court, S.D. New York.

IN RE: PACIFIC DRILLING S.A., et al., Debtors.

Case No. 17-13193 (MEW) (Jointly Administered)
|
Signed October 1, 2018

Attorneys and Law Firms

For the Debtors: TOGUT, SEGAL & SEGAL LLP, One Penn Plaza, New York, NY 10119, BY: ALBERT TOGUT, KYLE J. ORTIZ.

For Quantum Pacific: SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, Four Times Square, New York, NY 10036, BY: JAY M. GOFFMAN, GEORGE R. HOWARD.

For the Ad Hoc Group of Bondholders: PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP, 1285 Avenue of the Americas, New York, NY 10019, BY: ANDREW N. ROSENBERG.

For the RCF Group: WHITE & CASE LLP, 1221 Avenue of the Americas, New York, NY 10020, BY: CHARLES R. KOSTER.

For Citibank as RCF Agent: SHEARMAN & STERLING LLP, 599 Lexington Avenue, New York, NY 10022, BY: NED SCHODEK.

For Samsung Heavy Industries Co. Ltd.: DLA PIPER LLP, 120 North Market Street, Suite 2100, Wilmington, DE 19801, BY: R. CRAIG MARTIN.

For the Office of the United States Trustee: UNITED STATES DEPARTMENT OF JUSTICE, 201 Varick Street, Room 1006, New York, NY 10014, BY: BENJAMIN J. HIGGINS.

For the SSCF Agent: MILBANK, TWEED, HADLEY & MCCLOY LLP, 28 Liberty Street, New York, NY 10005, BY: MATTHEW BROD.

For Credit Suisse: CRAVATH, SWAINE & MOORE LLP, Worldwide Plaza, 625 Eighth Avenue, New York, NY 10019, BY: PAUL H. ZUMBRO.

Proposed Counsel for the Official Committee of Unsecured Creditors: BRINKMAN PORTILLO RONK APC, 4333 Park Terrace Drive, #205, Westlake Village, CA 91361, BY: DAREN BRINKMAN, LAURA PORTILLO.

BENCH DECISION REGARDING MOTION FOR APPROVAL OF TERMS OF EQUITY RIGHTS OFFERING AND EQUITY COMMITMENT AGREEMENT

MICHAEL E. WILES, UNITED STATES BANKRUPTCY JUDGE

*1 This is the final version of a bench decision that the Court announced in open court on September 25, 2018.

Before me is the Debtors' motion for approval of the terms under which additional equity capital will be raised in connection with the proposed plan of reorganization. I will not keep everybody in suspense: I am going to approve the arrangements, but not without a great deal of misgivings, which I am going to explain.

The proposed arrangements were negotiated during the course of a mediation supervised by former Judge Peck. The participants in the mediation included certain holders of fully secured obligations, a separate ad hoc group of holders of three classes of secured debts that apparently are undersecured, and Quantum Pacific, the majority equity owner, which I shall refer to as "QP."

As originally proposed in early August, the structure was similar to one that has become increasingly common in Chapter 11 cases. More particularly, the proposal called for $400 million to be raised through a rights offering. The opportunity to participate in the rights offering would be provided only to holders of the three classes of undersecured debts. Those holders would be given the opportunity to buy common stock at a 46.9 percent discount to the stipulated and expected value of that equity under the plan.

In addition, the proposal called for a private placement of $100 million pursuant to which the so-called Ad Hoc Group would have the exclusive right to buy additional stock, which would be sold for $100 million but at the same 46.9 percent discount to expected plan value.

The Ad Hoc Group also proposed to provide a backstop under which the Ad Hoc Group guaranteed its own purchases of stock and under which the Ad Hoc Group would have the exclusive right to buy any shares that other eligible holders did not subscribe to purchase pursuant to the rights offering. The backstop would ensure that the full $500 million would be raised under the various equity sales, and in exchange the proposal called for a backstop fee equal to 8 percent of the amount of stock to be issued pursuant to the offering, payable in common stock. Eight percent of $500 million is $40 million but since the eight percent fee was to be payable in the form of a percentage of the steeply discounted stock to be issued, the fee actually had an expected value of much greater than $40 million.

When this proposed structure was first before the Court early August, it was met with strong opposition from QP, which had its own proposal that it wanted to make. The QP proposal also contemplated a $500 million equity raise but it differed from the Ad Hoc Group proposal in at least three ways. First, the proposed backstop fee would be 7 percent rather than 8 percent. Second, the backstop premium would be available to any creditor participating in the rights offering who committed to make a purchase on or before an early election deadline that was to be established, but that was not described any further in the papers that I received. Third, QP proposed a $100 million private placement in which it, not the Ad Hoc Group, would be the buyer, but it proposed a slightly higher buy-in price than was proposed in the Ad Hoc Group proposal.

*2 I raised questions about the proposals on August 9 and expressed some skepticism about the structure and the fees. I asked if the Debtors had explored the option of raising equity in the markets and whether the Debtors had done their homework, so to speak, as to whether better terms might be available in the market. The answer at that time in so many words was that the Debtors had not done so. The Debtors have offered different explanations since then as to why they agreed to this structure, but at least on August 9th the answer essentially was that this was being proposed because it raised the amount of money the Debtors wanted and it was the structure that the Ad Hoc Group wanted.

I also asked why the private placements were being set aside either for the Ad Hoc Group (under its proposal) or for QP (under its proposal); why there was a need for a backstop at all, since the parties in front of me seem to be fighting for the chance to buy the equity at the proposed discounted price; and why such a large backstop fee of eight percent was needed in light of the fact that equity was to be sold at a very large 46.9 percent discount to expected value.

I did not get answers at that time that were very specific or very satisfactory, though in fairness to the parties, the structure had just been agreed to and was not actually before me for approval on that date. I noted on August 9th that rights offering structures like this can be a proper and useful way of raising financing, and that backstop fees can be appropriate when real risks are taken and when the fees are proportionate to those risks, but that like every other tool that has been invented they can be misused.

The theory of the Bankruptcy Code is that when the big creditors sit in a room and negotiate a deal, the little creditors who are in the same boat get the same deal. The Bankruptcy Code does not permit the unequal treatment of creditors in the same class; it also does not permit the payment of extra compensation to large creditors in exchange for their commitment to vote for a plan. The problem with special allocations in rights offerings, or with private placements that are limited to the bigger creditors who sat at the negotiating table, or big backstop fees that are paid to the bigger creditors who sat at the negotiating table but that are not even open to other creditors (and in particular to other creditors in the same class), is that it is far too easy for the people who sit at the negotiating table to use those tools primarily to take for themselves a bigger recovery than smaller creditors in the same classes will get. The Code allows for reasonable financing terms but they must be reasonable, and they cannot just be a disguised means of giving bigger creditors a preferential recovery. I therefore made clear that to the extent that these terms were being presented to me as reasonable financing terms, the parties would need to convince me that the terms were reasonable as a financing matter and were better than other options.

After the August 9th hearing, the parties returned to mediation, and since that time they have resolved their differences. The size of the proposed rights offering was changed to $350 million. In addition to the proposed $100 million private placement for the Ad Hoc Group, the parties proposed a separate $50 million private placement to QP on the same terms. The proposed backstop arrangement remained the same: the Ad Hoc Group would be paid an eight percent fee, payable on stock, with respect to the entire $500 million offering. The parties also entered into a Plan Support Agreement, which as I have noted previously, has not been presented for my approval and which contains some terms that I have previously said I would not approve.

*3 Last week, on September 18th, the parties appeared before me with their request for approval of the backstop fees and rights offering procedures. I heard evidence in the form of the testimony of Mr. Celentano of Evercore, the Debtor's investment banker. At the conclusion of the hearing, I made a few rulings.

First, I ruled that no legitimate justification had been offered for the proposed separate private placement to the Ad Hoc Group. I noted that the terms were to be the same as the proposed terms under the rights offering, and that in substance, if not in form, the proposed private placement was just a way of giving the Ad Hoc Group a disproportionate share of the rights offering. Counsel to the Ad Hoc Group agreed that the private placement would be eliminated and that the shares that would have been covered by the private placement to the Ad Hoc Group would instead be part of the rights offering for which all holders would be eligible.

Second, I ruled last week that the Debtors had failed to show the reasonableness of the proposed backstop fee, or the need for it in certain instances. During the hearing, the Debtors pointed to other bankruptcy cases in which large backstop fees have been paid. But Mr. Celentano readily acknowledged that he could think of no out-of-bankruptcy market context in which people who are being given the exclusive opportunity to buy stock at an expected 46.9 percent discount were nevertheless also paid an eight percent fee in exchange for their willingness to take advantage of that golden opportunity. In addition, Mr. Celentano acknowledged that even in prior bankruptcy cases there were few instances, if any, in which equity was offered at so steep a discount and in which parties nevertheless were paid such a high fee as the eight percent fee that was being proposed.

Some prior decisions have justified backstop fees by reference to put options since the backstop includes a commitment to buy at a fixed price no matter what the real value turns out to be. But there are several flaws in that analogy.

First, in most of the cases where these structures have been proposed the equity is offered at a steep discount to expected value. In this case, for example, the proposed discount is 46.9 percent. That means that the put option is very much out of the money. The more out of the money a put option is, the less the premium that it ought to command.

Second, there are features to the typical backstop arrangement that are far different from a typical put option. In a straight put option, the seller of the option takes the risk that it will have to buy the security if prices fall below the exercise price. But if prices stay above the exercise price, then the option will not be exercised. In that case, the seller of the put option gets nothing except the right to retain the option premium, and the option premium is paid in exchange for the risk that the price might fall.

In this case, though, and in other bankruptcy cases where similar structures have been proposed, the party who provides the backstop also is being given an exclusive right to buy at a discount. In other words, the backstop provider does not merely take the risk of a lower price. Instead, the backstop party also gets the benefit of the expected discount. That is more akin to being given a call option. It is a right that has additional value that ought to be valued and taken into account in determining, as a reasonable financing matter, whether a backstop fee is needed at all, or what a reasonable backstop fee should be.

*4 Here, the evidence that I received last week did not suggest that a backstop fee was needed or proper. I ruled after considering the evidence that the eight percent fee could be paid with respect to shares for which no commitments were yet in place, but that the fee had not been justified as a financing matter as to other portions of the proposed offering, including those to which QP and other creditors had committed and to which the Ad Hoc Group itself had committed. However, I also scheduled this further hearing today in case the parties wished to present additional evidence.

In advance of this hearing the parties have submitted a revised proposal that eliminates the proposed private placement to the Ad Hoc Group and that provides that $460 million of equity will be raised to a rights offering in which all members of the three impaired secured classes will be entitled to participate. They have also proposed that the Ad Hoc Group be paid a backstop fee equal to 8 percent of the uncommitted portions of the equity offering and 5 percent as to the rest. Again, that fee would be payable in stock. The parties have submitted an additional brief and an additional declaration that emphasizes the benefits to the Debtors of having obtained committed equity financing, and that repeats arguments that were previously made regarding the risks that allegedly are involved in providing the backstop. Mr. Celentano has also provided additional evidence as to not only fees approved in other bankruptcy cases but regarding committed underwriting fees that have been paid in a number of out-of-bankruptcy financings.

I have considered the additional evidence that has been provided and the revised terms of the proposed arrangements. As I said at the outset of my remarks here, I have misgivings. I have misgivings mainly because I am not completely satisfied with the evidence that I have as to the reasonableness of the proposed fee. There are tools that investment bankers and securities professionals use to calculate option values. There are option formulas that take account of how the exercise price compares to the current value (which in this case would be the expected plan value) and that take account of potential market volatility. As a general matter, the higher the market volatility, the higher the option value. In this case, the parties have made many submissions in which they have trumpeted the risks that oil prices might decline, but nobody has made any effort to calculate the actual degree of risk involved here, or to calculate the actual value of the put option portion of the backstop fee, or to calculate just how volatile the markets would have to be in order to justify an option fee of the size that has been proposed, given how out-of-the-money the put option would be.

I have been provided with evidence of committed underwriting fees that have been charged in cases outside bankruptcy. It is true, as the Debtors suggest, that in those cases the commitments usually were made only a few days before the sales of the relevant securities, and that significantly reduced the risks to the parties providing the commitments. But it is also the case that the prices to which the parties committed themselves in those instances were much closer to the expected values, as opposed to the steep 46.9 percent discounts that are being offered here.

I have also been given evidence of backstop fees that courts have approved in some other bankruptcy cases, but many of those were uncontested, and nobody has pointed me to any prior decision in which a court has approved these fees with any actual discussion of the evidence as to the economic reasonableness of a particular backstop fee, or as to how the reasonableness of such a fee should properly be evaluated.

*5 The parties have also urged me to approve the eight percent fee in reliance on the Debtors' business judgment. But in considering such arguments courts should not lose sight of the fact that these fees are typically payable in stock. As a result, they have no practical effect on the Debtors themselves. The real effect is on other creditors, because the issue of the added shares dilutes the value of the shares that those other creditors will receive.

Furthermore, the principle to be guarded here is one that requires equal treatment of similarly situated creditors, which is more a matter of bankruptcy philosophy than it is a matter of business judgment. As I said last week, as a business matter the Debtors just want to get out of bankruptcy. They can agree to reasonable fees as part of a financing, but it is for the courts to decide whether fees are reasonable or not and to decide whether, in effect, some larger creditors are really being given an unequal and preferential treatment that is disguised as a financing term.

I cannot help but continue to be skeptical based on the evidence I have as to the proposed backstop fee and the alleged need for it in this case. That is particularly true as to the Ad Hoc Group's own commitments to exercise their rights in the rights offering. They have ample economic incentive to exercise those rights and, in fact, participated in structuring those rights to make them attractive to themselves. They have already committed to exercise their rights as part of a Plan Support Agreement with other parties. I am concerned that nobody else was given a similar opportunity, which raises the possibility again that the backstop fee is really just an extra payment and an extra recovery rather than a reasonable, stand-alone financing term.

But, on the other hand, while I have expressed my own concerns many times over the past several weeks in the hearings on this matter, not one of the relevant indenture trustees and not a single holder of any of the relative debts has come forward to complain about the proposed terms. Instead, the Debtors and all of the other parties have in unison asked me to approve these revised arrangements.

I may be skeptical about what the evidence would show if objections were filed. I hope that in the future when these structures are presented, the parties will explore in more detail the issues and concerns that I have raised. But this is the wrong case in which to make rulings, particularly based only on skepticism. I have to rule on the evidence that is actually before me. While I have strong doubts, those doubts are not enough, without more and without any objections, for me to reject the terms that the parties have negotiated and for which they have sought approval today. So I will approve the revised arrangements that have been presented.

All Citations

Slip Copy, 2018 WL 11435661

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

NOT FOR PUBLICATION

In re:	:	
LATAM Airlines Group S.A., et al.,	:	Case No. 20-11254 (JLG) Chapter 11
Debtors.[1]	:	(Jointly Administered)

MEMORANDUM DECISION ON CONFIRMATION OF THE JOINT PLAN OF REORGANIZATION OF LATAM AIRLINES GROUP, S.A. *ET AL.* UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

A P P E A R A N C E S :

CLEARY GOTTLIEB STEEN &
HAMILTON LLP
Counsel for the Debtors and Debtors in Possession
One Liberty Plaza
New York, New York 10006
By: Jeffrey A. Rosenthal, Esq.
Lisa M. Schweitzer, Esq.
David H. Herrington, Esq.
Abena A. Mainoo, Esq.

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's tax identification number (as applicable), are: LATAM Airlines Group S.A. (59-2605885); Lan Cargo S.A. (98-0058786); Transporte Aéreo S.A. (96-9512807); Inversiones Lan S.A. (96-5758100); Technical Training LATAM S.A. (96-847880K); LATAM Travel Chile II S.A. (76-2628945); Lan Pax Group S.A. (96-9696800); Fast Air Almacenes de Carga S.A. (96-6315202); Línea Aérea Carguera de Colombia S.A. (26-4065780); Aerovías de Integración Regional S.A. (98-0640393); LATAM Finance Ltd. (N/A); LATAM Airlines Ecuador S.A. (98-0383677); Professional Airline Cargo Services, LLC (35-2639894); Cargo Handling Airport Services, LLC (30-1133972); Maintenance Service Experts, LLC (30-1130248); Lan Cargo Repair Station LLC (83-0460010); Prime Airport Services Inc. (59-1934486); Professional Airline Maintenance Services LLC (37-1910216); Connecta Corporation (20-5157324); Peuco Finance Ltd. (N/A); Latam Airlines Perú S.A. (52-2195500); Inversiones Aéreas S.A. (N/A); Holdco Colombia II SpA (76-9310053); Holdco Colombia I SpA (76-9336885); Holdco Ecuador S.A. (76-3884082); Lan Cargo Inversiones S.A. (96-9696908); Lan Cargo Overseas Ltd. (85-7752959); Mas Investment Ltd. (85-7753009); Professional Airlines Services Inc. (65-0623014); Piquero Leasing Limited (N/A); TAM S.A. (N/A); TAM Linhas Aéreas S.A. (65-0773334); Aerolinhas Brasileiras S.A. (98-0177579); Prismah Fidelidade Ltda. (N/A); Fidelidade Viagens e Turismo S.A. (27-2563952); TP Franchising Ltda. (N/A); Holdco I S.A. (76-1530348) and Multiplus Corredora de Seguros Ltda. (N/A). For the purpose of these chapter 11 cases, the service address for the Debtors is: 6500 NW 22nd Street Miami, FL 33131.

TOGUT, SEGAL & SEGAL LLP
Counsel to the Debtors and Debtors in Possession as to the Conflicted Claims
One Penn Plaza, Suite 3335
New York, New York 10119
By: Albert Togut, Esq.
Kyle J. Ortiz, Esq.
Bryan M. Kotliar, Esq.

KRAMER LEVIN NAFTALIS & FRANKEL LLP
Counsel to the Parent Ad Hoc Claimant Group
1177 Avenue of the Americas
New York, New York 10036
By: Kenneth H. Eckstein, Esq.
Rachael L. Ringer, Esq.
David E. Blabey Jr., Esq.
Natan Hamerman, Esq.
Douglas Buckley, Esq.
Andrew Pollack, Esq.

WHITE & CASE LLP
Counsel for the Ad Hoc Group of LATAM Bondholders
1221 Avenue of the Americas
New York, New York 10020
By: John K. Cunningham, Esq.
Brian D. Pfeiffer, Esq.
Gregory M. Starner, Esq.
Joshua Weedman, Esq.
Kathryn Sutherland-Smith, Esq.

200 South Biscayne Blvd., Suite 4900
Miami, Florida 33131
By: Richard S. Kebrdle, Esq. (admitted *pro hac vice*)
Varoon Sachdev, Esq. (admitted *pro hac vice*)

WACHTELL, LIPTON, ROSEN & KATZ
Counsel for Costa Verde Aeronáutica S.A. and Lozuy S.A.
51 West 52nd Street
New York, New York 10019
By: Richard G. Mason, Esq.
John R. Sobolewski, Esq.
Angela K. Herring, Esq.

ALSTON & BIRD LLP
Counsel for Qatar Airways Investments (UK) Ltd.
90 Park Avenue
New York, New York 10016
By: Gerard S. Catalanello, Esq.
James J. Vincequerra, Esq.

DAVIS POLK & WARDWELL LLP
Counsel for Delta Air Lines, Inc
450 Lexington Avenue
New York, New York 10017
By: Marshall S. Huebner, Esq.
Lara Samet Buchwald, Esq.
Adam L. Shpeen, Esq.

ARNOLD & PORTER KAYE SCHOLER LLP
Counsel to the Ad Hoc Group of Unsecured Claimants
70 West Madison Street, Suite 4200
Chicago, Illinois 60602
By: Michael D. Messersmith, Esq. (admitted *pro hac vice*)
Sarah Gryll, Esq.

250 West 55th Street
New York, New York 10019
By: Jeffrey A. Fuisz, Esq.
Robert T. Franciscovich, Esq.
Madelyn Nicolini, Esq.

WILLIAM K. HARRINGTON
UNITED STATES TRUSTEE, REGION 2
201 Varick Street, Room 1006
New York, New York 10014
By: Brian S. Masumoto, Esq.

PAUL HASTINGS LLP
Counsel for the TLA Claimholders Group
200 Park Avenue
New York, New York 10166
By: Daniel A. Fliman, Esq.
Christopher M. Guhin, Esq.
Emily L. Kuznick, Esq.
John F. Iaffaldano, Esq.

HUNTON ANDREWS KURTH LLP
Counsel to Columbus Hill Capital Management, L.P.
200 Park Avenue
New York, New York 10166
By: Paul N. Silverstein, Esq.
Brian Clarke, Esq.
Philip M. Guffy, Esq.

K&L GATES LLP
Counsel to 777 Components Leasing, LLC, GA Telesis, LLC and TC Skyward Aviation U.S., Inc.
599 Lexington Avenue
New York, New York 10022
By: Robert T. Honeywell, Esq.

MILBANK LLP
Counsel to Citibank, N.A. and Banco Citibank S.A., as L/C Issuers
55 Hudson Yards
New York, New York 10001
By: Tyson M. Lomazow, Esq.
Eric K. Stodola, Esq.
Andrew C. Harmeyer, Esq.

Mr. Jose M. Orozco Jr.
Appearing Pro Se
1173 Front Street
San Diego, CA 92101

DECHERT LLP
Counsel to the Official Committee of Unsecured Creditors
1095 Avenue of the Americas
New York, New York 10036
By: Allan S. Brilliant, Esq.
G. Eric Brunstad, Jr., Esq.
Craig P. Druehl, Esq.
David A. Herman, Esq.

PAUL HASTINGS LLP
Counsel to Banco del Estado de Chile, in its capacity as indenture trustee under the Chilean Local Bonds Series A through D and Series E issued by LATAM Airlines Group S.A.
200 Park Avenue
New York, New York 10166
By: Pedro A. Jimenez, Esq.
Andrew Tenzer, Esq.
Nicholas Bassett, Esq.
Douglass Barron, Esq.

HON. JAMES L. GARRITY, JR.
U.S. BANKRUPTCY JUDGE

Introduction[2]

LATAM Airlines Group S.A. ("LATAM Parent") and certain of its affiliates, are debtors and debtors in possession in these Chapter 11 Cases (the "Debtors"). The matter before the Court is the Debtors' request for the entry of an order (the "Confirmation Order") confirming their Seventh Revised Joint Plan of Reorganization of LATAM Airlines Group, S.A. et. al. Under Chapter 11 of the Bankruptcy Code [ECF No. 5331] dated May 11, 2022 (as may be revised, amended, restated, supplemented, altered or modified from time to time, the "Plan"), and as supplemented by the Plan Supplement (as may be revised, amended, restated, supplemented, altered or modified from time to time) pursuant to section 1129 of title 11 of the United States Code (as amended, the "Bankruptcy Code").

The following parties in interest filed objections to Plan confirmation (collectively, the "Plan Objections"): William K. Harrington, as the United States Trustee for Region 2 (the "U.S.

2 Capitalized terms used but otherwise not defined shall have the meanings ascribed herein or in the Plan or Disclosure Statement as applicable. References herein to "[ECF No.__]" are to documents filed on the electronic docket in these Chapter 11 Cases (Case No. 20-11254).

Trustee"),[3] the TLA Claimholders Group (the "TLA Claimholders"),[4] Columbus Hill Management, L.P. ("Columbus Hill"),[5] the Ad Hoc Group of Unsecured Claimants (the "A&P Ad Hoc Group"),[6] and Mr. Jose Manuel Orozco.[7] In addition, 777 Components Leasing, LLC and Certain Lenders filed a limited objection to confirmation (the "777 Limited Objection"),[8] and Citibank, N.A. and Banco Citibank S.A. jointly filed a statement and reservation of rights in connection with the Plan (the "Citibank Statement").[9] On May 2, 2022, each of the Official Committee of Unsecured Creditors (the "Committee") and Banco del Estado de Chile ("BancoEstado"), in its capacity as indenture trustee under the Chilean Local Bonds Series A through D and Series E issued by LATAM Parent, also filed an objection to the Plan.[10] Both

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[3] Objection of the U.S. Trustee to Revised Joint Plan of Reorganization of LATAM Airlines Group S.A. et al., Under Chapter 11 of the Bankruptcy Code [ECF No. 5176] (the "U.S. Trustee Obj."); Supplemental Objection to Confirmation and Mot. of the U.S. Trustee to Designate the Votes of Creditors Pursuant to Section 1126(e) of the Bankruptcy Code for the Debtors' Violation of Section 1125(b) of the Bankruptcy Code [ECF No. 5217] (the "U.S. Trustee Suppl. Obj.").

[4] Objection of the TLA Claimholders Group to Confirmation of the Debtors' Proposed Plan [ECF No. 5175] (the "TLA Claimholders Obj."); Supplemental Objection of the TLA Claimholders Group to Confirmation of the Debtors' Proposed Plan [ECF No. 5485] (the "TLA Claimholders Suppl. Obj.").

[5] Columbus Hill Capital Management's Objection to Confirmation of the Joint Plan of Reorganization of LATAM Airlines Group S.A., et al., Under Chapter 11 of the Bankruptcy Code [ECF No. 5177] (the "Columbus Hill Obj.").

[6] Objection of the Ad Hoc Group of Unsecured Claimants to Confirmation of the Debtors' Joint Plan of Reorganization [ECF No. 5202] (the "A&P Ad Hoc Group Obj.").

[7] Petitioner Objection of Jose Manuel Orozco [ECF No. 5103] (the "Orozco Objection").

[8] Limited Objection of 777 Components Leasing, LLC and Certain Lenders to Debtors' Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code [ECF No. 5171].

[9] Statement and Reservation of Rights of Citibank, N.A. and Banco Citibank S.A. in Connection with the Confirmation of the Joint Plan of Reorganization of LATAM Airlines Group S.A., et al. Under Chapter 11 of the Bankruptcy Code [ECF No. 5174].

[10] Objection of the Official Committee of Unsecured Creditors to Confirmation of the Debtors' Sixth Revised Joint Plan of Reorganization of LATAM Airlines Group S.A. et al., Under Chapter 11 of the Bankruptcy Code [ECF No. 5195]; Reservation of Rights and Supplement to the Objection of the Official Committee of Unsecured Creditors to Confirmation of the Debtors' Sixth Revised Joint Plan of Reorganization of LATAM Airlines Group S.A. et al., Under Chapter 11 of the Bankruptcy Code. [ECF No. 5281]; Objection of Banco del Estado de Chile to the Joint Plan of Reorganization of LATAM Airlines Group, S.A. et al Under Chapter 11 of the Bankruptcy Code [ECF No. 5207].

parties have since withdrawn their objections.[11] The Debtors filed the Debtors Omnibus Reply[12] to the Plan Objections, the 777 Limited Objection and the Citibank Statement. The Ad Hoc Group of LATAM Bondholders (the "W&C Ad Hoc Group"), Parent Ad Hoc Claimant Group (the "Parent GUC Ad Hoc Group"), Costa Verde Aeronáutica S.A. and Lozuy S.A., Delta Air Lines, Inc. ("Delta") and Qatar Airways Investments (UK) Ltd. ("Qatar") filed statements in support of Plan confirmation.[13]

The Court conducted an evidentiary hearing with respect to Plan confirmation.[14] On the record of that hearing, the Court overruled the Orozco Objection, and addressed and resolved the 777 Limited Objection and the matters raised in the Citibank Statement. The Court incorporates those rulings herein and will not further consider those matters. Based on the evidence of record

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[11] Notice of Withdrawal of Objection of Banco del Estado de Chile to Joint Plan of Reorganization of LATAM Airlines Group S.A., et al. under Chapter 11 of the Bankruptcy Code [ECF No. 5335]; Notice of Withdrawal of Objections of the Official Committee of Unsecured Creditors to Confirmation of the Debtors' Revised Joint Plan of Reorganization [ECF No. 5336].

[12] Memorandum of Law in Support of Confirmation and Omnibus Reply to Objections to Confirmation of the Plan of Reorganization of LATAM Airlines Group S.A., Et Al., Under Chapter 11 of the Bankruptcy Code [ECF No. 5373]. The Debtors also filed two supplemental replies specific to the U.S. Trustee Supplemental Objection and the TLA Claimholders Supplemental Objection. *See* Debtors Reply to the U.S. Trustee's Supplemental Objection to Confirmation of the Debtors' Plan of Reorganization [ECF No. 5374] (the "Reply to U.S. Trustee Suppl. Obj."); Debtors' Reply to the Supplemental Objection of the TLA Claimholders Group [ECF No. 5486] (the "Reply to TLA Claimholders Suppl. Obj.").

[13] Statement of the Ad Hoc Group of LATAM Bondholders in Support of Confirmation of the Seventh Revised Joint Plan and Reservation of Rights to the Objection of the Official Committee of Unsecured Creditors and Banco del Estado de Chile [ECF No. 5343]; Parent Ad Hoc Claimant Group's Reply to Plan Objections [ECF No. 5355] (the "Parent GUC Ad Hoc Group Reply"); Statement of Costa Verde Aeronautica S.A. and Lozuy S.A. in Support of Confirmation of the Debtors' Plan of Reorganization [ECF No. 5352]; Statement of Delta Air Lines, Inc. in Support of Confirmation of Debtors' Modified Seventh Revised Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code [ECF No. 5354]; and (I) Statement of Qatar Airways Investments (UK) Ltd. In Support of Confirmation of the Joint Plan of Reorganization of LATAM Airlines Group, S.A., Et Al. Under Chapter 11 of the Bankruptcy Code, (II) Reply to the Obj. Thereto, And (III) Reservation of Rights Thereto [ECF No. 5353].

[14] May 17, 2022 Hr'g Tr. [ECF No. 5511] (the "May 17, 2022 Hr'g Tr. – Public Session"); May 17, 2022 Hr'g Tr. (Sealed Portion) [not filed]; May 18, 2022 Hr'g Tr. [ECF No. 5499]; May 20, 2022 Hr'g Tr. [ECF No. 5513] (the "May 20, 2022 Hr'g Tr. – Public Session"); and May 20, 2022 Hr'g Tr. (Sealed Portion) [ECF No. 5662].

and for the reasons stated herein, the Court overrules the remaining Plan Objections and confirms the Plan. The Court will enter an appropriate Confirmation Order.[15]

Jurisdiction

The Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Amended Standing Order of Reference from the United States District Court for the Southern District of New York dated January 31, 2012 (Preska, C.J.). This matter is a core proceeding pursuant to 28 U.S.C. § 157(b).

Background

LATAM Parent is a publicly traded company incorporated in Chile. *See* Alfonsín First Day Decl. ¶¶ 5, 14.[16] LATAM[17] is Latin America's leading airline group, with a history extending back ninety years and boasting one of the largest route networks in the world. *Id.* ¶ 2. Before the onset of the COVID-19 pandemic, LATAM had a total fleet of 340 aircraft (comprised of aircraft operated by LATAM and aircraft that are leased to third parties), and offered passenger transportation services to 145 different destinations in twenty-six countries, including domestic flights in Argentina, Brazil, Chile, Colombia, Ecuador and Perú and international services within Latin America as well as to the United States, Europe, the Caribbean, Oceania, Asia and Africa. *Id.* ¶¶ 3, 16-18. While the majority of LATAM's revenues have traditionally come from its passenger airline services, LATAM also offers cargo-related

[15] This constitutes the Court's findings of fact and conclusions of law pursuant to Rule 52(a) of the Federal Rules of Civil Procedure, made applicable here pursuant to Rules 7052 and 9014(c) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

[16] Debtors Tr. Ex. 24 (Declaration of Ramiro Alfonsín Balza In Support of First Day Motions and Applications in Compliance with Local Rule 1007-2) (the "Alfonsín First Day Decl.").

[17] LATAM Parent, and its debtor and non-debtor subsidiaries and affiliates are collectively referred to as "LATAM."

services to 151 destinations in twenty-nine countries. *Id.* ¶¶ 7, 22-23. In 2019, LATAM's consolidated revenues were over $10 billion. *Id.* ¶ 17.

On May 26, 2020 (the "Initial Petition Date"), LATAM Parent and twenty-eight affiliates (collectively with LATAM Parent the "Initial Debtors") filed voluntary petitions under chapter 11 of the Bankruptcy Code in this Court (the "Initial Chapter 11 Cases"). On July 7 and 9, 2020 (the "Subsequent Petition Date" and, together with the Initial Petition Date, as applicable to each Debtor, the "Petition Date"), nine additional LATAM affiliates (the "Subsequent Debtors" and together with the Initial Debtors, the "Debtors") filed voluntary petitions under chapter 11 of the Bankruptcy Code (the "Subsequent Chapter 11 Cases" and together with the Initial Chapter 11 Cases, the "Chapter 11 Cases"). Since the Petition Date, the Debtors have continued to operate their businesses and manage their properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. The Chapter 11 Cases are jointly administered for procedural purposes only. *See* Order Granting Motion for Joint Administration [ECF No. 34].

On May 27, 2020, the Grand Court of the Cayman Islands granted the applications of certain of the Debtors for the appointment of provisional liquidators pursuant to section 104(3) of the Companies Law (2020 Revision). *See* Disclosure Statement (defined below) § IV.A.4. On June 4, 2020, the 2nd Civil Court of Santiago, Chile issued an order recognizing the Chapter 11 Cases with respect to LATAM Parent., Lan Cargo S.A., Fast Air Almacenes de Carga S.A., Latam Travel Chile II S.A., Lan Cargo Inversiones S.A., Transporte Aéreo S.A., Inversiones Lan S.A., Lan Pax Group S.A. and Technical Training LATAM S.A. *Id*. On June 12, 2020, the Superintendence of Companies of Colombia granted recognition to the Chapter 11 Cases. *Id*.

On June 5, 2020, the U.S. Trustee appointed the Committee. *See* Notice of Appointment of Official Committee of Unsecured Creditors [ECF No. 115]. No trustee or examiner has been appointed in any of these Chapter 11 Cases.

In June 2021, the Debtors began distributing to certain interested parties, subject to non-disclosure agreements, an indicative term sheet for a plan of reorganization and associated exit funding for review and feedback and negotiating over sixty non-disclosure agreements with qualified, interested parties in the process. Herlihy Report at 59.[18] Between September and October 2021, the Debtors received non-binding and preliminary proposals and responses from multiple groups of key stakeholders, including: (i) the Parent GUC Ad Hoc Group, (ii) the W&C Ad Hoc Group, (iii) certain of the Debtors' largest shareholders, comprising of Costa Verde Aeronáutica S.A. ("CVA") and Inversiones Costa Verde Ltda y Cia, en Comandita por Acciones ("CVL", together with CVA, "Costa Verde"), Delta and Qatar (together with Delta and CVA, and any Affiliate Transferee (as defined in the Restructuring Support Agreement), the "Backstop Shareholders"). *Id.* The Debtors engaged with these parties regarding potential exit financing and related matters and received various revised non-binding proposals. *Id*. Furthermore, the Debtors and certain Designated Parties engaged in multiple rounds of Court-appointed mediation overseen by the Honorable (Ret.) Allan L. Gropper (the "Mediator") regarding issues in connection with the terms of a proposed restructuring. *Id.* at 59-60.

Ultimately, the mediation process bore fruit as on November 26, 2021, the Debtors and each of the Parent GUC Ad Hoc Group (as signatories of the Restructuring Support

[18] Debtors Tr. Ex. 19 (Second Amended Expert Report and Declaration of Brent Herlihy, PJT Partners LP, dated April 27, 2022) (the "Herlihy Report").

Agreement,[19] the "Commitment Creditors"), Costa Verde, Delta, Qatar and the Eblen Group (the "RSA Shareholders") reached an agreement on a comprehensive restructuring and recapitalization of the Debtors, memorialized in the RSA, allowing the Debtors to emerge from Chapter 11 with an appropriate level of capital and debt, as well as access to substantial liquidity. *Id*. at 60-61. Subsequently, on February 11, 2022, certain members of the W&C Ad Hoc Group advised by Moelis & Company and White & Case LLP, holding approximately 27.7% of the LATAM 2024/2026 Bonds, signed onto the RSA. *Id.* at 62.

The restructuring contemplated under the RSA is reflected in the Plan and provides that LATAM will continue to operate as an integrated group (the "Reorganized Debtors") under LATAM Parent or any successor thereto, on or after the Effective Date (the "Reorganized LATAM Parent"). At its core, the economics of the Plan center on a $5.442 billion new equity capital raise in the Chilean capital market. The new money will be raised through a rights offering (the "ERO Rights Offering") in an amount of $800 million of new common stock of Reorganized LATAM Parent (the "ERO New Common Stock"), and Reorganized LATAM Parent's issuance of three series of convertible notes (the "New Convertible Notes Offerings") consisting of New Convertible Notes Class A (the "Class A Notes"), New Convertible Notes Class B (the "Class B Notes"), and New Convertible Notes Class C (the "Class C Notes" and with the Class A Notes and Class B Notes, the "New Convertible Notes" and, together with the ERO New Common Stock, the "Plan Securities"). *See*

[19] On November 26, 2021, the Debtors filed the Disclosure Statement with Respect to the Joint Plan of Reorganization of LATAM Airlines Group S.A., et al., Under Chapter 11 of the Bankruptcy Code [ECF No. 3667] (as it has been amended, altered, modified, revised or supplemented from time to time, the "Disclosure Statement"). Annexed thereto as Exhibit E was the first draft of the RSA (the "Original RSA"). On May 13, 2022, the Debtors filed the Notice of Filing of Fifth Amendment to Restructuring Support Agreement [ECF No. 370]. On May 16, 2022, the Debtors filed the Notice of Filing Additional Executed Local Bondholder Joinder Agreement to Restructuring Support Agreement [ECF No. 5402]. References to the "RSA" mean the Original RSA as amended and as additionally joined.

Plan §§ 6.1, 6.2. Each offering is subject to the rights of Eligible Equity Holders to exercise their preemptive rights under Chilean law to purchase the Plan Securities. Thus, the offering of each class of the New Convertible Notes will include a preemptive rights offering to Eligible Equity Holders. *See id.*

Key aspects of the Plan are (i) the agreements of the RSA Shareholders to consent to the Plan Securities offerings, and (ii) the agreements of the Commitment Creditors and a subset of the RSA Shareholders (the "Backstop Shareholders") to backstop a total of $5.4 billion of those offerings. The Commitment Creditors will act as a backstop to the ERO Rights Offering and Class C Notes Offering and, as necessary, will purchase up to $400 million of the unsubscribed ERO New Common Stock, and subscribe for and purchase up to $3.269 billion of the unsubscribed Class C Notes. *See* Plan §§ 5.5-5.7, 6.1, 6.2. As consideration for those commitments, the Debtors will pay the Commitment Creditors cash payments (the "Backstop Fees") equal to 20% of the $3.669 billion backstop commitments, or approximately $734 million, and will hold back and offer 50% of the Class C Notes to the Commitment Creditors, for their subscription and purchase under the Plan (the "Direct Allocation"). The Backstop Shareholders (with the Commitment Creditors, the "Backstop Parties") will backstop up to $400 million of the unsubscribed ERO New Common Stock, and up to $1.373 billion of the Class B Notes, subject to the Backstop Shareholders Cap. They will not be paid a fee for those commitments, but, like the Commitment Creditors under their backstop agreement, they are entitled to expense reimbursement and indemnification benefits from the Debtors. Those agreements are reflected in the "Commitment Creditors Backstop Agreement" and the "Backstop Shareholders Backstop Agreement" (collectively, the "Backstop Agreements").

In accordance with the RSA, on January 12, 2022, the Debtors filed a motion seeking authority and approval of the Court for the Debtors' entry into and performance under the Backstop Agreements, and the payment of the Backstop Fees, and reimbursement of expenses in connection therewith (the "Backstop Motion").[20] The Committee, BancoEstado, the A&P Ad Hoc Group and Columbus Hill each filed an objection to the Backstop Motion (collectively, the "Backstop Objections").[21] On February 10 and 11, 2022, the Court conducted a two-day evidentiary hearing on the Backstop Motion.[22] Thereafter, the Court issued its Memorandum Decision granting the Backstop Motion and overruling the Backstop Objections (the "Backstop Opinion").[23] The Court issued a corresponding order granting the Backstop Motion (the "Backstop Order").[24] Certain parties appealed the Backstop Opinion.[25] On May 10, 2022, the Honorable Jesse M. Furman of the Southern District of New York dismissed the appeals. *In re LATAM Airlines Group S.A.*, No. 22-CV-2556 (JMF), Opinion and Order (S.D.N.Y. May 10, 2022).

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[20] Debtors' Motion for Entry of an Order (I) Authorizing and Approving the Debtors' (A) Entry Into and Performance Under Backstop Agreements and (B) Payment of Related Fees and Expenses and Incurrence of Certain Indemnification Obligations, and (II) Granting Related Relief [ECF No. 4056].

[21] Columbus Hill Capital Management L.P.'s Objection to the Debtors' Motion [ECF No. 4184]; Objection of the Official Committee of Unsecured Creditors to the Debtor's Motion, [ECF No. 4289]; Objection of Banco del Estado de Chile to the Debtors' Motion [ECF No. 4293]; Objection of the Ad Hoc Group of Unsecured Claimants [ECF No. 4291].

[22] A&P Ad Hoc Group Tr. Ex. 116 (Feb. 10, 2022 Hr'g Tr.); and A&P Ad Hoc Group Tr. Ex. 118 (Feb. 11, 2022 Hr'g Tr.).

[23] Memorandum Decision Granting the Debtors' Motion for Entry of an Order Authorizing and Approving the Debtors' Entry Into and Performance Under Backstop Agreements and Payment of Related Fees and Expenses and Incurrence of Certain Indemnification Obligations [ECF No. 4667].

[24] Order (I) Authorizing and Approving the Debtors' (A) Entry into and Performance under the Backstop Agreements and (B) Payment of related Fees and Expenses and Incurrence of Certain Indemnification Obligations, and (II) Granting Related Relief [ECF No. 4732].

[25] Notice of Appeal by Columbus Hill [ECF No. 4924]; Notice of Appeal by A&P Ad Hoc Group [ECF No. 4773]; Notice of Appeal by BancoEstado [ECF No. 4763]; and Notice of Appeal by Committee [ECF No. 4751].

On November 26, 2021, the Debtors filed the Plan and the Disclosure Statement. On March 21, 2022, the Bankruptcy Court entered the order approving the Disclosure Statement, as supplemented (the "Disclosure Statement Order"),[26] and on March 25, 2022, the Debtors filed solicitation versions of the Plan [ECF No. 4776] and Disclosure Statement [ECF No. 4777]. Thereafter, the Debtors caused Kroll Restructuring Administration (formerly known as Prime Clerk LLC) (the "Solicitation Agent") to commence solicitation of votes on the Plan in compliance with the Disclosure Statement Order. After the distribution of Solicitation Packages and Non-Voting Status Notice Packages (each as defined in the Disclosure Statement Order), voting commenced. Consistent with the Disclosure Statement Order, on April 12, 2022, the Debtors filed the plan supplement [ECF No. 5014] (the "First Plan Supplement"), and on May 4, 2022, the Debtors filed the second plan supplement [ECF No. 5243] (the "Second Plan Supplement," together with the First Plan Supplement, the "Plan Supplement"). On May 4, 2022, the Bankruptcy Court entered a supplemental order [ECF No. 5221] approving the solicitation of the votes to accept or reject an amended Plan by Holders of RCF Claims in Class 1, including related solicitation materials and procedures, solely as it relates to the treatment of RCF Claims.

The Plan classifies Holders of Claims and Equity Interests throughout eleven classes. Classes 1, 5 and 7 are classified as impaired. *See* Plan §§ 2.2, 3.2. The Voting Deadline for all Holders of Claims entitled to vote on the Plan, except Holders of Local Bonds and RCF Claims, was May 2, 2022, at 4:00 p.m., prevailing Eastern Time. The Voting Deadline for the Local

[26] Order signed on 3/21/2022 Approving (I) the Adequacy of Information in the Disclosure Statement, (II) Solicitation and Voting Procedures, (III) Forms of Ballots, Notices and Notice Procedures in Connection Therewith, and (IV) Certain Dates With Respect Thereto [ECF No. 4728].

Bonds was May 4, 2022,[27] and the RCF Voting Deadline was May 10, 2022 at 4:00 p.m. On May 6, 2022, the Solicitation Agent filed the Voting Report,[28] and on May 11, 2022, it filed the Supplemental Voting Report.[29] As set forth in those reports, the Plan has been overwhelmingly accepted by Classes 1, 5 and 7.

In connection with the Plan and related RSA filed on May 13, 2022, holders of approximately $490.5 million of Local Bonds now support the confirmation of the Plan, in addition to the accepting Class 5 votes. *See* Notice of Fifth Amendment to Restructuring Support Agreement, Ex. B (Executed RSA Joinders) [ECF No. 5370]. Beginning in April 2022, the Debtors, the Commitment Creditors and BancoEstado began mediation in an effort to resolve BancoEstado's objections to the Plan and related disputes. *See* Herlihy Decl. ¶ 5.[30] In May 2022, the Backstop Shareholders and the Committee joined the negotiations. *Id.* On May 11, 2022, the Debtors announced that they had reached an agreement that would resolve all pending disputes with BancoEstado and the Committee, including BancoEstado's request for substantive consolidation of certain of the Debtors, with the support of the Commitment Creditors and the Backstop Shareholders. *Id.* ¶ 6. The Plan reflects these agreements and settlements. As set out in the Plan, the results of these negotiations include an increase in the overall recoveries to Allowed

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[27] Notice Regarding Extension of Local Bond Trustee's Plan Voting Deadline [ECF No. 5058].

[28] Preliminary Declaration of Alex Orchowski of Kroll Restructuring Administration LLC Regarding the Solicitation of Votes and Tabulation of Ballots Cast on the Joint Plan of Reorganization of LATAM Airlines Group, S.A. et al. Under Chapter 11 of the Bankruptcy Code [ECF No. 5260].

[29] Supplemental Declaration of Alex Orchowski of Kroll Restructuring Administration LLC Regarding the Solicitation of Votes and Tabulation of Ballots Cast on the Joint Plan of Reorganization of LATAM Airlines Group, S.A. et al. Under Chapter 11 of the Bankruptcy Code [ECF No. 5285].

[30] Debtors Tr. Ex. 31 (Declaration of Brent Herlihy, PJT Partners LP, in Further Support of the Debtors' Proposed Plan of Reorganization dated May 12, 2022) (the "Herlihy Decl.").

General Unsecured Class 5 Claims.[31] *Id*. ¶ 7. The parties' agreement also resulted in certain modifications to the Backstop Agreements, including to allow certain Holders of Local Bonds to become parties to the Commitment Creditors Backstop Agreement, and a revised RSA, including executed joinders for Holders of Local Bonds representing more than two-thirds in amount of the outstanding Local Bonds. *Id.* ¶ 10; *see also* Notice of Fifth Amendment to Restructuring Support Agreement, Ex. B (Executed RSA Joinders) [ECF No. 5370].

<u>The Plan Objections</u>

Below, the Court briefly summarizes the Plan Objections.

<u>The TLA Claimholders</u>

The TLA Claimholders are asserting unsecured claims against TAM Linhas Aereas S.A. ("TLA"). Under the Plan, their claims are classified in Class 6. The Plan calls for Holders of Allowed Class 6 Claims to be paid in full (i.e., principal and pre-petition interest, as applicable). *See* Plan § 3.2(f). It provides that Class 6 is unimpaired, and that Holders of Allowed Class 6 Claims do not vote on the Plan. *Id.* The TLA Claimholders assert that TLA is solvent and, as such, that they are entitled to be paid post-petition interest ("PPI") on account of their Class 6 claims. *See* TLA Claimholders Obj. ¶ 25. They maintain that because the Plan fails to provide for the payment of PPI on account of their claims, under section 1124(1) of the Bankruptcy Code, the Class 6 claims are impaired, and the TLA Claimholders are entitled to vote on the Plan. *See Id.* ¶¶ 23-26. They object to confirmation on the grounds that the Plan violates section 1124(1) and thus, fails to comply with section 1129(a)(1) of the Bankruptcy Code. They also contend that

[31] "Allowed General Unsecured Class 5 Claims," as used herein, means the "Allowed General Unsecured Claim[s] against LATAM Parent" as stated in the Plan. *See, e.g.*, Plan § 3.2(e)(ii). "Holders of Allowed General Unsecured Class 5 Claims," as used herein, means the "Holder[s] of [] Allowed General Unsecured Claim[s] against LATAM Parent" as stated in the Plan. *See id*.

the Plan fails to comply with section 1129(a)(8) of the Bankruptcy Code because Class 6 is impaired and did not vote to accept the Plan. *See id.*

<u>Columbus Hill</u>

Columbus Hill contends that the Plan violates Chilean law and as such, the Court cannot confirm the Plan because the Debtors filed it in bad faith in violation of section 1129(a)(3) of the Bankruptcy Code, and because the Plan is not feasible as required under section 1129(a)(11) of the Bankruptcy Code. *See* Columbus Hill Obj. ¶¶ 41-43.

<u>The A&P Ad Hoc Committee</u>

The A&P Ad Hoc Group objects to confirmation on the grounds that

> (i) the Plan does not comply with section 1129(a)(1) of the Bankruptcy Code because it violates section 1123(a)(4) of the Bankruptcy Code, since the Plan provides some, but not all, of the Holders of Allowed General Unsecured Class 5 Claims the ability to receive their pro rata allocation of the Direct Allocation Amount and a share of the Backstop Fees on account of the new ERO Common Stock;
>
> (ii) the Plan calls for the payment of excessive and unreasonable Backstop Fees to the Commitment Creditors in violation of section 1129(a)(4);
>
> (iii) the Corporate Incentive Plan established under the Plan violates section 503(c) of the Bankruptcy Code;
>
> (iv) the Plan violates section 1129(a)(3) of the Bankruptcy Code because it provides economics to the Commitment Creditors that amount to impermissible "vote buying";
>
> (v) the Non-Debtor Releases and Exculpation Clause in the Plan violate the Bankruptcy Code; and
>
> (vi) the Plan may violate the absolute priory rule under section 1129(b)(2) of the Bankruptcy Code.

See A&P Ad Hoc Group Obj. ¶¶ 20, 22-23, 27, 35, 41-42, 44, 55, 59.

The U.S. Trustee

The U.S. Trustee contends that the Plan does not satisfy sections 1129(a)(1) and 1129(a)(4) of the Bankruptcy Code because the Corporate Incentive Plan established under the Plan violates section 503(c) of the Bankruptcy Code. He further asserts that the Non-Debtor Releases and Injunction in the Plan violate the Bankruptcy Code and should be stricken from the Plan and the Exculpation Provision should be modified. *See* U.S. Trustee Obj. at 1, 6-14, 18.

In his supplemental objection, the U.S. Trustee contends that the Debtors solicited votes to accept the Plan from certain Holders of Allowed General Unsecured Class 5 Claims (the "Class 5 Claim Allowance Creditors") in violation of section 1125(b) of the Bankruptcy Code. He contends that the Plan is not confirmable because the Debtors cannot demonstrate that their actions comport with section 1129(a)(2) of the Bankruptcy Code. *See* U.S. Trustee Suppl. Obj. at 14-19.

* * * *

To summarize, the Plan Objections focus on the Debtors' alleged failure to demonstrate that the Plan satisfies section 1129(a)(1) (plan compliance with applicable provisions of title 11), section 1129(a)(2) (plan proponent's compliance with applicable provisions of title 11), section 1129(a)(3) (good faith requirement), section 1129(a)(4) (payments for services or costs under plan must be reasonable), section 1129(a)(8) (class acceptance of the plan), and section 1129(a)(11) (feasibility). The Court will address those matters below in its discussion of the Plan Objections. The Court finds that on the record of the Confirmation Hearing, the Debtors have demonstrated that the Plan complies with all other requirements of section 1129 of the Bankruptcy Code, as set forth in the Confirmation Order. The Court will not further discuss them.

Discussion

The TLA Claimholders Objection

Overview

The TLA Claimholders is an ad hoc group of creditors asserting unsecured claims aggregating approximately $300 million (the "TLA GUCs") against TLA. TLA Claimholders Obj. ¶ 20. The claims are evidenced by certain debt instruments that are governed by Brazilian law.[32] The Debt Instruments each provide for the payment of: (i) interest at specified pre-default rates, (ii) post-default rates of interest of 1% per month, (iii) a 2% post-default late payment charge, and (iv) certain fees and expenses, including attorneys' fees. *Id*. ¶ 9. It is undisputed that a default occurred under each of the Debt Instruments either on the Initial Petition Date, in the case of the BDB CCB and Convenio, or on the Subsequent Petition Date, in the case of the Bradesco CCBs. *Id*. ¶ 10. The Plan classifies TLA GUCs, and all other General Unsecured Claims against each Debtor other than LATAM Parent, Piquero Leasing Limited and LATAM Finance, in Class 6. Plan § 3.2(f).

The Plan provides that Holders of Allowed Class 6 Claims will receive:

(x) Cash equal to the amount of such Allowed Class 6 Claim;

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[32] The TLA GUCs consist of:

(i) that certain *Cédula de Crédito Bancário*, dated April 22, 2020 and numbered 313.202.489 (as reflected in Proof of Claim Nos. 3526 and 3703) (the "BDB CCB");

(ii) that certain *Convênio para Antecipação de Recebiveis a Fornecedores de Produtos Ou Serviços Mediante Cessão de Direitos Creditórios*, dated October 2, 2018 and numbered 313.202.444 (as reflected in Proof of Claim No. 3731) (the "Convenio");

(iii) that certain *Cédula de Crédito Bancário Empréstimo*, dated April 29, 2020 and numbered 351/3219142 (as reflected in Proof of Claim No. 3532); and

(iv) that certain *Cédula de Crédito Bancário Empréstimo*, dated May 7, 2020 and numbered 237/2372/0705 (as reflected in Proof of Claim No. 3532).

Items (iii) and (iv), together, are referred to herein as the "Bradesco CCBs," and the Bradesco CCBs, together with the BDB CCB and Convenio, are referred to as the "Debt Instruments." TLA Claimholders Obj. ¶ 7.

> (y) such other less favorable treatment as to which the Debtors and the Holder of such Allowed Class 6 Claim shall have agreed upon in writing; or
>
> (z) such other treatment such that the applicable Allowed Class 6 Claim will be rendered Unimpaired pursuant to section 1124 of the Bankruptcy Code.

Id. The amount of such Allowed Class 6 Claims excludes PPI.

The TLA Claimholders contend that TLA is solvent. They maintain that under the Bankruptcy Code to leave a class of unsecured creditors unimpaired under a plan of a solvent debtor, the plan must provide for the payment of principal in full, plus PPI, to those creditors. *See* TLA Claimholders Obj. ¶¶ 1-2. They claim that they are entitled to at least $150 million in PPI on their TLA GUCs. Debtors Omnibus Reply ¶ 56 n.53. Although the Plan does not call for TLA GUCs to be paid PPI, it states that their claims are unimpaired and denies them the right to vote on the Plan. Plan § 3.2(d)(iii). The TLA Claimholders object to confirmation. They contend that the Court cannot confirm the Plan because the Debtors cannot satisfy their burden of demonstrating that the Plan complies with sections 1124(1), 1129(a)(1), and 1129(a)(8) of the Bankruptcy Code. TLA Claimholders Obj. ¶ 26.

The Court concludes that the TLA GUCs are not impaired under the Plan. As discussed below, to hold otherwise would ignore the ban on "unmatured interest" (*i.e.*, PPI) under section 502(b)(2) of the Bankruptcy Code and caselaw reasoning that section 1124(1) speaks to impairment by a bankruptcy plan, not limitations set forth by the Bankruptcy Code. Below, the Court also assesses whether the TLA Claimholders are entitled to PPI notwithstanding that they are unimpaired. It does so because courts have held that unimpaired creditors of solvent debtors may nevertheless be entitled to PPI under various provisions of the Bankruptcy Code, namely sections 1124(1) and 1129(a)(7) as relevant here. The Court considers whether TLA is solvent under section 101(32) of the Bankruptcy Code as a threshold issue to this analysis. As discussed below, the Court finds that TLA is insolvent because: (a) the TLA Claimholders have failed to satisfy their burden to demonstrate that the sum of TLA's debts exceeds the sum of its property at a fair valuation, *see* 11 U.S.C. § 101(32), and (b) in any event, the Debtors have set forth affirmative evidence demonstrating that TLA is insolvent under section 101(32). Finally, the Court analyzes whether the TLA Claimholders would be entitled to PPI, and at what rate of interest, if the TLA Claimholders had in fact demonstrated TLA is solvent. In doing so, the Court finds that the solvent debtor exception to the ban on unmatured interest survived the enactment of the Bankruptcy Code through section 1129(a)(7) (as relevant here), not section 1124(1) and, thus, would demand the Debtors pay PPI on the TLA GUCs at the federal judgment rate (*i.e.*, the "legal rate" under section 726(a)(5) of the Bankruptcy Code), not at the rate called for in the Debt Instruments.

Accordingly, based on the above, and as set forth below, the Court overrules the TLA Claimholders Objection and finds that the Debtors have satisfied sections 1129(a)(1) and 1129(a)(8) of the Bankruptcy Code with respect to the Plan's treatment of the TLA GUCs.

Whether the TLA GUCs Are Impaired Under the Plan

"Confirmation of a plan of reorganization is the statutory goal of every chapter 11 case. Section 1129 of the Bankruptcy Code provides the requirements for such confirmation, containing Congress' minimum requirements for allowing an entity to discharge its unpaid debts and continue its operations." *Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship,* 526 U.S. 434, 465, n.4 (1999) (Stevens, J., dissenting) (quotation omitted). As the Plan proponents, the Debtors bear the burden of proving by a preponderance of the evidence that each of the confirmation requirements set forth in section 1129(a) of the Bankruptcy Code have been satisfied. *See In re Breitburn Energy Partners LP*, 582 B.R. 321, 349 (Bankr. S.D.N.Y. 2018)

("The proponent of the confirmation of a plan must prove by a preponderance of the evidence that it satisfies the relevant requirements of 11 U.S.C. § 1129(a), and if the plan is not fully consensual, 11 U.S.C. § 1129(b)."); *In re Quigley Co., Inc*., 437 B.R. 102, 125 (Bankr. S.D.N.Y. 2010) ("The proponent of confirmation bears the burden of proof by a preponderance of the evidence.").

"The Bankruptcy Code creates a presumption of impairment 'so as to enable a creditor to vote on acceptance of the plan.' Under 11 U.S.C. § 1124(1), the presumption of impairment is overcome only if the plan 'leaves unaltered the [creditor's] legal, equitable, and contractual rights.' The burden is placed on the debtor to demonstrate the plan leaves the creditor's rights unaltered." *Solow v. PPI Enters. (U.S.), Inc. (In re PPI Enters. (U.S.), Inc.)*, 324 F.3d 197, 203 (3d Cir. 2003) (internal citations omitted). The TLA Claimholders contend that the Debtors have failed to meet that burden because the Plan purports to leave the TLA GUCs unimpaired under section 1124(1) of the Bankruptcy Code without satisfying the standards set forth therein. For that reason, they say that the Court cannot confirm the Plan because the Debtors cannot satisfy their burden under section 1129(a)(1) of the Bankruptcy Code to prove that the Plan complies with all applicable provisions of the Bankruptcy Code, or their burden under section 1129(a)(8) to show that all classes either accepted the Plan or are unimpaired under the Plan. *See* TLA Claimholders Obj. ¶¶ 22-24.

Section 1124(1) of the Bankruptcy Code states that a class of claims is impaired under a plan unless, with respect to each claim, the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim . . . ." 11 U.S.C. § 1124(1). That section says nothing about the payment of interest. However, section 502(b)(2) of the Bankruptcy Code expressly disallows claims of unsecured creditors for "unmatured interest" (*i.e.*, PPI). 11 U.S.C. § 502(b)(2). It is settled that a creditor's "legal, equitable, and contractual rights" under section 1124(1) are subject to "the Bankruptcy Code's own limitations on claim allowance, including limitations on the allowance of postpetition interest." *In re 53 Stanhope LLC*, 625 B.R. 573, 579 (Bankr. S.D.N.Y 2021). *See also Keystone Gas Gathering L.L.C. v. Ad Hoc Comm. (In re Ultra Petroleum Corp.)*, 943 F.3d 758, 763-65 (5th Cir. 2019) ("*Ultra Petroleum I*"); *In re PPI Enters. (US) Inc.,* 324 F.3d at 201-02. Accordingly, "[w]here a plan refuses to pay funds disallowed by the Code, the Code—not the Plan—is doing the impairing." *Ultra Petroleum I*, 943 F.3d at 765; *see also In re PPI Enters. (U.S.), Inc.*, 324 F.3d at 205 (where "the Bankruptcy Code, not the Plan, is the only source of limitation" on a creditor's rights, the creditor's claim is not impaired). Because the Plan provides for payment of the TLA GUCs in full (*i.e*., principal and pre-petition interest) and the Bankruptcy Code itself disallows payment of PPI under section 502(b)(2), the claims are not impaired within the meaning of section 1124(1) the Bankruptcy Code. *Ultra Petroleum I*, 943 F.3d at 763; *see also Wells Fargo Bank, N.A. v. The Hertz Corp (In re The Hertz Corp.)*, No. 20-11218, 2021 WL 6068390, at *11 (Bankr. D. Del. Dec. 22, 2021) ("*Hertz*") ("[T]he Court concludes that any modification of the Noteholders' claim to unmatured interest . . . is an impairment of the Noteholders' contract claims by operation of section 502(b)(2) of the Bankruptcy Code, not the Debtors' Plan. Consequently, the Noteholders' claims are not impaired within the meaning of section 1124(1).").

<u>Whether Solvent Debtor Exception Applies and the TLA Claimholders are Entitled to PPI</u>

Still, the TLA Claimholders assert that the "solvent debtor exception" applies in this case and that they have an equitable right to be paid PPI on the TLA GUCs. TLA Claimholders Obj. ¶¶ 29-30. They say that is so because TLA is solvent and, thus, should be compelled to (and has the means) to pay them PPI. Below, the Court examines whether TLA is solvent, whether the solvent debtor exception survived the enactment of the Bankruptcy Code, and, if so, whether (and at what rate) the TLA Claimholders are entitled to PPI on the TLA GUCs.

The parties disagree whether the TLA Claimholders or the Debtors have the burden of proof on the issue of TLA's solvency. The former contend that the burden is on the Debtors to prove TLA is insolvent because the Debtors have the burden of proving that the TLA GUCs are unimpaired under the Plan—and that they can only do so by demonstrating that it is insolvent. *See id*. ¶¶ 23, 32. They say that is so because "[t]he Bankruptcy Code creates a presumption of impairment 'so as to enable a creditor to vote on acceptance of the plan.' Under 11 U.S.C. § 1124(1), the presumption of impairment is overcome only if the plan 'leaves unaltered the [creditor's] legal, equitable, and contractual rights.' The burden is placed on the debtor to demonstrate the plan leaves the creditor's rights unaltered." *In re PPI Enters. (U.S.), Inc.*, 324 F.3d at 203 (internal citations omitted). The Debtors contend that the TLA Claimholders have the burden to show TLA is solvent because plan objectors always bear the burden to substantiate their objections. Debtors Omnibus Reply ¶ 110 (citing *In re W.R. Grace & Co*., 475 B.R. 34, 162 (Bankr. D. Del. 2012)). The Debtors also contend that the TLA Claimholders' position is immaterial because "it is clear that the TLA [GUCs] are unimpaired under the Plan," meaning the whole question at issue concerns only solvency. *See id*. ¶ 110 n.55.

The Court agrees with the Debtors. As demonstrated above, the Debtors have met their burden to demonstrate that the TLA GUCs are not impaired under the Plan. *See, e.g.*, *Ultra Petroleum I*, 943 F.3d at 763; *Hertz*, 2021 WL 6068390, at *11. That burden does not extend to require the Debtors to also prove if (and how) the common law solvent debtor exception interacts with or overrides section 502(b)(2), which, according to the TLA Claimholders, would require the Debtors to prove TLA's insolvency in order to avoid paying interest under the solvent debtor exception. The TLA Claimholders have cited no caselaw for that proposition and the Court is aware of none. Finding otherwise would be illogical as it would, in effect, mean that a debtor could not obtain the benefit of section 502(b) unless and until it set forth affirmative evidence that it was insolvent (assuming the solvent debtor exception is applicable under the Bankruptcy Code). *See* May 20, 2022 Hr'g Tr. – Public Session, 194:2-10. As such, the Court finds that the TLA Claimholders bear the burden of proof to demonstrate TLA is solvent, as it is the lynchpin of their objection to the Plan. *See In re W.R. Grace & Co*., 475 B.R. at 162 (upholding bankruptcy court finding that creditors arguing for post-petition default interest "did not satisfy their burden and that there was insufficient evidence to render [the debtor] solvent.").

Whether TLA is Solvent

Section 101(32) of the Bankruptcy Code defines the term "insolvent" as the "financial condition such that the sum of [an] entity's debts is greater than all of such entity's property, at a fair valuation . . . ." 11 U.S.C. § 101(32)(A). The Bankruptcy Code does not provide a definition of "fair valuation." The parties each rely on an expert to opine on whether TLA is insolvent. The Debtors offer the testimony of Mr. Brock Edgar. He is a is a Senior Managing Director at FTI Consulting, Inc., the financial advisors to the Debtors.[33] The TLA Claimholders offer the testimony of Mr. Santiago Dellepiane. He is a Managing Director with Berkeley Research Group, LLC and Co-Chair of its Economics & Damages practice.[34] Mr. Edgar contends that

[33] Debtors Tr. Ex. 1 (Declaration of Brock Edgar in Support of the Debtors, dated April 29, 2022) (the "Edgar Decl.") ¶ 1.

[34] TLA Claimholders Tr. Ex. 121(Amended Declaration of Santiago Dellepiane, dated May 15, 2022) (the "Am. Dellepiane Decl.") ¶ 3.

under the standards set forth in section 101(32) of the Bankruptcy Code, TLA is insolvent; Mr. Dellepiane contends that TLA is solvent.

While the TLA GUCs are classified in Class 6 under the Plan, the Plan's treatment of Class 4 claims is indirectly relevant to Mr. Dellepiane's analysis of TLA's solvency. Class 4 of the Plan consists of unsecured claims against LATAM Finance and LATAM Parent by the holders of the LATAM 2024/2026 Bonds. *See* Plan §§ 3.2(d). The Plan's treatment of the Class 4 LATAM 2024/2026 Bond Claims comprises and depends on a combined recovery on account of allowed claims against both LATAM Parent and LATAM Finance. *See id*. § 3.2(d); *see also* Am. Herlihy Rebuttal Report at 7.[35] The Plan calls for Class 4 creditors to be paid in full, without PPI and without any new money investment rights. Class 4 is unimpaired and presumed to accept the Plan. *See* Plan § 3.2(d).[36] The Plan's classification and treatment of the Class 4 claims reflects an agreement and compromise among the Debtors and the parties to the RSA (the "Class 4 Compromise") and is set forth in the RSA. *See* Herlihy Report at 60-63, 69.

In the Plan, the Debtors seek approval of the Class 4 Compromise—and all the integrated compromises and settlements reflected in the Plan—pursuant to Bankruptcy Rule 9019. *See* Plan § 5.2. In support of that request, the Debtors submitted the expert testimony of Mr. Brent Herlihy. He is a Managing Director in the Restructuring and Special Situations Group at PJT Partners LP ("PJT"), the investment banker that the Debtors have retained in these Chapter 11 Cases. Through Mr. Herlihy's testimony, the Debtors seek to demonstrate that there is sufficient distributable value at LATAM Finance and LATAM Parent to provide a full recovery of the

[35] Debtors Tr. Ex. 20 (Amended Rebuttal Report of Brent Herlihy, PJT Partners LP, dated April 27, 2022) ("Am. Herlihy Rebuttal Report").

[36] Nevertheless, the Debtors solicited the votes of Holders of Allowed Class 4 Claims in the manner and to the extent provided in the Disclosure Statement Order. Plan § 3.2(d)(iii) n.14.

LATAM 2024/2026 Bonds at a $14 billion valuation (*i.e*., that at a $14 billion valuation, the LATAM 2024/2026 Bonds were entitled to 100% recovery of principal and pre-petition interest). *See* Herlihy Report at 64-69. In his opinion, the Class 4 Compromise is within the range of reasonable outcomes based on the allocation methodology described below. Initially, the Committee and BancoEstado objected to the Class 4 Compromise. They have since withdrawn their objections. The Court finds that the Debtors have demonstrated that the Class 4 Compromise satisfies the well-settled standards governing the approval of settlement agreements. *See In re W.T. Grant Co.,* 699 F.2d 599, 608 (2d Cir. 1983) (bankruptcy courts assessing settlement agreements must "see whether the settlement falls below the lowest point in the range of reasonableness"); *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414, 424-25 (1968) (in evaluating a settlement under Bankruptcy Rule 9019, a court must determine that it is fair, equitable, and in the best interests of the estate); *In re Hibbard Brown & Co., Inc.,* 217 B.R. 41, 46 (Bankr. S.D.N.Y. 1998) (a court may exercise its discretion to approve or deny a settlement "in light of the general public policy favoring settlements").

Mr. Herlihy's methodology in evaluating the merits of the Class 4 Compromise is relevant to the TLA Claimholders Objection. In support of the objection, Mr. Dellepiane utilizes two methodologies to determine the value of TLA: (1) a discounted cash flow methodology (the "DCF Methodology"); and (2) a distributable value waterfall, which allocates value to TLA based on Mr. Herlihy's total enterprise value of the Debtors as an integrated unit (the "Distributable Value Waterfall"). *See* Am. Dellepiane Decl. ¶¶ 19-37. From these two valuation figures ($5.8 to $7.0 billion (DCF Methodology) and $3.446 billion (Distributable Value Waterfall)), Mr. Dellepiane subtracts a claims value of $1.08 or $1.96 billion to opine that the fair value of TLA's property exceeds its liabilities and, thus, that TLA is solvent. *See id*. ¶¶ 36-37. The Court briefly discusses the methodology Mr. Herlihy employed in evaluating the merits of the Class 4 Compromise.

In seeking approval of the Class 4 Compromise, the Debtors sought to demonstrate that there is sufficient distributable value at LATAM Finance and LATAM Parent to provide a full recovery of the LATAM 2024/2026 Bonds at a $14 billion valuation of the Debtors as a whole. Mr. Herlihy needed to assign value to each Debtor in order to isolate the value attributable to LATAM Finance and LATAM Parent, as issuer and guarantor of the LATAM 2024/2026 Bonds, respectively, to determine if they had sufficient capital to pay the holders of LATAM 2024/2026 Bond Claims 100% of their principal and pre-petition interest pursuant to the Class 4 Treatment under the Plan. *See* Herlihy Report at 64-69. To do so, he undertook the following process:

> Mr. Herlihy began with a Total Enterprise Value of $14 billion ("TEV"), which is the middle point of the various estimates he assigns to the consolidated value of the Debtors. *See id*. at 66-68. He adopted this figure from Exhibit D to the Disclosure Statement. *Id*. at 66 ("I evaluated recoveries across the full range of enterprise values ($13 - $15bn) filed as Exhibit D to the Disclosure Statement").
>
> Next, Mr. Herlihy estimated a "Total Distributable Value" for the consolidated group of Debtors. The Total Distributable Value is the amount of funds available for creditors after performing the following calculations on the TEV: (i) subtracting each Debtor's share of the DIP; (ii) adding excess cash; and (iii) subtracting net operating losses. *See id*. at 65. Mr. Herlihy calculated the Debtors' Total Distributable Value to be $10.995 billion. *See* Debtors Tr. Ex. 14 (the "Herlihy Waterfall Output") at 002 (($14bn TEV) + ($289m excess cash) – ($295m net operating losses) – ($3bn DIP Tranches A, B, and C)).
>
> Mr. Herlihy then calculated the percentage of the Debtors' Total Distributable Value (*i.e*., $10.995 billion) that should be allocated to each Debtor. Although his focus was on LATAM Parent and LATAM Finance, in doing this analysis, he determined that TLA should be allocated 29% (or $3.213 billion) of the Total Distributable Value. *See id*. at 007. He arrived at that figure by blending three different allocation methodologies. *See* Herlihy Report at 64. According to Mr. Herlihy, $3.213 billion is TLA's operating allocation of the consolidated Debtors' Total Distributable Value. *See* Herlihy Waterfall Output at 002, 007.

> Applying the adjustments called for in the Distributable Value Waterfall, *see* Herlihy Report at 65, Mr. Herlihy calculates the distributable value of TLA to be \$3.446 billion. *See* Herlihy Waterfall Output at 033. According to Mr. Herlihy, this is the value that TLA holds to settle any claims that sit at TLA—*i.e.*, the starting point for allocating that distributable value through a waterfall for creditors (the "TLA Creditor Waterfall").[37]
>
> Mr. Herlihy then applied the TLA Creditor Waterfall.[38] The TLA Creditor Waterfall leaves an "Equity Value" of \$2.366 billion after satisfying all claims identified in the Herlihy Waterfall Output. *See id*. at 033-038. The claims identified as sitting at TLA in the Herlihy Waterfall Output total \$1.080 billion.

See id.

Distributable Value Waterfall

Mr. Dellepiane applies the Distributable Value Waterfall to allocate a portion of the Debtors' consolidated enterprise value to TLA individually. In doing so, he borrows from the calculations behind Mr. Herlihy's conclusion that the Class 4 Compromise passes muster under Rule 9019. Mr. Dellepiane—purporting simply to adopt Mr. Herlihy's methodology—contends that TLA's equity value is \$2.336 billion ((\$3.446 bn) – (\$1.080 bn)). Am. Dellepiane Decl. ¶ 36. He concludes that this figure demonstrates that TLA is solvent because it is the value remaining at TLA "even after satisfying 100% of all identified claims." *Id*. Mr. Dellepiane adopts \$1.080 billion as the applicable claims value because, he contends, it is "the most recent record of claim amounts against TLA that have been produced by the Debtors[.]" *Id*. ¶ 30.[39] He

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37 TLA Claimholders Tr. Ex. 131 (Deposition Transcript of Brent Herlihy) at 466:19-467:9.

38 Mr. Herlihy performed these steps for each individual Debtor, again, as part of his assessment of the Plan's treatment of the LATAM 2024/2026 Bond Claims in Class 4. *See generally* Herlihy Waterfall Output. The Court focuses here on his calculations for TLA only because they are relevant to Mr. Dellepiane's analysis, which is based, in part, on Mr. Herlihy's calculations.

39 Mr. Dellepiane, however, does recognize that other documents from the Debtors reflect higher calculations of claims against TLA. *See* Am. Dellepiane Decl. ¶ 29 ("Such documents that I have reviewed include (1) FTI General Claims Breakdown, which indicates that there are approximately \$1.15 billion of claims attributed to TLA, (2) the TLA Schedules of Assets and Liabilities as of July 6, 2020, which indicates that there were approximately \$1.332 billion of claims attributed to TLA as of TLA's petition date, and (3) the Cleansing Blowout Materials as of November 26, 2021 which indicate a range of claims against TLA between \$1.720 billion and \$1.938 billion."). He does not offer why he rejects these figures and adopts a claims value of \$1.080 billion, other than noting this is the

estimates the total claims against TLA at $1.96 billion, which he contends accounts for TLA's share of 29% of the $3 billion DIP taken out by the Debtors. *Id*. ¶ 31. Mr. Dellepiane, however, does not use $1.96 billon as the proper liability figure—presumably because Mr. Herlihy did not either. As set forth below, however, he utilizes this liability figure in the DCF Methodology for purposes of netting TLA's assets and liabilities.

DCF Methodology

Mr. Dellepiane's DCF Methodology calculates TLA's free cash flow and then applies a discount rate to find the present value of those cash flows. *Id*. ¶ 21. Mr. Dellepiane contends that the DCF is the "most appropriate and most reasonable" method to determine the fair value of TLA's assets. *Id*. The DCF Methodology borrows from Mr. Herlihy's discounted cash flow. *See* Herlihy Report at 43 (estimating the Debtors' total enterprise value at $13.3 to $15.9 billion). Mr. Dellepiane starts with projected monthly financial information from the Debtors' five-year business plan, which runs through 2026 (the "Business Plan"). Am. Dellepiane Decl. ¶ 21. From that, he estimates TLA's free cash flows by considering its total revenues, total expenses, and Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA")—all of which is provided in the Debtors' projections. *Id*. ¶ 22. Next, Mr. Dellepiane estimated working capital variations, income tax, and capital expenditures in order to determine TLA's cash flows. *Id*.

This process only measured TLA's estimated cash flow through December 31, 2026—the projection period in the Debtors' Business Plan. To estimate TLA's cash flows after this, Mr. Dellepiane attempted to account for future growth of TLA's cash flows. He settles on two

"most recent" claims estimate, as well as the estimate utilized by Mr. Herlihy in the Distributable Value Waterfall. *See id*. ¶ 30; *see also* Herlihy Waterfall Output at 033-038.

options to do so: (1) a Perpetual Growth Model (2.25% growth rate)[40]; and (2) an Exit Multiple Model (6.0x EV/EBITDAR multiple). *Id*. ¶ 23.

Because this process estimates the value of TLA's cash flows in the future, Mr. Dellepiane acknowledges that a discount rate must be applied to value the cash flows today. To do so, he utilizes two weighted average cost of capital ("WACC") estimates: (1) 9.18% (borrowed from Mr. Herlihy, *see* Herlihy Report at 43, 48); and (2) 8.09% (which Mr. Dellepiane opines is the appropriate rate for a Brazilian airline company). Am. Dellepiane Decl. ¶ 24.

Applying the two WACC estimates across the two growth factors (the Perpetual Growth Model and the Exit Multiple Model), Mr. Dellepiane calculates the fair value of TLA's assets (before subtracting the fair value of its liabilities) as follows:

<u>Perpetual Growth Model</u>

8.09 % WACC: $7.0 billion

9.18% WACC: $5.8 billion

<u>Exit Multiple Model</u>

8.09% WACC: $6.4 billion

9.18% WACC: $6.2 billion

Id. ¶ 27. As such, Mr. Dellepiane estimates the present value of TLA's future cash flows to be worth between $5.8 and $7.0 billion. *Id*.

To determine the total value of TLA's liabilities, Mr. Dellepiane borrows from Mr. Herlihy's calculation of the share of the Debtors' claims attributable to TLA as part of the Distributable Value Waterfall. As set forth above, these claims total $1.080 billion. *See* Herlihy

[40] This is the same factor utilized by Mr. Herlihy. *See* Herlihy Report at 44 (identified as a "key assumption").

Waterfall Output at 033-038. Mr. Dellepiane adds $877 million on top of this figure to account for TLA's 29% share of the Debtors' DIP, as described above. As such, for purposes of the DCF Methodology, he contends that the proper claims (*i.e.*, liability) amount is $1.96 million. Am. Dellepiane Decl. ¶¶ 31, 37.

Mr. Dellepiane contends that TLA is solvent because—even utilizing his lowest estimated value of TLA, $5.8 billion—subtracting the claims figure leaves residual equity value of at least $3.8 billion (($5.8 billion) – ($1.96 billion)). *Id*. ¶ 37.

Mr. Dellepiane's Methodologies Do Not Measure TLA's Solvency

The Court accords little to no weight to Mr. Dellepiane's methodologies—both the Distributable Value Waterfall and the DCF Methodology. Both suffer from unrebutted infirmities demonstrated by Mr. Edgar.

To frame the issue, the Court finds that, as the Debtors contend, insolvency is determined, in part, by the fair market price that a debtor could obtain through the sale of its assets in a prudent matter. *See In re SunEdison, Inc*., 556 B.R. 94, 104 (Bankr. S.D.N.Y. 2016) ("the test for insolvency turns on a comparison between the debtor's debts and the 'fair valuation' of its property. 'Fair value, in the context of a going concern, is determined by the fair market price of the debtor's assets that could be obtained if sold in a prudent manner within a reasonable period of time to pay the debtor's debts.'") (internal citation omitted). The TLA Claimholders acknowledge as much. *See* TLA Claimholders Obj. ¶ 28. Mr. Dellepiane's methodologies, as described above, fail to follow this directive. Neither the DCF Methodology nor the Distributable Value Waterfall assesses the aggregate price TLA could obtain for its assets and, thus, both fail to calculate the fair value of its assets. Indeed, Mr. Dellepiane testified that he sought to calculate the "fair market value of the company", not the fair value of individual property. *See* May 17, 2022 Hr'g Tr. – Public Session, 117:21-118:3; *see also id.* at 118:4-10 (admitting he did not calculate the proceeds from the sale of individual assets).

The Court agrees with the Debtors that the Distributable Value Waterfall methodology applied by Mr. Dellepiane does not accurately measure if TLA is insolvent. The Debtors say that is so for two primary reasons: (1) it ignores claims excluded from Mr. Herlihy's analysis; and (2) it excludes certain liabilities that TLA would hold if it operated alone.

The Debtors contend that the Distributable Value Waterfall undercounts TLA's liabilities at only $1.08 billion, which, in turn, artificially inflates TLA's alleged solvency. Edgar Rebuttal Decl. ¶ 13.[41] Mr. Edgar says that is so because the Distributable Value Waterfall was never intended to, and does not, provide an exhaustive list of the value of all debts of the individual operating entities. Rather, as with its calculation of assets, it simply takes the liabilities of the consolidated Debtor group and distributes them across each Debtor. *Id*. Edgar claims that the true value of TLA's liabilities is one of the following: (1) $1.72 to $1.938 billion (reflecting total claims against TLA in the "Cleansing Blowout Materials" the Debtors publicly disclosed in November 2021); or, more accurately (2) $3.5 billion (reflecting the total liabilities listed on TLA's most recent balance sheet). *Id*. ¶ 14.

The Court agrees. While Mr. Dellepiane recognizes that TLA's liabilities may be higher than the $1.08 billion reflected in the Herlihy Waterfall Backup, neither his declarations nor evidence at trial provide any compelling reason why TLA's balance sheets do not accurately reflect TLA's liabilities at $3.5 billon, as described below. Instead, Mr. Dellepiane simply adopts the Distributable Value Waterfall's allocated amount of liabilities without further analysis. If the

[41] Debtors Tr. Ex. 7 (Rebuttal Declaration of Brock Edgar in Support of the Debtors) ("Edgar Rebuttal Decl.").

balance sheets are correct and TLA's liabilities are approximately $3.5 billion[42]—and the Court finds they were unrebutted at trial—it tops the $3.446 billion value of TLA's assets under the Distributable Value Waterfall. As such, even utilizing the Distributable Value Waterfall (but correcting for Mr. Dellepiane's undercount of TLA's liabilities) the Court finds the methodology demonstrates that TLA is insolvent, not solvent.

Mr. Edgar also contends that beyond undercounting TLA's liabilities, the Distributable Value Waterfall ignores additional liabilities TLA would hold if it operated alone. Edgar Rebuttal Decl. ¶ 15. He says that is so, in part, because LATAM Parent (or another operating entity) owns most of the aircraft that TLA operates. TLA rents the majority of its fleet through short-term subleases from other Debtors. *Id*. ¶ 16. Because of the short-term leasing structure, TLA avoids holding the liabilities of those aircraft. *Id*. If that was not the case, Mr. Edgar contends that TLA's fleet-related liabilities would balloon by $1.386 billion—all of which he contends should be added to Mr. Dellepiane's calculations. *Id*. ¶¶ 16-17.

The TLA Claimholders have failed to rebut these criticisms. There is no evidence in the record demonstrating why an additional $1.386 billion in liabilities should not be subtracted from the $3.446 billion value of TLA produced by the Distributable Value Waterfall (even assuming *arguendo* the Distributable Value Waterfall honors the definition of "insolvent" under section 101(32) of the Bankruptcy Code). The Court finds that including this figure renders TLA even further insolvent and, thus, provides further support for why the Distributable Value Waterfall does not help the TLA Claimholders satisfy their burden to show TLA is solvent.

[42] Mr. Dellepiane takes issue with utilizing TLA's financial statements to assess the fair value of its assets and liabilities, claiming they utilize book values of assets and liabilities, which can differ from fair value. *See* TLA Claimholders Tr. Ex. 123, Amended Rebuttal Declaration of Santiago Dellepiane, dated May 15, 2022 ¶¶ 17-22. But his criticism focuses largely on how the fair value of assets may exceed their book value, not on the fair value of liabilities.

In failing to account for the liabilities set forth above, Mr. Dellepiane has overlooked section 101(32)'s directive that TLA is solvent only if "the sum of [its] debts is" not greater than its assets. *See* 11 U.S.C. § 101(32). Mr. Dellepiane's consideration of only a subset of TLA's liabilities plainly does not provide a calculation of "the sum" of its liabilities. *See id*.

Moreover, the Court finds the Distributable Value Waterfall is ill suited to assess the fair value of the assets and liabilities of any individual Debtor and thus does not provide a solvency analysis. Mr. Herlihy performed a waterfall analysis to determine if the Class 4 Compromise falls within the range of reasonable outcomes. *See*, *e.g.*, Herlihy Report at 69. He concluded such a settlement was in fact reasonable, in part, because it was crafted as part of the RSA negotiations, which "include various interrelated terms" and ultimately culminated in the Backstop Agreements and the Plan and paved the way for the Debtors to emerge from Chapter 11. *See*, *e.g.*, *id*. at 62-64. In other words, his analysis is predicated on a holistic review of the Class 4 Compromise and a task of determining whether the settlement falls within a range of reasonableness when viewed in the context of the requests from the holders of the LATAM 2024/2026 Bonds and how the RSA, Backstop Agreement, and ultimately the Plan itself, rest, in part, on recognizing those requests. *See id*. at 69 ("Based on a holistic review of these scenarios, PJT determines that it was within the range of reasonableness to pay 100% of the principal and accrued pre-petition interest on [the LATAM 2024/2026 Bonds] in cash at emergence, without any post-petition interest or new money investment rights."); *see also id*. at 62 ("Without the Class 4 Treatment, as part of the comprehensive plan terms that addressed their various claims, it is unlikely that the parties to the RSA and related exit new money commitments under the Backstop [] Agreements . . . would have supported the Plan and provided the approximately $5.4bn of commitments that they have agreed to provide"). That directive does not speak to whether "the sum of [TLA's liabilities] is greater than all of [TLA's property] . . . ." *See* 11 U.S.C. § 101(32). Section 101(32) does not call for such a holistic approach and Mr. Herlihy does not purport to perform a solvency analysis through the Distributable Value Waterfall.[43]

The Debtors criticize the DCF Methodology because it relies on financial projections that assume TLA will operate as part of the consolidated Debtor group. They say that assumption inflates the value of TLA's assets. *See* Debtors Omnibus Reply ¶ 113. These projections incorporate the Debtors' assumptions in their Business Plan and they contend that it is illogical for Mr. Dellepiane to base his DCF Methodology on those assumptions and projections. *Id*. ¶ 124. They say that is so because if the TLA Claimholders are successful in obtaining PPI at the rate they calculate, it would substantially undermine their execution of the Business Plan by extracting approximately $150 million in interest and thus depleting the cash and liquidity the Debtors need to exit chapter 11. *Id*.

The Debtors also contend that the DCF Methodology fails to assess solvency as required under section 101(32) of the Bankruptcy Code because it attempts to measure the *current* value of *future* cash flows—amounts that are inherently subjective, indefinite, and do not speak to the value of the assets TLA holds today or held at the Petition Date. *See id*. ¶ 113. The Court agrees—the discounted value of future cash flows does not measure the "sum of . . . [an] entity's property" and, thus, does not provide a fair value of an entity's assets from which to compare the fair value of its liabilities. *See* 11 U.S.C. § 101(32). In other words, the DCF Methodology, by attempting to measure today's value of TLA's future cash flows under the assumptions in the Business Plan, does not speak to the test called for under section 101(32). Put simply, it does not

[43] The disconnect between Section 101(32)'s definition of insolvency and the Distributable Value Waterfall is reinforced by the fact that Mr. Dellepiane did not review the Bankruptcy Code's definition of "insolvent" as part of rendering his opinion. May 17, 2022 Hr'g Tr. – Public Session at 102:21-24.

provide a means to determine the fair value of TLA today. Courts have regularly expressed skepticism of discounted cash flow valuations for this reason. *See, e.g., In re Breitburn Energy Partners LP*, 582 B.R. 321, 331 (Bankr. S.D.N.Y. 2018) (a "forward-looking discounted cash flow analysis . . . is even more subjective [than a precedent-transactions or comparable-company analysis]. It involves predicting future revenues and expenses, and therefore requires assumptions regarding future prices and future costs . . . that are no more than guesses."); *In re PTM Techs., Inc*., No. 10-50980c-11W, 2013 WL 4519306, at *6 (Bankr. M.D.N.C. 2013) (finding measurements of cash flow do not measure solvency under section 101(32) of the Bankruptcy Code). Accordingly, the Court finds that the DCF Methodology does not accurately measure the fair value of TLA's assets and, thus, does not accurately determine if TLA is solvent.

The Liquidation Analysis and Balance Sheet Test Comport with Section 101(32)

Mr. Edgar utilizes two methodologies: (1) a liquidation analysis (the "Liquidation Analysis"); and (2) a balance sheet analysis (the "Balance Sheet Test"). TLA is insolvent under both. The Court finds both methodologies satisfy section 101(32) of the Bankruptcy Code for the reasons set forth below.

The Liquidation Analysis analyzes the funds that would be raised if each item of property (*i.e*., each asset) of TLA were sold at market value in an orderly sale process,[44] and then

[44] The Liquidation Analysis sets forth values for the following categories of liabilities: wind down costs, DIP carve out, payment of secured claims up to the value of collateral, DIP repayment, payment of administrative and priority claims, and payment of general unsecured claims. It provides no recovery to these final two categories because of insufficient recovery from TLA's assets in the hypothetical liquidation. *See* Debtors Tr. Ex. 4 (Liquidation Analysis of TAM Linhas Aereas S.A.) ("TLA Liquidation Backup").

Mr. Edgar presents the Liquidation Analysis for the aggregate Debtor group, as well as for each individual Debtor, including TLA. *See* TLA Liquidation Backup; Debtors Tr. Ex. 3 (Declaration of Brock Edgar in Support of the Liquidation Analysis Presented in Exhibit B to the Fifth Revised Disclosure Statement of LATAM Airlines Group S.A., et al.) (the "Edgar Disclosure Statement Decl."), at Ex. 2. The Liquidation Analysis contemplates a "low recovery scenario" and a "high-recovery scenario." In a low-recovery scenario, asset realization recoveries are compares that total amount to the total amount of TLA's claims and liabilities. Debtors Omnibus Reply ¶ 116. Mr. Edgar estimates that the sale of property yields between $360.1 and $490.8 million[45]—an insufficient amount to pay all administrative and priority claims, let alone all claims (*i.e.*, the general unsecured claims, including the TLA GUCs). *See* TLA Liquidation Backup. Because claims against TLA constitute part of its liabilities, the Liquidation Analysis purports to show that TLA is insolvent.

Under the Balance Sheet Test, Mr. Edgar compares TLA's total liabilities and assets as reflected on: (1) TLA's 2021 audited financial statements; and (2) TLA's March 2022 unaudited balance sheet. Using both sources, TLA's assets exceed its liabilities and, thus, Mr. Edgar contends TLA is insolvent. *See* Edgar Decl. ¶ 11. The 2021 financial statement shows that TLA's liabilities as of December 31, 2021 exceeded its assets by more than BRL 2 billion (or approximately $360 million). *Id*. The monthly balance sheet shows that TLA's liabilities

assumed to be negatively impacted while claims not already finally determined in the Chapter 11 claims process are estimated at their highest potential amount. Edgar Decl. ¶ 9. This scenario assumes a liquidation over a 12-month period. Edgar Disclosure Statement Decl. ¶ 12. In a high-recovery scenario, the liquidation proceedings are assumed to occur over an 18-month period, asset realization recoveries increase, and claims not finally determined in the Chapter 11 claims process are estimated at a lower potential amount. Edgar Decl. ¶ 9. Based on these two paradigms, Edgar states the Liquidation Analysis presents a range of potential recoveries creditors may likely receive under a hypothetical Chapter 7 liquidation proceeding. In both the low- and high-recovery scenarios, Edgar estimates that TLA's unsecured creditors recover nothing. Edgar Decl. ¶ 10.

[45] Mr. Edgar states that the proceeds from the hypothetical liquidation of TLA include the following assets: cash and cash equivalents, accounts receivable, intercompany receivables, "other financial assets" (assets held for sale, cash deposits, certain collateralized letters of credit, and other cash financial guarantees provided to secure the supply of aircraft equipment and other goods and services), prepaid expenses and deposits, inventory, other receivables and prepayments, intangible assets, property, plant and equipment, deferred tax assets, and investments in related parties. Edgar Disclosure Statement Decl., Ex. 2 § D.1. Mr. Edgar assigns both a "book value" (approximately $1.912 billion in total) and "proforma value" (approximately $1.468 billion in total) to these assets, which he then multiplies by his hypothetical low-end and high-end recovery percentages. *See* TLA Liquidation Backup. This yields a collective recovery of $360.1 to $490.8 million. *See id*.

Mr. Edgar indicates that he derives the fair value of each asset by estimating what it could be sold for in the market. For example, the Liquidation Analysis relies on third-party appraisals for certain assets, such as spare parts inventory, and relies on blue book valuation reports for aircraft. Edgar Disclosure Statement Decl., Ex. 2 § D.1.

exceeded its assets by BRL 6 billion (or approximately $1.3 billion). *Id.*[46] Accordingly, Mr. Edgar contends that TLA is insolvent using either source.

Mr. Dellepiane contends that Mr. Edgar's Liquidation Analysis does not provide the fair value of TLA's assets and liabilities and, thus, does not accurately compare the figures. First, Mr. Dellepiane states that the Liquidation Analysis is unreliable because it reflects an assumption that is at odds with the Debtors' Business Plan—that TLA will not continue to operate post-emergence as a going concern. *See* Am. Dellepiane Rebuttal Decl. ¶¶ 11-14. He says the Liquidation Analysis itself recognizes this fact given its disclaimer stating: "THE LIQUIDATION ANALYSIS DOES NOT PURPORT TO BE A VALUATION OF THE DEBTORS' ASSETS AS A GOING CONCERN." Am. Dellepiane Rebuttal Decl. ¶ 12 (quoting Edgar Disclosure Statement Decl., Ex. 2 at 4). Second, Mr. Dellepiane contends that the Liquidation Analysis inaccurately includes liabilities that would not exist but for a liquidation[47] (which, again, Dellepiane contends, is contrary to the Debtors' Business Plan). *Id.* ¶ 15 (citing Edgar Decl., Ex. 2 § B.4).

Mr. Dellepiane also contends that Mr. Edgar's Balance Sheet Test does not accurately value TLA's assets and thus does not accurately determine if TLA is solvent. *See id.* ¶ 18. He says that is so because the methodology relies on the book value of assets, which is the original price paid for an asset less allowable depreciation. *Id.* Mr. Dellepiane contends that an asset's current or market value will exceed its book value for entities with "significant growth opportunities." *Id.* ¶ 20. He utilizes a bevy of examples where a company is balance-sheet

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[46] *See also* Debtors Tr. Ex. 6 (Classified Financial Statements of TAM Linhas Aereas S.A.) (the "TLA Financial Statements").

[47] Mr. Edgar notes that these include: "employee termination and severance claims, tax liabilities and damages claims related to the termination of executory contracts and unexpired leases, including claims arising from the rejection of aircraft lease agreements." Edgar Disclosure Statement Decl., Ex. 2 (Liquidation Analysis) § B.4.

insolvent (utilizing book value of its assets), yet its market value is positive on a going concern basis. *Id*., Figures 1-3 (showcasing negative book value of equity yet positive market capitalization for American Airlines, Air France, and Air Canada across various years). He also points to examples outside the aviation sector in an effort to purportedly discredit Mr. Edgar's methodology, noting that Starbucks's recent Form 10-K suggests that it is "balance-sheet" insolvent, yet trades a value of $133 billion. *Id.* ¶ 24. Mr. Dellepiane further contends that even companies in chapter 11 proceedings can sell their assets in excess of book value, pointing to Hertz Global Holdings Inc.'s sale of a subsidiary for a $400 million gain over book value. *Id.* ¶ 25. Mr. Dellepiane also maintains that the Debtors implicitly concede that utilizing book value is inappropriate given that Mr. Herlihy's methodologies in assessing the Class 4 Compromise do not rely on it, as demonstrated above. *Id.* ¶ 26.

The Court finds these criticisms are without merit. The Liquidation Analysis and Balance Sheet Test both comport with the definition of "insolvent" under Section 101(32) of the Bankruptcy Code. Unlike the Distributable Value Waterfall and DCF Methodology, they measure TLA's assets on an asset-by-asset basis. The TLA Liquidation Backup sets forth high- and low-end recoveries for eleven categories of assets, which provide the total proceeds from selling TLA's assets. *See generally* TLA Liquidation Backup. Mr. Edgar compiled this data by estimating what each asset could be sold for in the market over a twelve-to-eighteen month period. *See*, *e.g*., Edgar Disclosure Statement Decl., Ex. 2 (Liquidation Analysis) § D.1. That methodology comports with both the plain language of section 101(32) (calling for "the sum" of an entity's debts and liabilities) and caselaw measuring "fair valuation" for purposes of an insolvency analysis—caselaw that the TLA Claimholders themselves cite. *See* 11 U.S.C. § 101(32); *In re BWP Transp., Inc.,* 462 B.R. 225, 234 (Bankr. E.D. Mich. 2011) (adopting liquidation analysis detailing aggregate value of individual items of property if sold off at fair market value). Moreover, the duration of the sale process in the high-end recovery scenario—18 months—undercuts the TLA Claimholders' argument that the Liquidation Analysis provides depressed, forced-sale asset recoveries and thus does not reflect "fair valuation."[48] Edgar Disclosure Statement Decl., Ex. 2 § D (comparing the low-end recovery scenario where "asset realization recoveries are assumed to be negatively impacted by the reduced liquidation time frame" with the high-end scenario where "asset realization recoveries increase"). Under the high-end scenario, the Liquidation Analysis aggregates TLA's assets at $490.8 million—still well short of providing TLA with a means to satisfy its liabilities and thus demonstrating TLA is insolvent.

The Balance Sheet Test likewise aggregates the sum of TLA's assets and liabilities unlike the Distributable Value Waterfall and the DCF Methodology and, thus, the Court finds it also satisfies section 101(32) of the Bankruptcy Code. TLA is insolvent under the Balance Sheet Test because the sum of TLA's assets exceed the sum of its liabilities by approximately $360 million to $1.3 billion using year-end 2021 financial statements and March 2021 month-end statements, respectively. Edgar Decl. ¶ 11. While Mr. Dellepiane takes issue with the use of book values in the Balance Sheet Test, claiming that an asset's true value may exceed its book value, he has provided no concrete evidence that is the case for any particular asset of TLA and, moreover, he takes no issue with the book value of liabilities listed in TLA's financial statements. Given the delta between TLA's assets and liabilities on the March 2022 financial statement (*i.e.*, approximately $1.3 billion), Mr. Dellepiane's criticism does not even purport to demonstrate how this gap could be bridged. *See* TLA Financial Statements. Moreover, courts regularly

[48] Mr. Dellepiane has set forth no evidence that an 18-month sale is somehow a rushed "fire sale" and does not provide "fair valuation" under section 101(32) of the Bankruptcy Code. *See* Rebuttal Edgar Decl. ¶ 20.

employ balance sheet tests to determine insolvency, *i.e*., whether the sum of an entity's assets exceeds the sum of its liabilities*. See, e.g.*, *In re PTM Techs., Inc*., 2013 WL 4519306, at *6 ("the Bankruptcy Code defines insolvency using the balance sheet test, not cash flow. The test for whether a debtor is solvent is whether the debts of such entity are less than its assets, at fair valuation"); *In re Uhlmeyer*, 67 B.R. 977, 980 (Bankr. D. Ariz. 1986) ("Insolvency is determined by use of § 101[32] of the Code, the so-called balance sheet test: Debtor is insolvent if the sum of her debts is greater than her assets at fair valuation"); *see also* 2 Collier on Bankruptcy P 101.32 (16th ed. 2022) ("the Code definition of insolvency is essentially a balance sheet test").

Accordingly, for the reasons set forth above, the Court finds that Mr. Edgar's Balance Sheet Test and Liquidation Analysis appropriately assess whether TLA is solvent under section 101(32) of the Bankruptcy Code. The Court finds TLA is insolvent under both methodologies. Accordingly, the TLA Claimholders have no right to recover PPI on the TLA GUCs.

<u>Whether the Solvent Debtor Exception Is Applicable Under the Bankruptcy Code</u>

Moreover, assuming *arguendo* that the TLA Claimholders could prove that TLA is solvent, they nonetheless would not be entitled to PPI on the TLA GUCs at the rate set forth in the Debt Instruments. The TLA Claimholders contend that the solvent debtor exception survived the enactment of the Bankruptcy Code through section 1124(1) and, if TLA is solvent, they should be permitted to recover PPI at the contract rate specified in the Debt Instruments.[49] The

[49] The Debtors have requested that the Court exclude certain slides that the TLA Claimholders presented as part of their argument at the evidentiary hearing concerning Plan confirmation (the "Closing Presentation"). The Debtors contend that these slides are not proper demonstratives because they do not categorize or otherwise comment on the record evidence, but instead present new legal argument and new case law absent from the TLA Claimholders Objection.

The Court does not find that the Closing Presentation presents new legal arguments and, accordingly, declines to exclude its contents. The slides at issue speak squarely to the legal theory behind the TLA Claimholders' Objection to the Plan. These include (1) whether solvent debtors must pay PPI to creditors under section 1124(1); (2) the evolution of the solvent debtor exception; (3) whether (and how) the solvent debtor exception survived the enactment of the Bankruptcy Code; (4) the proper methodology to assess TLA's solvency under section 101(32) of

Court disagrees and finds that the solvent debtor exception survived through section 1129(a)(7),[50] not section 1124(1). Because section 1129(a)(7) adopts section 726(a)(5) of the Bankruptcy Code, which calls for interest to be paid "at the legal rate," the Court finds that if TLA was solvent, the TLA Claimholders would only be entitled to interest at the federal judgment rate, not the so-called contract rate—i.e., the rate set forth in the Debt Instruments.

In support of their position, the TLA Claimholders rely heavily on a pre-Bankruptcy Code case, *Ruskin v. Griffiths*, in which the Second Circuit articulated the solvent debtor exception, which they contend requires that unsecured creditors of a solvent debtor receive their full contract rights, including post-petition interest on their claims. *See* 269 F.2d 827, 832 (2d Cir. 1959). They say that is so because the solvent debtor exception recognizes a long-standing equitable principle: a debtor with the ability to pay his debts in full should be required to do so. TLA Claimholders Obj. ¶ 29.

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the Bankruptcy Code; and (5) the proper interest rate at which solvent debtors must pay PPI to their creditors. Courts will exclude closing presentations as improper when they rely on new legal arguments, but here, the issues listed above are not new. *See*, *e.g*., *Bank One, Texas, N.A. v. F.D.I.C.*, 16 F. Supp. 2d 698, 706 (N.D. Tex. 1998) ("The court has analyzed Bank One's demonstrative aids by assessing whether they raise arguments included in Bank One's briefing, and has relied only on arguments and materials fairly presented in Bank One']s briefs filed prior to oral argument."). And, moreover, with the exception of two slides in the Closing Presentation, the remaining allegedly improper slides largely recast the same case law the parties have already debated in their briefs. With respect to case law not discussed in the TLA Claimholders Objection or the Debtors Omnibus Reply, the Court finds their inclusion in the Closing Presentation little different than had counsel simply raised them orally at the evidentiary hearing—an avenue that even the Debtors could not reasonably object to.

[50] Section 1129(a)(7)(A) of the Bankruptcy Code states that:

> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> (7) With respect to each impaired class of claims or interests—
>
> (A) each holder of a claim or interest of such class—
> (i) has accepted the plan; or
> (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date[.]

11 U.S.C. § 1129(a)(7).

The TLA Claimholders contend the solvent debtor exception articulated in *Ruskin* has survived the enactment of the Bankruptcy Code and thus provides an exception to section 502(b)(2)'s ban on post-petition interest. *Id*. ¶ 30. They say that is so based on the legislative history of the repeal of section 1124(3) of the Bankruptcy Code. *Id*. ¶ 31. Thus, they claim that section 1124(1) effectively codified *Ruskin* and provides the mechanism for them to recover PPI from the Debtors. *See id*. ¶¶ 29-31.

In addition to citing the bar to the payment of PPI under section 502(b)(2), the Debtors advance four primary arguments in opposition to paying PPI on account of the TLA GUCs. First, the Debtors contend that the solvent debtor exception did not survive the enactment of the Bankruptcy Code in the way the TLA Claimholders claim it did, as only sections 1129(a)(7) and 726(a)(5) of the Bankruptcy Code provide exceptions to section 502(b)(2) (as relevant here), neither of which is applicable. Debtors Omnibus Reply ¶ 131. They claim if the solvent debtor exception survived, it lives in those provisions, not within section 1124(1). Second, they contend that the solvent debtor exception is not applicable because it is contrary to Supreme Court authority that limits bankruptcy courts' use of equitable power in a way that contravenes the Bankruptcy Code. *Id*. ¶ 133. Third, the Debtors argue that even if the Court finds *Ruskin* remains good law following the enactment of the Bankruptcy Code, it is distinguishable on its facts and cannot provide a rationale to award the TLA Claimholders PPI on their claims. *Id*. ¶¶ 135-136. And fourth, and relatedly, the Debtors contend that the TLA Claimholders misrepresent and distort the post-Bankruptcy Code law concerning the solvent debtor exception, none of which they claim supports a "freestanding equitable exception that permits a court to disregard § 502(b)(2)'s express disallowance of unmatured interest." *Id.* ¶ 138. The Parent GUC Ad Hoc

Group makes similar arguments in opposing the TLA Claimholders' request. *See* Parent GUC Ad Hoc Group Reply ¶¶ 32-41.

The TLA Claimholders and Debtors also debate what interest rate should apply to the TLA GUCs, assuming that the TLA Claimholders are entitled to PPI. The TLA Claimholders contend that Congress has "defined impairment in the broadest possible terms," *Taddeo v. Di Pierro (In re Taddeo)*, 685 F.2d 24, 28 (2d Cir. 1982), and the "Bankruptcy Code creates a presumption of impairment." *In re PPI Enter. (U.S.), Inc.*, 324 F.3d at 203; *see also Windsor on the River Assocs., Ltd. v. Balcor Real Estate Fin. (In re Windsor on the River Assocs., Ltd.)*, 7 F.3d 127, 130 (8th Cir. 1993) ("any alteration of a creditor's rights, no matter how minor, constitutes 'impairment.'"). The TLA Claimholders concede that PPI has been calculated differently by different courts. TLA Claimholders Obj. ¶ 34. *Compare In re Ultra Petroleum Corp.*, 624 B.R. 178, 198-199 (Bankr. S.D. Tex. 2020) ("*Ultra Petroleum II*") (contract rate) *and In re Mullins*, 633 B.R. 1, 19-20 (Bankr. D. Mass. 2021) (state judgment rate), *with Hertz*, 2021 WL 6068390, at *16 (federal judgment rate) *and In re PG&E Corp.*, 610 B.R. 308 (Bankr. N.D. Cal. 2019) (same).

The TLA Claimholders contend that the disparity in interest rates is new, and that, decades ago, *Ruskin* directed that the contractual rate of interest should be applied to provide creditors what they bargained for in solvent debtor cases. *See* Claimholders Obj. ¶¶ 35-36 (citing *Ruskin*, 269 F.2d at 832 (reversing district court and applying PPI at the contractual default rate, finding that such rate was neither a penalty nor unconscionable and reasoning that a solvent debtor cannot be allowed to "escape the expressly-bargained-for result of its act")).

The Debtors rely heavily on *In re PG&E Corp.*, 610 B.R. 308, and *Hertz*, 2021 WL 6068390, to argue that, at best, the TLA Claimholders are entitled to PPI at the federal judgment rate. *See* Debtors Omnibus Reply ¶ 140; *see also In re Daffy's, Inc*., No. 12-13312 (MG), 2013 WL 1703267, at *19 (Bankr. S.D.N.Y. Apr. 17, 2013) ("Courts have held that a creditor who receives payment in full with interest at the federal judgment rate is not impaired"). The TLA Claimholders contend that *In re PG&E Corp.* and *Hertz* should not be applied here because they are contrary to binding Second Circuit precedent (*i.e*, *Ruskin*). TLA Claimholders Obj. ¶ 39. They say these cases are premised on a mistaken finding that section 1129(a)(7) (the best interest test) is the only basis to provide PPI to unimpaired unsecured creditors. *In re PG&E Corp*., 610 B.R. at 312 (bankruptcy court's decision was based on its reading of Ninth Circuit precedent as dictating that the best interests test, and the standard in section 726(a)(5) of the Bankruptcy Code, was the only basis for unimpaired creditors of solvent debtors to obtain PPI); *Hertz*, 2021 WL 6068390, at *16 ("Significantly, neither the Bankruptcy Code nor the Legislative History expressly states that unimpaired creditors are entitled to their contract rate of interest or even to <u>more</u> than impaired creditors in the case of a solvent debtor. Instead, the Legislative History provides strong evidence Congress intended that unimpaired creditors in a solvent chapter 11 debtor case should receive post-petition interest only in accordance with sections 1129(a)(7) and 726(a)(5).").

The TLA Claimholders contend that the Court should not follow this line of cases (and reasoning) because it is contrary to Second Circuit precedent, other rulings in this district, the solvent debtor exception, and the Bankruptcy Code. TLA Claimholders Obj. ¶ 39 (citing *In re Mullins*, 633 B.R. at 16 ("[I]n solvent debtor cases, the requirement in § 1129(b) that a plan of reorganization be 'fair and equitable' may require the payment of postpetition interest on allowed claims in amounts greater than would be required to satisfy the 'best interests test' of § 1129(a)(7)(A)(ii) and the 'absolute priority rule' set out in § 1129(b)(2)(B).")). They say that is so because in the Second Circuit, an unimpaired creditor's entitlement to receive contract rate interest from a solvent debtor arises from equitable considerations and is not limited by the best interest test. *Id*. ¶ 42 (citing *In re 53 Stanhope*, 625 B.R. at 578-79).

The Court finds that if TLA was solvent, the TLA Claimholders would be entitled to PPI on the TLA GUCs at the federal judgment rate, not the rate called for in their Debt Instruments. As set forth below, providing contract-rate interest is contrary to the express prohibition of unmatured interest on claims under section 502(b)(2), relies too heavily on the reasoning in *Ultra Petroleum II*, and mischaracterizes the degree to which (and how) the solvent debtor exception has survived the enactment of the Bankruptcy Code.

In *Ultra Petroleum II*, the bankruptcy court on remand analyzed whether the solvent debtor exception survived enactment of the Bankruptcy Code and, if so, what provision of the Bankruptcy Code implicitly codified it and called for a solvent debtor to pay its unimpaired unsecured creditors interest at their contract rate. 624 B.R. at 200-204. The court held that the solvent debtor's unimpaired creditors were entitled to post-petition interest at the contract rate pursuant to section 1124(1) of the Bankruptcy Code in order to ensure their equitable rights to such interest were not altered. *Id*. at 202; 11 U.S.C. § 1124(1) ("a class of claims or interests is impaired under a plan unless . . . [it] leaves unaltered the legal, equitable, and contractual rights" of a claimholder). It held as such based on the legislative history of section 1124 and the fact that the provisions of the Bankruptcy Code that expressly codified aspects of the solvent debtor exception—*e.g*., section 1129(a)(7)—were not applicable. *Ultra Petroleum II*, 624 B.R. at 200-202. The court noted that Congress amended section 1124 in response to *In re New Valley Corp*., 168 B.R. 73 (Bankr. D.N.J. 1994) ("*New Valley*"), which held that a solvent debtor's plan permissibly withheld post-petition interest from a class of unsecured creditors pursuant to section

1124(3) of the Bankruptcy Code. Section "1124(3) stated that a claim was unimpaired where 'the holders of such claim . . . receive[d] . . . cash equal to . . . the allowed amount of such claim.'" *Ultra Petroleum II*, 624 B.R. at 199 (quoting 11 U.S.C. § 1124(3) (1988)). In 1994, Congress removed section 1124(3) from the Bankruptcy Code. *See* H.R. Rep. No. 103-835 (1994). In doing so, it stated:

> The principal change in this section ... relates to the award of postpetition interest. In a recent Bankruptcy Court decision in *New Valley*, unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent. The *New Valley* decision applied section 1124(3) of the Bankruptcy Code literally by asserting ... that a class that is paid the allowed amount of its claims in cash on the effective date of a plan is unimpaired under section 1124(3), therefore is not entitled to vote, and is not entitled to receive postpetition interest .... In order to preclude this unfair result in the future, the Committee finds it appropriate to delete section 1124(3) from the Bankruptcy Code.

Ultra Petroleum II, 624 B.R. at 200 (citing H.R. Rep No. 103-835, at 47-48 (1994)).

The court found that this excerpt from the House Reporter demonstrates that in enacting the Bankruptcy Code, Congress did not intend to eliminate the solvent debtor exception for unimpaired unsecured creditors of solvent debtors, notwithstanding that no provision of the Bankruptcy Code expressly provided for them to receive PPI from solvent debtors.[51] *See id.* at 199-200. Focusing on the "unfair result" evoked by Congress, the court found that the repeal of section 1124(3) of the Bankruptcy Code demonstrated that unimpaired unsecured creditors must receive their "bargained for interest"—*i.e.*, interest under their contractual rates—through the solvent debtor exception's operation in section 1124(1). *See id.* at 200.

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[51] The court recognized that the Bankruptcy Code codified the solvent debtor exception for impaired unsecured creditors in section 1129(a)(7) of the Bankruptcy Code but found that provision could not justify an award of PPI to unimpaired creditors. *See Ultra Petroleum II*, 624 B.R. at 202 ("[n]othing in the text of the Bankruptcy Code applies § 1129(a)(7) to unimpaired creditors."). As such, it found it necessary to look elsewhere in the Code to "understand the solvent debtor exception's operation." *Id*. at 200.

However, *Ultra Petroleum II* does not persuasively demonstrate why Congress intended for contract-rate interest to apply to creditors' claims against solvent debtors. First, applying PPI to unimpaired creditors' claims is contrary to the express language of the Bankruptcy Code. Section 502(b)(2)'s bar on unmatured interest is not limited to cases other than solvent debtors. Congress could have amended this provision accordingly—in 1994 or otherwise—but it did not. Second, *Ultra Petroleum II* analyzed only a part of the legislative history of the repeal of section 1124(3). Analyzing the Congressional record in a more fulsome way demonstrates that Congress intended to address the "unfair result" of *New Valley* in the context of section 1129(a)(7), not section 1124(1) where the court in *Ultra Petroleum II* grounded its analysis.

Judge Walrath found as much in *Hertz*; this Court finds that reasoning persuasive. The court in *Hertz* also rejected *Ultra Petroleum II*'s conclusion that the legislative history of Congress' repeal of section 1124(3) of the Bankruptcy Code showcases Congress' intent that the solvent debtor exception survived enactment of the Code through section 1124(1) and calls for unimpaired creditors of solvent debtors to receive contract-rate interest. In doing so, the *Hertz* court noted that Congress explained the repeal's impact as follows:

> The principal change in this section is set forth in subsection (d) and relates to the award of postpetition interest. In a recent Bankruptcy Court decision in *In re New Valley Corp*., 168 B.R. 73 (Bankr. D.N.J. 1994), <u>unsecured creditors were denied the right to receive postpetition interest on their allowed claims even though the debtor was liquidation and reorganization solvent.... In order to preclude this unfair result in the future</u>, the Committee finds it appropriate to delete section 1124(3) from the Bankruptcy Code.
>
> As a result of this change, if a plan proposed to pay a class of claims in cash in the full allowed amount of the claims, the class would be impaired, entitling creditors to vote for or against the plan of reorganization. If creditors vote for the plan of reorganization, it can be confirmed over the vote of dissenting class of creditors only if it complies with the "fair and equitable" test under section 1129(b)(2) of the Bankruptcy Code and it can be confirmed over the vote of dissenting

> individual creditors only if it complies with the "best interests of creditors" test under section 1129(a)(7) of the Bankruptcy Code.
>
> <u>The words "fair and equitable" are terms of art that have a well established meaning under the case law of the Bankruptcy Act as well as under the Bankruptcy Code. Specifically, courts have held that where an estate is solvent, in order for a plan to be fair and equitable, unsecured and undersecured creditors' claims must be paid in full, including postpetition interest, before equity holders may participate in any recovery</u>.

637 B.R. at 796 (citing H.R. Rep. No. 103-835, at 48 (1994)).

Judge Walrath found that this synopsis from the House Reporter, analyzed collectively, undermines the conclusion of *Ultra Petroleum II* that Congress intended to ground the solvent debtor exception in section 1124(1) for unimpaired creditors of solvent debtors. *Id.* Judge Walrath said that is so because:

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

Id. Indeed, the legislative history explicitly cites section 1129(a)(7), not section 1124(1), while discussing the "unfair result" in *New Valley*. The Court finds that this suggests that Congress intended to preserve the solvent debtor exception in the context of the "best interest of creditors" test under 1129(a)(7), not section 1124(1)'s requirement that a class of creditors is impaired unless a plan leaves their "legal, equitable, and contractual rights" "unaltered." *See* 11 U.S.C. § 1124(1). As analyzed above, the latter speaks to impairment under a "plan", not the Bankruptcy Code and, thus, forecloses any argument that unimpaired creditors of solvent debtors are entitled to PPI at their contract rate. *See id.*; *see also Ultra Petroleum I*, 943 F.3d at 763; *In re PG&E Corp*., 610 B.R. at 315-16 (reasoning that group of unsecured creditors of a solvent debtor were entitled to interest on their claims at the federal judgment rate, not the contract rate, and rejecting argument that section 1124(1) demanded otherwise).

The Court finds that to reason otherwise—and deem the solvent debtor exception to be embodied within section 1124(1)—is contrary to the Supreme Court's directive that bankruptcy courts avoid creating judicial exceptions that contravene express provisions of the Code. *See*, *e.g.*, *Law v. Siegel*, 134 S. Ct. 1188, 1196-97 (2014) ("the Code's meticulous . . . enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions."). That is so because of the unconditioned prohibition on unmatured interest within section 502(b)(2). 11 U.S.C. § 502(b)(2) (a claim "shall [be] allow[ed] . . . except to the extent that . . . such claim is for unmatured interest[.]"). Grounding the solvent debtor exception in section 1129(a)(7), on the other hand, complies with *Siegel* by finding a textual hook for the common law doctrine—one that comports with Congress' intent as evidenced by the House Reporter excerpt analyzed in *Hertz*. As such, the Court finds that to the extent the TLA Claimholders are entitled to PPI, the award is derived from section 1129(a)(7) of the Bankruptcy Code. *See Hertz*, 2021 WL 6068390, at *16 ("after consideration of the . . . express language of the Bankruptcy Code, and its Legislative History, the Court is convinced that the solvent debtor exception survived passage of the Bankruptcy Code only to a limited extent . . .. [including] in section 1129(a)(7) and 726(a)(5) as to unsecured creditors.").

That is not the end of the inquiry, as the Court must reconcile how section 1129(a)(7)—which on its face applies only to an "impaired class of claims or interests"—applies to the TLA Claimholders. If section 1129(a)(7) is applicable, it would yield the TLA Claimholders post-petition interest on the TLA GUCs at the federal judgment rate—totaling approximately $3 million. That is so because section 1129(a)(7), the best interest of creditors test, prevents confirmation of a plan under chapter 11 if a dissenting impaired class obtains less under the plan than it would if the debtor were liquidated under chapter 7. *Ultra Petroleum II*, 624 B.R. at 201. Since an unsecured creditor under chapter 7 must receive post-petition "interest at the legal rate," 11 U.S.C. § 726(a)(5), before any distribution to the debtor, section 1129(a)(7) operates to provide impaired, unsecured creditors of solvent debtors with interest on their claims at the federal judgment rate via section 726(a)(5) of the Bankruptcy Code.

The court in *Hertz* resolved this quandary by concluding that section 1129(a)(7) must apply to both impaired and unimpaired creditors, notwithstanding that, by its plan language, it applies only to the former. *See Hertz*, 2021 WL 6068390, at *16. Judge Walrath said that is so, again, based on the legislative history of Congress' repeal of 1124(3). That history, as detailed above, abrogated *New Valley*, which held that unimpaired creditors were not entitled to post-petition interest because "sections 726(a)(5) and 1129(a)(7) were only applicable to impaired creditors and because section 1124(3) required only the payments of the allowed amount of their claims. . . ." *Id.* at *11 (citing *New Valley*, 168 B.R. at 79-81). By abrogating that "unfair result", and explicitly referencing section 1129(a)(7), the Court in *Hertz* found that Congress must have intended that both impaired and unimpaired unsecured creditors of solvent debtors who are receiving payment of their claims in cash in full should receive PPI "at the legal rate," *see* 11 U.S.C. § 726(a)(5)—*i.e.*, the federal judgment rate. *See Hertz*, 2021 WL 6068390, at *16.

The Court agrees with *Hertz* and holds that if TLA was solvent, then the Debtors would have to include PPI at the federal judgment rate to satisfy the TLA GUCs under the Plan. This is so because the Court finds that the solvent debtor exception survived the enactment of the Bankruptcy Code through section 1129(a)(7) (as relevant here), not section 1124(1) as the TLA Claimholders contend. While the Court is cautious with reaching conclusions based, in part, on equitable principles that seemingly wrangle with the Bankruptcy Code, it finds that the alternative outcomes—awarding no PPI or, alternatively, PPI at the rate under the Debt Instruments—are simply untenable and illogical. The former would offend basic tenants of fairness and the purposes of the Bankruptcy Code by essentially allowing impaired creditors to be treated better than unimpaired creditors via an overly strict reading of section 1129(a)(7) that is contrary to Congressional intent. While that outcome would comport with the plain language of section 1129(a)(7), this Court is cognizant that it should not adopt an "overly literal interpretation of the Bankruptcy Code," but rather must craft holdings that give effect to the Bankruptcy Code's provisions in harmony with legislative history and public policy. *See*, *e.g.*, *CompuAdd Corp. v. Tex. Instruments Inc., (In re CompuAdd Corp.)*, 137 F.3d 880, 882 (5th Cir. 1998); *see also Buchwald v. Williams Energy Mktg. & Trading Co. (In re Magnesium Corp. of Am.)*, 460 B.R. 360, 367 (Bankr. S.D.N.Y. 2011) ("Statutory provisions (including, and perhaps especially, those in the Bankruptcy Code) must be considered *in pari materia*, and one statutory provision in the Bankruptcy Code cannot be considered without reference to other relevant provisions of the same statute, and its object and policy."). And, if the Court followed *Ultra Petroleum II* and awarded contract-rate PPI on the TLA GUCs, doing so would lack a clear provisional hook in the Bankruptcy Code or its legislative history given that it rests on an interpretation of section 1124(1) that the Court finds is not appropriate for the reasons set forth above.

This result is not at odds with *Ruskin*, despite the TLA Claimholders claiming otherwise. TLA Claimholders Obj. ¶ 42. They rely heavily on *Ruskin*, contending that it is binding Second Circuit precedent that mandates that the Plan provide them PPI at the contractual rates set forth in their Debt Instruments. TLA Claimholders Obj. ¶ 2. They say that is so because *Ruskin* articulated the common law solvent debtor exception in the Second Circuit by reasoning that principles of equity and fairness dictate that a solvent debtor cannot "escape [its] expressly-bargained for" agreements. *Ruskin*, 269 F.2d at 832. Furthermore, the TLA Claimholders contend that *Ruskin* has survived the enactment of the Bankruptcy Code because it has been cited approvingly by courts within the Second Circuit after Congress enacted the Bankruptcy Code.[52]

The Court does not disagree. But the TLA Claimholders fail to note that the cases they cite primarily address whether oversecured creditors, not unsecured creditors, are entitled to contract-rate interest from solvent debtors. *See, e.g., In re Gen. Growth Prop., Inc*., 451 B.R. 323, 328 (Bankr. S.D.N.Y. 2011) ("*General Growth*") (awarding default interest at the contract rate pursuant to section 506(b)); *Urb. Communicators PCS Ltd. P'Ship v. Gabriel Cap. L.P*., 394 B.R. 325, 338-340 (S.D.N.Y. 2008) ("*Urb. Communicators*") (utilizing *Ruskin* to apply contractual default rate to calculate interest due on oversecured creditors' claims under section 506(b)"). That distinction matters because section 506(b) of the Bankruptcy Code expressly provides that on "such claim[s], there shall be allowed to the holder of such claim[s], interest on such claim . . . provided for under the agreement or state statute under which such claim arose."

[52] For these reasons, the TLA Claimholders contend that the Court, bound by *Ruskin* and its progeny in the Second Circuit, could not reach the same outcome as the court in *Hertz*. *See* TLA Claimholders Obj. ¶ 42. The TLA Claimholders also contend that another recent bankruptcy court case, *In re Mullins*, undercuts *Hertz*'s logic concerning where and how the solvent debtor exception survived the enactment of the Bankruptcy Code. *See id*. ¶ 39 (citing *In re Mullins* for the proposition that "*Hertz* . . . should not be followed here as [it] runs counter to . . . the solvent debtor exception[] and the Bankruptcy Code"). The Court rejects that argument because it ignores the fact that *In re Mullins* and *Hertz* analyzed the solvent debtor exception in different legal contexts. The court in *Hertz* addressed whether the solvent debtor exception could be encompassed within section 1124(1)'s requirement that to be unimpaired, a plan must "leave[] unaltered the legal, equitable, and contractual rights" of a claimholder. *See* 11 U.S.C. § 1124(1). It found the solvent debtor exception did not survive within section 1124(1). *See Hertz*, 2021 WL 6068390, at *15 ("this Court cannot agree with the Bankruptcy Court in *Ultra Petroleum [II]* that being unimpaired mandates that the Noteholders receive their contract rate of interest [under section 1124(1)] in contravention of section 502(b)(2)."). The court in *In re Mullins* court found that the solvent debtor exception survived the enactment of the Bankruptcy Code through section 1129(b)'s cram down provision and held that for the solvent debtor to satisfy the "fair and equitable" provision of section 1129(b), it had to pay post-petition interest to an impaired class of creditors that did not accept the plan. 633 B.R. at 16. As such, *In re Mullins* is inapposite because, here, the Plan treats the TLA Claimholders as unimpaired and there is no need for the Court to analyze section 1129(b) of the Bankruptcy Code.

11 U.S.C. § 506(b). As such, unlike here, the creditors in *General Growth* and *Urb. Communicators* benefited from an *express* textual hook in the Bankruptcy Code—section 506(b)—through which the bankruptcy court could exercise its equitable power. In other words, unlike the case with unsecured creditors, the courts in *General Growth* and *Urb. Communicators* were not faced with the potential for utilizing their equitable powers in a way that contravened the Bankruptcy Code—*i.e.*, the problem that, in the Court's view, renders *Ultra Petroleum II* unpersuasive, especially its holding that the solvent debtor exception for unsecured creditors was de facto codified within section 1124(1).[53] *See*, *e.g*., *Hertz*, 2021 WL 6068390, at *15-16.

In that sense, the Court finds that *Ruskin* provides a court-created tool from which a bankruptcy court can construe express allowances through express provisions of the Bankruptcy Code, like the interest rate used to calculate PPI due to oversecured creditors, without running afoul of *Siegel* and creating judicial exceptions to the Bankruptcy Code's provisions. *See*, *e.g*., *General Growth*, 451 B.R. at 328 ("The payment of default interest . . . is also consistent with the increasing reluctance of courts in this and other circuits, in construing the requirement of § 506(b) that an oversecured creditor receive 'interest,' to modify private contractual arrangements imposing default interest rates except where: (i) there has been creditor misconduct; (ii) application of the contractual interest rate would cause harm to the unsecured creditors; (iii) the

[53] The TLA Claimholders also rely on *In re 53 Stanhope* seemingly to support the idea that *Ruskin* carves out a separate stand-alone home for the solvent debtor exception. *See* TLA Claimholders Obj. ¶ 42 (citing *In re 53 Stanhope*, 625 B.R. at 578–79 (citing how "longstanding case law" can provide an exception to the Bankruptcy Code's ban on unmatured interest). The Court finds that the TLA Claimholders put too much emphasis on this reference. *See id*. The court in *In re Stanhope* did not reason that exceptions to section 502(b) could be grounded in case law, such as *Ruskin*, in a manner divorced from the plain language of the Bankruptcy Code, and its object and policy. Further, the TLA Claimholders' reliance on *In re 53 Stanhope* is curious given that the exceptions to section 502(b) in the excerpt it cited—i.e., (i) the "best interests" test in section 1129(a)(7)"; (ii) "the fair and equitable test of section 1129(b)"; and (iii) "long standing case law"—did not provide the basis for its award of PPI to an oversecured creditor. *See id*. Instead, section 506(b) did. *See id*. at 580 ("I therefore conclude that unimpairment under section 1124(1) does not eliminate the factors that courts consider when they decide whether to apply a contract interest rate under section 506(b) and, more specifically, the consideration of those factors when deciding whether to employ a default rate as opposed to a non-default contract rate.").

contractual interest rate constitutes a penalty; or (iv) its application would impair the debtor's fresh start."); *In re 53 Stanhope*, 625 at 579 ("[i]t is well established that section 506(b) does not require an oversecured creditor's post-petition interest to be paid at any *particular* rate, the issue here.").

The TLA Claimholders further contend that, notwithstanding the above, the balance of the equities separately entitles them to PPI on the TLA GUCs calculated at their contractual rate of interest. *See* TLA Claimholders Obj. ¶ 45. They cite to the fact that section 1124(1) of the Bankruptcy Code specifically states that a plan only unimpairs creditors when it leaves their "equitable" rights unaltered. *See* 11 U.S.C. §1124(1). The Court is unpersuaded for the reasons set forth above. Section 1124 speaks to impairment under a plan, not limitations expressly set forth in the Code. *See*, *e.g. Ultra Petroleum I*, 943 F.3d at 765. As such, and as set forth above, the Court declines to exercise its equitable powers in a manner at odds with the express language of the Code, including its ban on "unmatured interest" (*i.e.*, PPI) under Section 502(b)(2).[54]

But even if the Court indulged the TLA Claimholders, their argument is without merit. The Court agrees with the Debtors that it would not be equitable to allow the TLA Claimholders to receive approximately $150 million more to satisfy the TLA GUCs given the context of the Plan. The Plan represents a delicate, intricate, and integrated compromise of myriad claims, arguments, and rights. *See*, *e.g.*, Plan § 5.2. As such, providing the TLA Claimholders with an additional recovery would reduce the recoveries to impaired creditors under the Plan and risk disrupting the delicate balance set forth in it. The Court will not sanction that result.

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[54] As with their contention that they are entitled to PPI calculated with the rates set forth in the Debt Instruments based on the Bankruptcy Code, the TLA Claimholders rely on caselaw concerning oversecured creditors, not unimpaired unsecured creditors like TLA. *See, e.g.*, *General Growth*, 451 B.R. at 328. These are distinguishable for the reasons set forth above and thus provide no support for the TLA Claimholders' equitable arguments.

In conclusion, the Court overrules the TLA Claimholders Objection.[55] The Court finds that the TLA GUCs are treated as unimpaired under the Plan and that the Plan does not run afoul of section 1124(1) of the Bankruptcy Code. As such, the Plan does not violate section 1129(a)(1) of the Bankruptcy Code. Finally, the Plan does not violate section 1129(a)(8) with respect to the TLA GUCs because the TLA Claimholders are not impaired and thus have no right to vote to accept or reject the Plan.

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[55] The Court also overrules the TLA Claimholders Supplemental Objection. This objection arose from the TLA Claimholders' supplemental deposition of Mr. Edgar, which took place after the Court concluded the evidentiary hearing with respect to Plan confirmation. The Court permitted the TLA Claimholders to conduct this supplemental deposition concerning an appraisal of the Debtors' frequent flier program, LATAM Pass (the "FF Program"), which the Debtors produced after the Court's deadline for parties in interest to file objections to Plan confirmation.

The TLA Claimholders contend that the Court should not give credence to Mr. Edgar's expert opinion because his Liquidation Analysis fails to expressly value the FF Program, including specific aspects of the FF Program that could be monetized (*e.g.*, intellectual property associated with the FF Program and proceeds generated from selling frequent flier points to third-party partners). *See* TLA Claimholders Supplemental Objection ¶¶ 1-7. They also contend that TLA could have used the value of the FF Program to raise debt, which they claim undermines Mr. Edgar's conclusion that TLA could not continue to operate as a going concern without LATAM Parent. *See id*. ¶ 3; *see also* Edgar Rebuttal Decl. ¶ 22 ("[w]ithout that association, it would be difficult for TLA to survive. It is questionable whether TLA on a standalone basis would have been able to obtain sufficient DIP financing on its own to survive . . . .").

The Court finds no merit to these contentions. First, as discussed above, the TLA Claimholders, not the Debtors, bear the burden of proof with respect to the issue of TLA's solvency. The supplemental objection sets forth no affirmative evidence of the value of the FF Program, let alone whether it is sufficient to boost the sum value of TLA's assets over its liabilities, as required under section 101(32) of the Bankruptcy Code. Second, the TLA Claimholders appear to take issue primarily with Mr. Edgar's Liquidation Analysis, not the Balance Sheet Test. Even assuming *arguendo* that Mr. Edgar's failure to expressly consider the value of the FF Program is fatal to the Liquidation Analysis, the Court found above that the Balance Sheet Test adequately assesses whether TLA is "insolvent" under section 101(32) (and indeed demonstrates TLA is insolvent). Finally, the Court declines to find that the potential value of the FF Program undermines Mr. Edgar's assessment that TLA could not obtain a loan. Mr. Edgar assessed whether TLA could obtain a loan as a potential alternative for TLA to continue to operate as a going concern without its affiliation with LATAM Parent and the financial benefits it obtains from that affiliation. *See* Edgar Rebuttal Decl. ¶ 22. He concluded that TLA was unlikely to obtain DIP financing on its own for various reasons, including its lack of available collateral. *Id*. The TLA Claimholders have set forth no evidence that the FF Program is valuable enough to change that assessment.

The Columbus Hill Objection

As a publicly held Chilean corporation, LATAM Parent is governed by the Corporations Act,[56] Corporations Act Regulation,[57] and Securities Market Act,[58] and regulations promulgated thereunder. Ried Decl. at 6.[59] It is also subject to the oversight of Chile's securities regulator, the Financial Market Commission (*Comisión para el Mercado Financiero,* or the "CMF"). *Id.* at 7. Under the Corporations Act, a Chilean corporation cannot issue new shares of stock without first obtaining shareholder approval. *See* Corporations Act, Art. 15. The Corporations Act also grants the shareholders preemptive rights to subscribe for their pro rata portion of any shares issued by that corporation. *Id.*, Art. 25. The foregoing applies equally when the corporation is issuing shares or securities convertible into shares. *Id.* It is only after the corporation has obtained shareholder approval for the issuance of new shares, and the expiration of the mandated thirty-day preemptive rights period, that a Chilean corporation may allocate or offer shares or convertible securities that have not been purchased by existing shareholders, to third parties. *Id.,* Arts. 25, 29. The corporation cannot offer those shares or convertible securities to third parties at a price lower (or otherwise on terms more favorable) than the price or other terms offered to shareholders during the preemptive rights period. *Id.*, Art. 29.

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[56] Law No. 18,046, Ley Sobre Sociedades Anónimas [Chilean Corporations Act], 1981, Diario Oficial [D.O.] (the "Corporations Act").

[57] Decree No. 702, Reglamento de la Ley de Sociedades Anónimas [Chilean Corporations Act Regulation], 2012 (the "Corporations Act Regulation").

[58] Law No. 18,045, Ley de Mercado de Valores [Chilean Securities Market Act], 1981, Diario Oficial [D.O.] (the "Securities Market Act").

[59] Columbus Hill Tr. Ex. 1 (Declaration of José Miguel Ried) (the "Ried Decl."). Mr. Ried is a Chilean lawyer and a Professor of Commercial law in Chile. He provided expert testimony on various Chilean law matters in support of the Columbus Hill Objection. *Id.* at 1.

Article 15 of the Corporations Act provides that a corporation can offer new shares for cash or non-cash "in kind" consideration. *Id.*, Art. 15. Where the purchaser offers "in kind" consideration for new shares, Articles 15 and 67 of the Corporations Act mandate (i) that the corporation obtain appraisals of the "in kind" consideration from at least two qualified independent experts (unless the shareholders vote unanimously to waive the requirement), and (ii) that shareholders holding a two-thirds or greater supermajority of the outstanding shares entitled to vote approve the transaction and the valuation. *Id.*, Arts. 15, 67; *see also* Ried Decl. at 14-16; Puga Decl. at 4.[60] It is settled that the "in kind" standards apply to the issuance of new shares, but not to the issuance of convertible securities. *See* Third Contador Decl. ¶¶ 17-18;[61] *see also* May 6, 2022 Ried Dep. at 64:22-65:6 (testifying that Corporations Act Article 15 does not discuss convertible notes).[62]

Chilean courts and regulators evaluate transactions to ensure that Chilean corporations are not seeking to avoid or impair the statutory appraisal, approval, and preemptive rights of shareholders. They will not recognize transactions that are structured to avoid compliance with these shareholder rights. *See* Ried Decl. at 18-20; Puga Decl. at 3. Under Chilean law, if a set of purportedly valid legal acts is put in place either to obtain a result forbidden or avoided by the law, or to conceal a breach of the law, those otherwise legal acts could be declared void under the "simulation" ("simulación") or fraud to the law ("fraude a la ley") doctrines. Ried Decl. at

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60 Columbus Hill Tr. Ex. 2 (Declaration of Juan Esteban Puga) (the "Puga Decl."). Mr. Puga is a Chilean lawyer and Professor of Commercial law in Chile. He provided expert testimony on Chilean law matters in support of the Columbus Hill Objection. *Id.* at 1.

61 Debtors Tr. Ex. 18 (Declaration of Nelson Contador in Response to the Statements of Juan Esteban Puga Vial and José Miguel Ried Concerning the Plan's Alleged Violation of the Protections Granted to Shareholders of LATAM Under Chilean Law) (the "Third Contador Decl."). Mr. Contador is a Chilean lawyer and Professor of Commercial law in Chile. He provided expert testimony on Chilean law matters in support of the Debtors' request that the Court confirm the Plan. *Id.*, Ex. A (C.V. of Nelson Contador).

62 Columbus Hill Tr. Ex.14 (May 6, 2022 Deposition of José Miguel Ried) (the "May 6, 2022 Ried Dep.").

18-20; Puga Decl. at 4. An act would be considered simulated if (i) it consists of a declared intention that does not match the actual intention of the parties, (ii) the declared intention has been agreed upon by both parties and (iii) the actual intention is to deceive third parties. Ried Decl. at 18-19. In contrast, fraud to the law involves indirectly circumventing a legal mandate or prohibition in a manner that it is rendered ineffective, and its final intention is evaded. *Id*. at 19. While the purpose of simulation is to conceal a violation of the law, the purpose of a fraud to the law is to circumvent a statutory rule. *Id.*

Columbus Hill asserts that the provisions of the Plan governing the issuance of the New Convertible Notes violate Chilean law and cannot be implemented in Chile. For that reason, it says that the Court must deny confirmation because the Plan does not satisfy section 1129(a)(11) of the Bankruptcy Code since it is not feasible, and because the Debtors cannot show that they proposed the Plan in good faith, as required by section 1129(a)(3) of the Bankruptcy Code. *See* Columbus Hill Obj. ¶¶ 9, 46. Columbus Hill makes several arguments in support of the objection. It contends that the Plan violates the preemptive rights of LATAM Parent's shareholders over stock, and securities convertible into stock, because it offers Class B Notes and new LATAM Parent shares underlying the notes to the RSA Shareholders on better terms than it offers to existing LATAM Parent shareholders. *See id*. ¶¶ 1, 8, 27; Ried Decl. at 3, 5. It also asserts that the Plan violates the preemptive rights of the LATAM Parent shareholders to acquire Class A Notes and Class C Notes and the new LATAM Parent shares underlying those notes because it offers the notes to Holders of Allowed General Unsecured Class 5 Claims at lower prices and on better terms than those that will be offered to existing shareholders during the preemptive rights offering period. *See* Columbus Hill Obj. ¶¶ 1, 16-26; Ried Decl. at 4-5, 9-12, 36-37.

On a different note, in support of the objection, Columbus Hill contends that the procedures that the Debtors intend to implement in issuing the Class A Notes and Class C Notes violate Chilean law. In substance, Columbus Hill argues that the Court must disregard the labels attached to the notes and treat them as stock, because the Class A Notes and Class C Notes are not bona fide debt instruments, but rather are vehicles for issuing new shares of LATAM Parent common stock to General Unsecured Class 5 Creditors. *See* Columbus Hill Obj. ¶¶ 2, 31-33, 46; Ried Decl. at 20-22. It asserts that, in reality, the Plan calls for Holders of Allowed General Unsecured Class 5 Claims to make an "in kind" contribution consisting of the Allowed General Unsecured Class 5 Claims in exchange for the new LATAM Parent shares. It maintains that the Plan violates Chilean law because it does not call for LATAM Parent to obtain an appraisal of the Allowed General Unsecured Class 5 Claims at fair market value, or for LATAM Parent's shareholders, by a vote of at least two-thirds of all shares, to approve both the issuance of the shares to creditors in exchange for their claims, and the valuation of such claims. *See* Columbus Hill Obj. ¶¶ 1, 16, 28-33; Ried Decl. at 17-18, 36-37. It asserts that the Chilean courts will not merely reject the transaction. It contends that under the simulation or fraud to the law doctrines, the Chilean courts will nullify and avoid the Debtors' attempt to issue new shares of LATAM Parent common stock to third parties in the form of "convertible notes" that are not bona fide debt instruments. *See* Columbus Hill Obj. ¶¶ 31-32, 48-49; Ried Decl. at 9-11, 20-22, 36-37.

The Debtors challenge the objection. In short, they deny that the Plan compromises the preemptive rights of the LATAM Parent shareholders with regard to the issuance of the New Convertible Notes and new LATAM Parent shares underlying the notes. *See* Debtors Omnibus Reply ¶ 86; Third Contador Decl. ¶¶ 34-37, 43. They also deny that LATAM Parent will acquire the Allowed General Unsecured Class 5 Claims in consideration for the new LATAM Parent stock. They maintain that Columbus Hill mischaracterizes the transactions under the Plan and, as a consequence, misstates applicable Chilean law. *See* Debtors Omnibus Reply ¶ 91; Third Contador Decl. ¶ 36. They contend that the issuance of the New Convertible Notes under the Plan complies with Chilean law and, if challenged in Chile, will be approved by the Chilean courts and regulators. *See* Debtors Omnibus Reply ¶ 85; Third Contador Decl. ¶ 49.

The Court first considers Columbus Hill's assertion that the Plan violates the LATAM Parent's shareholders' preemptive rights over stock and securities convertible into stock pursuant to the Class B Notes. Columbus Hill complains that non-controlling shareholders who purchase the Class B Notes and their underlying shares will be subject to a four-year lock-up period, but that the RSA Shareholders are excepted from this requirement for trades among themselves. *See* Columbus Hill Obj. ¶¶ 8, 27, 44; Ried Decl. at 5. For that reason, it maintains that the Plan violates Chilean law preemptive rights because it is offering these notes to the Backstop Parties on preferential terms not available to the other shareholders. *See* Columbus Hill Obj. ¶¶ 8, 27, 44; Ried Decl. at 5. The Court questions that contention. Like all shareholders who are getting the opportunity to participate in the Class B Notes based on their Chilean preemptive rights and not as Plan distributions, the RSA Shareholders are subject to the lockup restrictions against selling shares in the market, thus achieving the goal of the lockup. That they may trade shares among themselves does not alter this restriction.

Columbus Hill also contends that the Plan violates LATAM Parent shareholders' preemptive rights because under Chilean law, the Backstop Fee that the Debtors will pay the Commitment Creditors under the Commitment Creditors Backstop Agreement is a direct 20% discount that is not available to shareholders or other non-backstop parties. *See* Columbus Hill Obj. ¶ 21, 26; *see also* Ried Decl. at 13-14; Commitment Creditors Backstop Agreement §

3.1(a). However, that payment will be made in exchange for backstopping certain offerings under the Commitment Creditors Backstop Agreement. *See* Backstop Opinion at 51 ("The Backstop Payments to the Commitment Creditors provide consideration in exchange for that substantial capital commitment to backstop the entire $3.669 billion new money investment for the entire commitment period."). The Debtors contend, and Columbus Hill does not dispute, that the right to receipt of a fee in exchange for this commitment is not triggered by, has no relation to, and is not paid as consideration for, the acquisition of the New Convertible Notes by the Commitment Creditors in their capacity as unsecured creditors. *See* Debtors Omnibus Reply ¶ 94; Third Contador Decl. ¶ 50. Thus, they maintain that "the [Class C Notes] Backstop Fee is not consideration for the acquisition of the Notes that grants the [Commitment Creditors] an undue benefit in comparison to the terms on which the Notes will be offered to the shareholders." Third Contador Decl. ¶ 51; *see* Debtors Omnibus Reply ¶ 94. It does not appear that Mr. Ried disputes that contention. He testified that this preemptive rights argument would apply only if the Backstop Fee on the Class C Notes were paid to shareholders of the Debtors. *See* May 6, 2022 Ried Dep. at 115:9-105:11. That is plainly not the case here.

The Court next considers Columbus Hill's assertion that the provisions in the Plan governing the issuance of the Class A Notes and Class C Notes violate Chilean law. The Class A Notes and Class C Notes mature in ninety-nine years, pay no interest, have no contractual covenants, and carry a conversion ratio that is cut in half if such note is not converted within sixty days of the Effective Date. Columbus Hill Obj. ¶ 17. Moreover, once 50% of the Class A Notes or 50% of the Class C Notes are converted, all the remaining notes in that respective class will mandatorily convert simultaneously. *See* Class A Notes Term Sheet at 4; Class C Notes

Term Sheet at 4.[63] Columbus Hill asserts that because members of the LATAM Parent Ad Hoc Group hold well over 50% of the Allowed General Unsecured Class 5 Claims, and all of them will exercise the conversion rights under the notes on the Effective Date, it is a certainty that on that day, all of the Class A Notes and Class C Notes will convert into LATAM Parent common stock. *See* Columbus Hill Obj. ¶¶ 17, 33.[64] Columbus Hill argues that the Class A Notes and Class C Notes are a "legal fiction" because their terms demonstrate that they are not genuine debt instruments. *Id.* ¶ 17; *see* Ried Decl. at 9. It says that the notes are equivalent to equity and are designed to permit LATAM Parent to issue shares of new common stock to the Holders of Allowed General Unsecured Class 5 Claims in exchange, in part, for their Class 5 claims against LATAM Parent, without invoking the "in kind" standards applicable under Articles 15 and 67 of the Corporation Act. *See* Columbus Hill Obj. ¶ 17.[65] It maintains that Chilean courts and

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[63] The New Convertible Notes Class A Term Sheet (the "Class A Notes Term Sheet") and the New Convertible Notes Class C Term Sheet (the "Class C Notes Term Sheet") are annexed to the Disclosure Statement as Exhibits E-4 and E-6, respectively [ECF No. 4777].

[64] Columbus Hill maintains that the Debtors and every other party in interest in these cases openly acknowledge this fact, and all pro forma projections and other financial materials in the Disclosure Statement assume the full conversion of all the Class A Notes and Class C Notes. Columbus Hill Obj. ¶ 17 (citing Restructuring Term Sheet, annexed to the Disclosure Statement as Exhibit E-3 [ECF No. 4777] at 6).

[65] Mr. Ried states, as follows:

> The Class A and Class C Notes have a number of peculiarities that, taken together, show that they are not bona fide debt instruments but are rather stock: they have a maturity of 99 years, bear no interest, have no customary covenants from the issuer (in fact, they do not have any covenants), and do not contemplate any events of default.
>
> However, the most unusual feature of the notes is that they are, for practical purposes, mandatorily convertible and, as I understand it, are expected to be converted on the effective date of the Plan.
>
> The only sensible purpose of the bonds is to be immediately converted into LATAM shares.
>
> Therefore, the Class A and Class C Notes have practically no value as debt instruments (99 year bonds that pay no interest have a present financial value of, essentially, zero) and are all but required to be converted into shares. In fact, the conversion is mandatory at any moment if 50% of the notes are converted, which I understand will occur on the Plan effective date as soon as the Commitment Creditors convert their Class C Notes.

Ried Decl. at 20-21.

regulators will look through the form of the transactions and in focusing on their substance, will hold the Debtors to the standards applicable to the issuance of new shares to LATAM Parent's creditors in exchange for, in part, non-cash consideration–i.e., unsecured claims against LATAM Parent. *See id*. ¶¶ 31-33.[66]

Columbus Hill says that the Class A Notes are being issued in exchange for Allowed General Unsecured Class 5 Claims, and the Class C Notes are being issued in exchange for Allowed General Unsecured Class 5 Claims and cash. It maintains that these notes and their underlying shares will be converted on the Effective Date, and that because they are being exchanged for assets other than money–i.e., Allowed General Unsecured Class 5 Claims–Chilean law requires the Debtors to provide at least two expert valuations of those Class 5 claims; and

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[66] Mr. Ried maintains that the transaction violates the Chilean simulation and fraud to the law doctrines. He contends that:

> the overly complex structure of the convertible notes and its almost immediate and forceful conversion into shares, combined with the preferential terms on which such convertible notes and their underlying shares are available to unsecured creditors after the expiration of shareholders' preemptive rights, has been put in place to capitalize the LATAM general unsecured claims in a way that does not comply with otherwise applicable restrictions, including statutory mandates with respect to preemptive rights and contribution in kind rules.

Ried Decl. at 22. "Therefore, it is [his] opinion that the different steps of the Plan would be considered fatally flawed and declared void under the simulation or fraud to the law doctrines." *Id.*

Mr. Contador denies that LATAM Parent could be found liable for actions taken in connection with the Plan under either the simulation or fraud to the law doctrines. He maintains that the simulation doctrine is not applicable because LATAM Parent's declared intention does not differ from its true intention, and there is no claim that the purpose is to deceive third parties. Third Contador Decl. ¶¶ 29-30. He says that the terms and effects of the transactions devised under the Plan have been openly disclosed and there is no third party who could be "deceived" by a declared intention which differs from the true intention. *Id*. ¶ 30. Further, he says that the fraud to the law doctrine is not applicable because:

> There is no legal rule prohibiting the issuance of the Notes or the payment to general unsecured creditors with the cash proceeds obtained from the subscription and payment of the Notes by shareholders during the preemptive offering or with any remaining Notes. [And there] is no legal mandate directing a corporation to capitalize or acquire the claims against it instead of extinguishing and paying those claims with cash arising from the subscription and payment of those Notes or with the Notes themselves.

Id. ¶ 31.

requires holders of at least two-thirds of the outstanding shares with voting rights to approve these transactions. *See id*. ¶¶ 1, 16, 28-30; Ried Decl. at 14-18. It asserts that although the Disclosure Statement acknowledges that existing shareholders must approve the issuance of the Class A Notes and Class C Notes at an extraordinary meeting of the shareholders, the Debtors incorrectly state that the requisite voting threshold for such approval is a simple majority of the existing shares in attendance at the meeting. *See* Columbus Hill Obj. ¶ 29 (citing Disclosure Statement). Columbus Hill contends that without obtaining this required two-thirds or greater supermajority approval, the Plan transactions would be void under Chilean law. *Id*.; Ried Decl. at 22.

Columbus Hill also argues that the shareholders' preemptive rights with respect to the New Convertible Notes are illusory and do not comply with Chilean law. *See* Columbus Hill Obj. ¶ 18; *see also* Ried Decl. at 8. It says that is so because existing LATAM Parent shareholders must pay the full-face value of the Class A Notes and Class C Notes entirely in cash to exercise their preemptive rights to acquire new LATAM Parent stock, but would receive shares worth significantly less than the amount of cash paid, while the notes not acquired by the LATAM Parent shareholders will be offered to Holders of Allowed General Unsecured Class 5 Claimson substantially more favorable terms (both in terms of the form of consideration and the value of the consideration being provided by the creditors), all in violation of Chilean law. *See* Columbus Hill Obj. ¶ 18.[67]

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[67] Mr. Ried succinctly summarizes the issue, as follows:

> [S]hareholders are being offered the Class A and Class C Notes for an aggregate price of $8.283 billion in cash. At Plan value, the stock underlying the Class A and Class C Notes is worth an aggregate of approximately $5.092 billion [based on the Plan value set forth in the Disclosure Statement and the RSA]. This means that LATAM's shareholders are being asked to pay $1.64 for every $1.00 worth of shares underlying the Class A and Class C Notes.

The Debtors deny the Class A Notes and Class C Notes are being offered to Holders of Allowed General Unsecured Class 5 Claims on different terms than they are offered to shareholders. *See* Debtors Omnibus Reply ¶ 90. They correctly note that the Plan provides that the notes will be offered to shareholders at par value, and to the extent the shareholders purchase them, the proceeds will be used to pay the claims of the General Unsecured Class 5 Creditors. *See id.*; Plan § 3.2(e). Any notes that remain after the preemptive rights period closes will be used to pay and discharge the Allowed General Unsecured Class 5 Claims at par value. *See* Debtors Omnibus Reply ¶ 90. Beyond that, the terms on which the notes are offered are consistent. *See id.*

The Debtors also say that Columbus Hill mischaracterizes the transactions under the Plan and, as a consequence, misstates applicable Chilean law. *Id.* ¶ 92. They maintain that Columbus Hill's objection rests on the erroneous assertion that the Holders of Allowed General Unsecured Class 5 Claims are purchasing the notes from LATAM Parent with their Allowed General

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> According to my calculations, LATAM's general unsecured creditors, on the other hand, are being offered the Class A and Class C Notes for an aggregate price equal to the value of stock underlying those notes. This means that the LATAM's creditors in the aggregate are being asked to pay $1.00 for every $1.00 worth of shares underlying the Class A and Class C Notes. Under the Plan, if unsecured creditors were to purchase all the Class A and Class C Notes, they would pay in part with $3.269 billion cash and in part with $5.014 billion in credits or claims ($8.283 billion in face value of the Class A and Class C Notes minus $3.269 billion in cash yields $5.014 billion face value for claims). To my knowledge, no party disputes that the $3.269 billion in cash payable by LATAM general unsecured creditors will be exchanged for convertible notes and their underlying shares that are similarly worth $3.269 billion. For the remaining $1.823 billion in convertible notes and shares, the LATAM general unsecured creditors are paying with $5.014 billion in credits or claims. Simple math dictates that that the $5.014 billion in unsecured credits or claims are worth no more than approximately 36.4%, which is the quotient of $1.823 billion in convertible notes in shares divided by the $5.014 billion in unsecured credits or claims used to acquire such convertible notes and shares. Allowing LATAM general unsecured creditors to subscribe for the Class A and Class C Notes with an exchange of LATAM general unsecured claims worth a fraction of their face value while requiring shareholders to pay a far higher price to exercise preemptive rights with respect to such Class A and Class C Notes violates Chilean law.

Ried Decl. at 4-5; *see also id.* at 12 ("Requiring LATAM shareholders to pay the par value of convertible notes in cash to exercise their preemptive rights while subsequently offering such convertible notes to creditors in exchange for credits or claims against a debtor that are worth significantly less than par value violates Chilean law.")

Unsecured Class 5 Claims. *Id.* They assert that notwithstanding Columbus Hill's claims to the contrary, LATAM Parent will not acquire the claims. *Id.* The holders of those claims will neither transfer their claims to LATAM Parent nor exchange those claims for either the Class A Notes or Class C Notes. Third Contador Decl. ¶ 6. The Debtors maintain that when they incurred the Class 5 general unsecured debt, they did so with the expectation that they would pay and discharge that debt with cash. The Plan calls for them to do so with the proceeds generated from the sale of the stock during the preemptive rights offering period. *See* Plan § 3.2(e). It also provides that the Debtors will deliver any notes that remain available after the expiration of the preemptive offering period to the Class 5 unsecured creditors in full satisfaction and settlement of those claims. *See id.* The Debtors say that the Holders of Allowed General Unsecured Class 5 Claims are tendering the notes to pay, discharge and extinguish those claims, not to acquire them. *See* Debtors Omnibus Reply ¶ 92; First Contador Decl. ¶ 24;[68] Third Contador Decl. ¶¶ 3, 6-8, 11, 16. They say that they are authorized to do so because under Chilean law, pursuant to a doctrine known as "*dación en pago*", a debtor and its creditor can agree to extinguish a debt obligation with an object different than the one originally owed. Debtors Omnibus Reply ¶ 92; Third Contador Decl. ¶ 6. The Debtors say that under the Plan, Holders of Allowed General Unsecured Class 5 Claims have agreed to receive payments on account of their claims in the Class A and Class C Notes and that the Plan discharges and extinguishes those claims as if they had been paid in cash. *See* Third Contador Decl. ¶ 8.[69] ("[T]he claims will be extinguished by their payment with the cash proceeds obtained from the subscription and payment from the notes

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[68] Debtors Tr. Ex. 16 (Declaration of Nelson Contador Regarding Execution in Chile of a Foreign Reorganization Plan Involving the Issuance of New Stock and Convertible Notes) (the "First Contador Decl.").

[69] Mr. Contador does not dispute that the payment of the notes with general unsecured claims would result in the transfer of the claims to LATAM Parent. Third Contador Decl. ¶ 8.

by the shareholders during the preemptive offering period and with any notes remaining unsubscribed after such preemptive offering period.”). The Debtors maintain that since LATAM Parent will never acquire, possess, or otherwise hold the claims, it does not need to subject them to an appraisal or obtain shareholder approval of the appraisal under Articles 15 and 67 of the Corporations Act. *See* Debtors Omnibus Reply ¶ 92; Third Contador Decl. ¶¶ 8, 9 (noting that “under Chilean law, notes are financial instruments and, therefore those who acquire them are not subscribing equity or making an equity contribution in kind that should be appraised.”).[70] Thus, they maintain that the Plan complies with Chilean law.

In support for their argument, the Debtors rely on the cases of *Enjoy S.A.* and *La Polar S.A.* They contend that in those Chilean proceedings, the companies used and offered convertible notes with terms that are almost identical to the notes at issue here to pay creditor claims in the same way as the Debtors propose to do here, with the approval of their creditors and simple majority of their shareholders and with the approval of the CMF, which reviewed and registered the notes. First Contador Decl. ¶¶ 11-19, 24-25; Third Contador Decl. ¶¶ 46, 52-64; *see also* Debtors Omnibus Reply ¶ 93.

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[70] Mr. Contador explains that:

> Under Chilean law, claims against LATAM are obligations, which may be extinguished by several means listed in the Chilean Civil Code. *Payment* is one of these means. Another means is *confusion*, which is when one person simultaneously holds the capacity of debtor and creditors regarding the same obligation. Therefore, when a debtor acquires a claim against itself from its creditor, the obligation or claim is extinguished by *confusion*. In the case of *confusion,* the claim is previously transferred from the creditor to the debtor. On the other hand, when an obligation is paid, either in kind or in cash, there is no transfer of the claim to the debtor and the debtor does not acquire it, but instead the claim is extinguished while still held by the creditor.
>
> Therefore, as the Notes will not be paid for with the claims of their creditors and LATAM will not acquire the claims, the issuance of the Notes may be approved by a simple majority of the shareholders and is not subject to an appraisal requirement.

Third Contador Decl. ¶¶ 11-12.

Enjoy S.A. is a stock corporation whose shares are listed on the Santiago Stock Exchange. Its Judicial Reorganization Agreement (the "JRA") provided for, among other things (i) the payment of more than 70% of the unsecured debt by means of delivery in payment of notes convertible into shares; and (ii) the acquisition of new funds through the subscription and payment of the convertible notes during their preemptive rights offering period by the shareholders of Enjoy S.A. *See* First Contador Decl. ¶ 12; Columbus Hill Tr. Ex. 9 (Judicial Reorganization Agreement of Enjoy S.A.) at 9-11. The JRA called for Enjoy S.A. to offer the convertible notes to its shareholders at par value during the preemptive rights period, and then to distribute to its general unsecured creditors, in full satisfaction of their claims (a) the proceeds of the subscription and payment of the notes by the shareholders to the extent shareholders exercised their preemptive rights; or (b) the convertible notes that were not acquired by the shareholders during the preemptive rights offering period. First Contador Decl. ¶ 13. Under the JRA, 80% of all unsecured claims would be paid, at par value, with two different series of ninety-nine year maturity convertible notes, that accrued no interest and were convertible within seventy-five days after the expiration of the preemptive rights offering period. *Id*. ¶ 14. Enjoy S.A. neither acquired the claims of its creditors nor exchanged the convertible notes in return for those claims. Rather, it used the new convertible notes to pay and discharge the claims of its creditors, serving their purpose as negotiable instruments (*títulos de crédito*). *Id.* ¶ 15. In turn, those creditors did not subscribe to or pay for the convertible notes with their claims, but instead received the convertible notes in payment and satisfaction of their claims. *Id.*

Shortly after the court approved the JRA, Enjoy S.A. convened a shareholders meeting at which the shareholders approved the capital increase and the issuance of the convertible notes. *Id.* ¶ 16. After the shareholders approved the notes offering, Enjoy S.A. requested that the CMF register the convertible notes. *Id.* ¶ 17. After reviewing the procedures by which the convertible notes were approved and issued, and making some observations, (*Id.*, Ex. D-8 (Letter from the CMF dated December 4, 2020, requesting Enjoy S.A. to clarify some issues before registration of the notes)) the CMF duly registered the notes. *Id.* ¶ 17; *Id.*, Ex. D-4 (Registration of notes in the CMF Securities Register).[71] The Debtors contend that Enjoy S.A. obtained the approval of its JRA, (*Id.*, Ex. D-2 (Enjoy S.A Creditors' Meeting, dated August 14, 2020)) then carried out the capital increase (Columbus Hill Tr. Ex. 7 (Aug. 26, 2020 Mins. of the Extraordinary Meeting of the Shareholders of Enjoy S.A.)) and, in accordance with the JRA, the majority of the shareholders waived their right to exercise any preemptive subscription right, and all the requirements set forth in the proceeding, including the payment of the unsecured claims with the convertible notes issued by the company to that end, were fulfilled. Columbus Hill Tr. Ex. 4 (Material Fact Report (Hecho Esencial), Enjoy S.A., Securities Registry Inscription No. 1,033, Apr. 19, 2021); First Contador Decl., Ex. D-10 (Material Fact disclosed by Enjoy S.A., dated April 30, 2021). The Debtors maintain that the final implementation of the payment of the general unsecured claims through the delivery of convertible notes occurred successfully (First Contador Decl., Ex. D-7 (Material Fact disclosed by Enjoy S.A., dated October 13, 2020)) and on February 24, 2022, Enjoy S.A. fully complied with the obligations prescribed in its JRA,

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[71] Before Enjoy S.A. submitted its Judicial Reorganization Agreement to a vote at the creditors' meeting, a group of shareholders that in the aggregate owned 60.52% of the company signed a support agreement stating that:

> (i) they agreed to attend a shareholders' meeting to be held upon the approval of the Judicial Reorganization Agreement and vote in favor of the company's capital increase,
> (ii) they agreed to waive their preemptive subscription right regarding notes convertible into shares to be issued, whenever said rights arise under the terms of the support agreement and
> (iii) they agreed to refrain from selling their shares.
> In addition, Enjoy S.A.'s Judicial Reorganization Agreement included, as a condition precedent for the agreement to become effective, the main shareholders' fulfillment of the obligations undertaken in the support agreement.

First Contador Decl. ¶ 18.

which was deemed concluded for all legal purposes, thus ceasing to be subject to the Judicial Reorganization Procedure, without objections from the creditors or any government agency. *Id*. ¶ 19.

La Polar S.A. is a stock corporation whose shares are listed on the Santiago Stock Exchange. Its approved reorganization plan (the "La Polar Plan") provided that the debtor would issue convertible notes that would be first offered to its shareholders at par value in compliance with their preemptive rights. *Id*., Ex. D-5 (Extraordinary Shareholders' Meeting Minute of Empresas La Polar S.A., dated August 8, 2014) at 36. The notes had a ninety-nine year maturity and accrued no interest. The La Polar Plan called for unsecured creditors to be paid with the proceeds of the subscription and payment of the convertible notes by the shareholders, or with the convertible notes that remained available after the preemptive rights offering. *Id.,* Ex. D-5 (Extraordinary Shareholders' Meeting Minute of Empresas La Polar S.A., dated August 8, 2014) at 36. At the shareholders meeting convened by La Polar, the shareholders approved the issuance of convertible notes. Thereafter, the notes were submitted for registration with the CMF, which after reviewing the procedure, duly registered the notes. *Id.*, Ex. D-4 (Registration of notes in the CMF Securities Register).

The Debtors maintain that in *Enjoy S.A*. and *La Polar S.A*., the requirement of the two-thirds majority of the outstanding voting shares or the prior valuation of the claims against the company under the Corporation Act were not applicable because the convertible notes were not acquired with the claims but given in payment of the claims. *Id.* ¶ 25. In substance, the Debtors maintain that *Enjoy S.A.* and *La Polar S.A.* provide a "road map" for a restructuring that calls for the issuance and distribution of convertible notes in satisfaction of creditor claims under Chilean law.[72]

Columbus Hill contends that the Debtors overstate the significance of *Enjoy S.A.* and *La Polar S.A.* and that those cases provide no support for the Plan. To summarize, it asserts that the transactions executed by Enjoy S.A. and La Polar S.A. were never judicially tested, are materially different than the transactions proposed here in the Plan and were formally approved by shareholders holding more than two-thirds of the outstanding shares with voting rights. It contends that both transactions were fully consensual, with no objections. These transactions were also explicitly described as a capitalization of outstanding claims against the companies. As a result, it contends that those cases provide no precedent or support for the Plan, and that the transactions called for under the Plan violate Chilean Law. *See* Columbus Hill Obj. ¶¶ 34-40; Ried Decl. at 24-25.

The Debtors maintain that *Enjoy S.A*. and *La Polar S.A*. support their position that convertible notes have been issued under Chilean law and used to pay unsecured creditors in reorganization agreements in terms substantially identical to those devised in the Plan. They deny that Enjoy S.A.'s and La Polar S.A.'s reorganization agreements were implemented with the consent of all shareholders and outside of contested legal processes. They maintain that the *Enjoy S.A.* and *La Polar S.A.* cases were challengeable legal proceedings conducted before

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[72] Mr. Contador summarized, as follows:

> In my opinion, the structure and mechanics of the equity increase through equity and convertible notes devised in the Plan . . . complies with all Chilean law requirements . . . and is substantially similar to that implemented in the Enjoy S.A. and La Polar S.A. proceedings. Further, as noted with respect to the Enjoy S.A. and La Polar S.A. proceedings, the requirement to have the favorable vote of two-thirds of the issued shares with voting rights or to have a prior valuation of the credits against the company would not be applicable to LATAM's offering of convertible notes and securities.

First Contador Decl. ¶ 25.

Chilean courts in which the reorganization agreements were approved despite the negative vote of certain creditors. Third Contador Decl. ¶¶ 53-54. Moreover, they assert that the CMF and the Chilean Insolvency Agency were aware of the terms and conditions of the agreements and raised no objections. They contend that the notes were submitted for registration with the CMF, which duly registered the notes after reviewing the procedures by which they were approved and issued and after requesting certain clarifications from Enjoy S.A. First Contador Decl., Ex. D-8. They argue that if the CMF had any objection, it would not have registered the notes. *Id.* ¶ 55; *see also* Debtors Omnibus Reply ¶ 93.

Columbus Hill and the Debtors agree that the Chilean courts and regulators will have the final say on whether the procedures in the Plan governing the issuance of the Plan Securities comply with Chilean law. Yrarrázaval Decl. ¶¶ 54-56;[73] Columbus Hill Obj. ¶ 14; *see also* Second Contador Decl. ¶ 19[74] ("Failure to comply with the regulations governing capital increases in public corporations, including the need to approve a capital increase at a shareholders' meeting and to provide shareholders with preemptive rights to subscribe to the capital increase if they wish, would cause the absolute nullity of the act providing for the issuance of the new shares."); May 17, 2022 Hr'g Tr. at 197:9-199:14 (Ried) (asserting that if the Court confirms that Plan, even a single shareholder will have the power to object to the Plan in the Chilean courts and with the CMF).

Section 1129(a)(3) of the Bankruptcy Code mandates that a "plan [be] proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). Under this section, "a plan will be found in good faith if it 'was proposed with honesty and good intentions and with a

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[73] Columbus Hill Tr. Ex. 6 (Declaration of Arturo Yrarrázaval) (the "Yrarrázaval Decl.").

[74] Debtors Tr. Ex. 17 (Declaration. of Nelson Contador in Response to the Statements of Rodrigo Delaveau and Juan Luis Goldenberg Concerning the Public Policy Exception Under Chilean Law) (the "Second Contador Decl.").

basis for expecting that a reorganization can be effected.'" *Argo Fund, Ltd. v. Bd. of Dirs. of Telecom Argentina, S.A.,* 528 F.3d 162, 169 (2d Cir. 2008) (quoting *Koelbl v. Glessing (In re Koelbl)*, 751 F.2d 137, 139 (2d Cir. 1984)). Columbus Hill does not challenge the Debtors' process in formulating the Plan. Rather it contends that the Debtors filed the Plan in bad faith because it violates Chilean law. That argument is misplaced because "the requirement of Section 1129(a)(3) speaks more to the process of plan development than the content of the plan." *In re Chemtura Corp*., 439 B.R. 561, 608 (Bankr. S.D.N.Y. 2010) (citations omitted). Whether the Plan complies with Chilean law will be addressed, if at all, by the Chilean courts and regulators. The Court need not and will not attempt to resolve that issue in considering whether the Plan satisfies section 1129(a)(3). "[T]he plain language of section 1129(a)(3) does not require that the Plan's contents comply 'in all respects with the provisions of all nonbankruptcy laws and regulations' because it 'speaks only to the proposal of a plan.'" *In re Charter Commc'ns*, 419 B.R. 221, 261 (Bankr. S.D.N.Y. 2009) (quoting *In re Buttonwood Partners, Ltd.*, 111 B.R. 57, 59 (Bankr. S.D.N.Y. 1990)); *accord Garvin v. Cook Invs. NW, SPNWY, LLC*, 922 F.3d 1031, 1035 (9th Cir. 2019) ("[W]e conclude that § 1129(a)(3) directs courts to look only to the proposal of a plan, not the terms of the plan.").

The Court recognizes that some courts find that a plan that violates applicable non-bankruptcy law is not filed in good faith and is not confirmable under section 1129(a)(3). However, in those cases the courts find that on its face, the plan violates applicable law. *See, e.g., In re Walden Palms Condo Ass'n*, 652 B.R. 543, 550 (Bankr. M.D. Fla. 2020) (denying confirmation where the plan called for legal costs incurred by an individual unit owner to be paid by the entire condominium community in clear violation of Florida law); *In re Arm Ventures*, 564 B.R. 77, 86 (Bankr. S.D. Fla. 2017) ("the Amended Plan is based on an enterprise illegal under Federal law, and therefore one that I cannot confirm because the Debtor cannot satisfy the requirements of 11 U.S.C. § 1129(a)(3)"); *see also In re Food City, Inc*., 110 B.R. 808, 813 n.12 (Bankr. W.D. Tex. 1990) (suggesting that an illegal plan provision is less likely to be proposed in good faith). *But see Garvin v. Cook Invs.*, 922 F.3d at 1035-36 (not sustaining a plan objection pursuant to 1129(a)(3) where the plan clearly violated federal law noting that 1129(a)(3) concerns legality of the proposal and not substantive provisions). Even under that standard, the Plan does not run afoul of section 1129(a)(3). Based on the foregoing, the Court finds that there is legitimate debate among Columbus Hill and the Debtors regarding the enforcability of the procedures in the Plan governing the issuance of the Plan Securities under Chilean law. The Plan does not clearly, if at all, violate Chilean law. The Court overrules Columbus Hill's Objection to the Plan as violating section 1129(a)(3).

Section 1129(a)(11) of the Bankruptcy Code requires that the Court determine that:

> Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

11 U.S.C. § 1129(a)(11). To demonstrate that a plan is feasible a debtor is not required to prove that it will successfully reorganize its business. Rather, "the feasibility standard is whether the plan offers a reasonable assurance of success. Success need not be guaranteed." *See Kane v. Johns-Manville Corp*, 843 F.2d 636, 649 (2d Cir. 1988); *see also In re DBSD North America, Inc.,* 419 B.R. 179, 202 (Bankr. S.D.N.Y. 2009) ("In making determinations as to feasibility, . . . a bankruptcy court does not need to know to a certainty or even a substantial probability, that the plan will succeed. All it needs to know is that the plan has a reasonable likelihood of success.") (collecting cases). For a debtor to withstand a creditor's or interest holder's challenge to the feasibility of a plan on the grounds that it violates applicable non-bankruptcy law, it must

demonstrate that the Plan has a "reasonable prospect of success." *See In re TCI 2 Holdings, LLC*, 428 B.R. 117, 155 (Bankr. D.N.J. 2010) (finding the plan to be feasible where there was a reasonable prospect that new owners of casino could obtain necessary gaming licenses); *see also In re Food City, Inc*., 110 B.R. at 812 n.10, 813 n.12 (noting that an "obvious illegality" exposes a plan to feasibility considerations). Courts find that plans that violate applicable non-bankruptcy law on their face fail the feasibility test. *See In re Walden Palms Condo. Ass'n Inc.*, 625 B.R. at 550 (finding that the creditor's plan was infeasible in that it clearly violated Florida law, thereby surpassing the reasonable prospect of success standard); *In re Wabash Valley Power Ass'n Inc.,* No. 85–2238–RWV–11, 1991 WL 11004220, at *73-74 (Bankr. S.D. Ind. August 7, 1991) (finding that a competing plan clearly violated Indiana state law and denying confirmation under 1129(a)(11)). The facts and law in the record do not support a determination that the Plan is "obviously illegal" under Chilean law. The Court finds that the Debtors have demonstrated that they have reasonable grounds for contending that the Plan complies with Chilean law. Accordingly, the Court overrules Columbus Hill's Objection and in doing so, finds that, as the Plan relates to Chilean law matters, the Debtors have demonstrated that the Plan complies with section 1129(a)(11) and is feasible.

The A&P Ad Hoc Group Objection

The A&P Ad Hoc Group asserts that the Plan provides the Commitment Creditors with unprecedented value in comparison to other *pari passu* Holders of the Allowed General Unsecured Class 5 Claims (the "Non-Commitment Creditors"), and that the Plan's economics disclose that the Backstop Fees are disproportionately high compared to the risks the Commitment Creditors are assuming in providing the Commitment Creditor Backstop Agreement. It contends that those payments are nothing more than a mechanism through which the Commitment Creditors can take greater value and recovery from the Debtors' estates at the expense of other similarly situated creditors. *See* A&P Ad Hoc Group Obj. ¶¶ 1-4, 22-26. The A&P Ad Hoc Group asserts that the Plan violates section 1123(a)(4) of the Bankruptcy Code because it does not provide for equal treatment of General Unsecured Class 5 Creditors, and thus, the Plan does not satisfy section 1129(a)(1). It also contends that the Plan violates section 1129(a)(4) of the Bankruptcy Code by paying excessive and unreasonable fees to the Commitment Creditors. *See id.* ¶¶ 3-4, 22-34. The Debtors dispute those contentions. The Court considers those matters below.

Section 1123(a)(4) of the Bankruptcy Code addresses intra-class treatment and requires that a plan "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); *see In re Adelphia Commc'ns Corp*., 368 B.R. 140, 249 (Bankr. S.D.N.Y. 2007); *In re Quigley Co*., 377 B.R. 110, 116 (Bankr. S.D.N.Y. 2007). Thus, by its terms, this provision does not mandate that members of the same class receive the same treatment on account of their claims. *See In re Quigley*, 377 B.R. at 116 ("Section 1123(a)(4) does not require precise equality, only approximate equality").

The A&P Ad Hoc Group complains that while the Non-Commitment Creditors and the Commitment Creditors are classified together in Class 5, the Commitment Creditors will receive a far superior opportunity for recovery compared to the Non-Commitment Creditors who, by default, receive Class 5a Treatment of their claims. *See* A&P Ad Hoc Group Obj. ¶¶ 22-24. It asserts that the Commitment Creditors–who automatically receive Class 5b treatment-receive over 85% of the Class C Notes through the Direct Allocation Amount, the ability to subscribe

70.74%[75] of their remaining Allowed Claims after the Direct Allocation Amount, and Backstop Fees totaling $734 million. *Id*. ¶¶ 4, 23.

The A&P Ad Hoc Group contends that the award of 85% of the Class C Notes to the Commitment Creditors converts to a 43.4% recovery (before factoring in any fees) on account of their General Unsecured Class 5 Claims, while the Non-Commitment Creditors also are slated to receive Class 5 treatment, but will receive their pro rata share of the $1.467 billion Class A Notes issuance—which will result in a 19.3% recovery on their similarly-situated General Unsecured Class 5 Claims. *Id*. In this light, the A&P Ad Hoc Group alleges that the inequality in opportunity for recovery among creditors holding the exact same type of claims is stark as (i) the limitation on the Non-Commitment Creditors' ability to subscribe to the Class C Notes permits the Commitment Creditors to impermissibly receive outsized recoveries; and (ii) the fees payable pursuant to the Commitment Creditors Backstop Agreement are in no way commensurate to the risk associated with providing the backstop. *Id.* ¶ 24.

This element of the A&P Ad Hoc Group Objection implicates two aspects of section 1123(a)(4) of the Bankruptcy Code. The first is that it requires equality of treatment, among creditors in the same class, not equality of result. It is satisfied if claimants in the same class have the same opportunity for recovery. *See In re W.R. Grace & Co.*, 729 F.3d 311, 327 (3d Cir. 2013) ("[C]ourts have interpreted the 'same treatment' requirement [of section 1123(a)(4)] to mean that all claimants in a class must have 'the same opportunity' for recovery."); *Ad Hoc Comm. of Pers. Inj. Asbestos Claimants v. Dana Corp. (In re Dana Corp)*, 412 B.R. 53, 62 (S.D.N.Y. 2008) ("The key inquiry under § 1123(a)(4) is not whether all of the claimants in a

75 The most recent version of the Plan, filed after the A&P Ad Hoc Group submitted their objection to the Plan, notes that the Commitment Creditors now have the ability to subscribe to 72.46% of their remaining Allowed Claims after the Direct Allocation Amount. Plan § 5.10.

class obtain the same thing, but whether they have the same opportunity."). The second is that "[t]he requirements of section 1123(a)(4) apply only to a plan's treatment *on account of particular claims* or interests in a specific class—not the treatment that members of the class may separately receive under a plan on account of the class members' other rights or contributions." *In re Adelphia Commc'ns Corp.*, 368 B.R. at 250-51; *see also In re CHC Grp., Ltd.*, Case No. 16-31854 (BJH), 2017 WL 11093971, at *12 (Bankr. N.D. Tex. Mar. 3, 2017) (finding that put option premium payable to plan sponsors as consideration for commitment to backstop rights offering was not a distribution on account of plan sponsors' claims); *In re TCI 2 Holdings, LLC*, 428 B.R. 117, 133 (Bankr. D.N.J. 2010) (finding that backstop fee proposed to be paid to the Backstop Parties was not a distribution to the parties on account of their claims); *In re Heron, Burchette, Ruckert & Rothwell*, 148 B.R. 660, 672 (Bankr. D.D.C. 1992) ("The objectors fail to distinguish between a partner's treatment under the plan on account of a claim or interest and treatment for other reasons. Only the former is governed by § 1123(a)(4)."). The Debtors maintain that the Plan satisfies both aspects of section 1123(a)(4) because all Holders of Allowed General Unsecured Class 5 Claims have the same opportunity for recovery, are being treated equally, and that the Backstop Fees and Direct Allocation are distributed to the Backstop Parties in consideration for their willingness to backstop the Class C Notes and the ERO Rights Offering, not on account of their General Unsecured Class 5 Claims. *See* Debtors Omnibus Reply ¶¶ 40-42. The Court agrees.

The treatment that the Commitment Creditors are receiving in their capacity as Holders of Allowed General Unsecured Class 5 Claims of LATAM Parent is the same as the Non-Commitment Creditors in Class 5. Each General Unsecured Class 5 Creditor will receive, in full satisfaction and discharge of its claims, the opportunity to elect for either (i) Class 5a Treatment, consisting of the receipt of Class A Notes plus its pro rata portion of the cash payments now provided under the Plan, or (ii) Class 5b Treatment, consisting of the receipt of its pro rata share of the New Convertible Notes Class C Offering (the latter of which requires a new money contribution) plus its pro rata portion of the cash payments now provided under the Plan. *See* Plan § 3.2(e)(ii); *see also* Backstop Opinion at 17-18 (describing Class 5 treatment); Disclosure Statement §§ V.A.1(e), V.B.10.[76] Non-Commitment Creditors are free to choose which of the two treatment options they prefer. The Non-Commitment Creditors who elect to receive Class 5b Treatment receive the same distribution on account of their claims as the Commitment Creditors – *i.e.,* each receives their pro rata share of the Class C Notes in exchange for the contribution of new money and their General Unsecured Class 5 Claims. *See* Class C Notes Term Sheet at 4; Plan §§ 3.2(e), 5.10. The additional compensation that the Commitment Creditors will receive under the Plan is not based on their status as Holders of Allowed General Unsecured Class 5 Claims; it is in consideration for their commitments described in the Commitment Creditors Backstop Agreement. *See* Commitment Creditors Backstop Agreement at 1-2, 8, 12, 24, 33-35; Disclosure Statement §§ I.A, IV.K; Herlihy Report at 61 (describing consideration provided by Commitment Creditors). This includes the Direct Allocation Amount, the Backstop Fees and the Class C Backstop Commitment, which are each described at length in the Commitment Creditors Backstop Agreement. *See* Commitment Creditors Backstop Agreement at 8, 12, 24, 26, 33-35; Disclosure Statement § IV.K.

[76] Pursuant to the amendments filed on May 11, 2022, the Plan now includes an additional election option, Class 5c Treatment, which entitles a General Unsecured Creditor to elect to receive its pro rata share of New Local Notes. *See* Plan § 3.2(e). The Backstop Parties generally are not eligible to elect Class 5c Treatment. *See id.*; Commitment Creditors Backstop Agreement § 2.2(a). The Class 5c Treatment is simply another option that General Unsecured Creditors may elect to receive and does not change the equal treatment analysis.

The Commitment Creditors Backstop Agreement clearly states that the Direct Allocation Amount and the Backstop Fees are provided to the Commitment Creditors in their roles as Backstop Parties. Commitment Creditors Backstop Agreement at 2 ("[P]ursuant to the terms of this Agreement, the Company will offer the Backstop Parties [Class C Notes] . . . in an aggregate principal amount equal to the Direct Allocation Amount."), 33-35 (describing payment of the Backstop Fees). That the Commitment Creditors must discharge their claims to access the Direct Allocation Amount does not implicate section 1123(a)(4) of the Bankruptcy Code. It is the mechanism through which Class C Notes are obtained. *See* Plan § 3.2(e). Under the Class C Backstop Commitment, the Commitment Creditors are agreeing to purchase the unsubscribed Class C Notes at the Class C Purchase Price, *see* Commitment Creditors Backstop Agreement at 15 (defining the Class C Purchase Price), 26 (defining the Class C Backstop Commitment), after the Non-Commitment Creditors have declined the opportunity to subscribe to their pro rata share of Class C Notes, in lieu of electing to receive Class 5a Treatment. *See* Plan § 1.1 (defining Commitment Creditors); *id.* § 3.2(e). That is to say that they are committing to purchase Class C Notes at the Class C Purchase Price, even if other Holders of Allowed General Unsecured Class 5 Claims (*i.e.* the Non-Commitment Creditors) decline to do so. The Commitment Creditors' obligation to purchase unsubscribed Class C Notes does not provide them with something of value unavailable to the Non-Commitment Creditors. The Commitment Creditors are not receiving outsized recoveries on account of their Allowed General Unsecured Class 5 Claims.

The A&P Ad Hoc Group complains that the Backstop Fees create a section 1123(a)(4) problem because they "are in no way commensurate to the risk associated with the backstop." A&P Ad Hoc Group Obj. ¶ 24. However, in the Backstop Opinion, the Court found that the benefits to the Commitment Creditors were reasonable, *see* Backstop Opinion at 85, and that the

Direct Allocation Amount and the Backstop Fees are appropriate given the risks assumed by the Commitment Creditors, including the "risks of material changes to the Debtors' business outlook which could negatively impact the price of the Debtors' stock" such as "the Omicron variant and volatile fuel prices." *Id*. at 50-51. These findings are equally applicable here.

Moreover, the A&P Ad Hoc Group asserts that "despite the Commitment Creditors and [Non-Commitment] Creditors having the same types of claims, only the Commitment Creditors were invited to the table and provided with resulting opportunities to participate in the Direct Allocation and Commitment Creditors Backstop Agreement." A&P Ad Hoc Group Obj. ¶¶ 25-26. Relying on *In re Pacific Drilling S.A.* ("*Pacific Drilling*"), No. 17-13193 (MEW), 2018 Bankr. LEXIS 3024, at *6 (Bankr. S.D.N.Y. Oct. 1, 2018), the A&P Ad Hoc Group contends that "the Plan's failure to ensure equal opportunity to claimants within the same class violates section 1123(a)(4) of the Bankruptcy Code and renders the Plan unconfirmable." *Id.*

Pacific Drilling does not suggest that compensating the Backstop Parties through the Direct Allocation Amount and Backstop Fees implicates section 1123(a)(4). Courts approve Plans with similar provisions. *See In re TCI 2 Holdings, LLC,* 428 B.R. at 133; *In re CHC Grp, Ltd*., 2017 WL 11093971, at *12. Moreover, this Court considered and rejected the same arguments in the Backstop Opinion. In opposing the Backstop Motion, the objecting parties (including the A&P Ad Hoc Group) contended that in pursuing the Backstop Agreements, the Debtors did not conduct arm's-length negotiations with third parties for the best financing terms possible, but, instead, settled for an unreasonable deal with the Commitment Creditors that vastly overcompensates them with special treatment, generous fees, and steep discounts to divert money to the Debtors' controlling shareholders and procure votes by the Commitment Creditors in favor of the Plan. *See* Backstop Opinion at 31. They asserted that the Debtors' intent to favor the Commitment Creditors is evident from the fact that the Commitment Creditors hold roughly 70% of the Debtors' general unsecured claims and, as such, are collectively a key voting block needed to approve the Plan. *Id.* They maintained that the Debtors failed to conduct a fair process in negotiating the Backstop Agreements because they (i) limited their pool of prospective counterparties for the Backstop Agreements to the RSA Shareholders and a handful of large creditors; (ii) failed to respond to a competing backstop financing proposal from Ducera Partners LLC ("Ducera"); and (iii) failed to subject the Commitment Creditors Backstop Agreement to market competition. *Id.* They also asserted that the LATAM Parent board lacked sufficient information to properly vet the Backstop Agreements. *Id.*

The Court found no merit to those contentions. In doing so, and as relevant, the Court found that:

> The Plan is the "best alternative" for the Debtors to emerge from these Chapter 11 Cases and is a product of hard-fought and lengthy mediation overseen by Judge Gropper, which focused in part on issues of Chilean securities law and Chilean shareholder rights in these Chapter 11 Cases.
>
> The Debtors explored a number of restructuring proposals during the pendency of these Chapter 11 Cases and contacted numerous investment funds and other entities in an effort to raise capital, and the Debtors' financial condition was open and obvious, suggesting that parties with workable financing offers had the opportunity to come forward and work with the Debtors.
>
> No entity sought to provide the Debtors with backstop proposals that would provide a framework to permit the Debtors to raise a level of capital they believe to be necessary to emerge from the Chapter 11 Cases.
>
> The Ducera Proposal fell short of a viable alternative or substitute for the Backstop Agreements because the proposal consists of an unsigned letter offering no binding commitments, and, among other things, the proposal: (i) did not provide sufficient committed capital; (ii) has an expansive due diligence condition that would allow the A&P Ad Hoc Group to withdraw its proposal at any time, at its sole discretion; and (iii) did not provide a secure path to confirmation.

Id. at 33, 36. The Court adheres to its rulings in the Backstop Opinion. The A&P Ad Hoc Group has failed to demonstrate grounds for denying confirmation under section 1123(a)(4) of the Bankruptcy Code.

Section 1129(a)(4) of the Bankruptcy Code requires that "[a]ny payment made or to be made by the proponent, by the debtor . . . for services or for costs and expenses in or in connection with the case, or in connection 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). The A&P Ad Hoc Group contends that while payments of backstop fees under a plan to support financing are permitted, here, the Backstop Fees are not reasonable, and the economics of the Plan expose that the payment of the fees is nothing more than "a disguised means of giving bigger creditors a preferential recovery." A&P Ad Hoc Group Obj. ¶ 27 (quoting *Pacific Drilling*, 2018 Bankr. LEXIS 3024, at *6-7). The A&P Ad Hoc Group argues that a backstop fee is reasonable only to the extent that it protects against the actual risk of a lack of participation in a rights offering. *Id.* ¶ 28. It contends that the Backstop Fees fail to serve this basic function because the Commitment Creditors have already committed themselves to approximately 85% of the Class C Notes, and the Plan economics provide the Debtors and Commitment Creditors with near certainty that the remaining approximately 15% of Class C Notes will be fully subscribed. *Id.* ¶ 29. It maintains that as no reasonable creditor would choose to receive an inferior recovery, this superior recovery virtually guarantees full participation in the Class C Notes and greatly diminishes the purported risk to the Commitment Creditors. *Id.* Moreover, it contends that if the Debtors and the Commitment Creditors wanted to guard against the risk that the Class C Notes would not be fully subscribed, they could have encouraged parties entitled to subscribe to the Class C Notes to participate without a cap limitation. It contends that doing so would provide for an equitable pro rata backstop by all eligible Holders of Allowed General Unsecured Class 5 Claims. *Id*. ¶ 31. Finally, the A&P Ad Hoc Group asserts that in assessing the reasonableness of the Backstop Fees, the Court must consider that the Commitment Creditors allegedly leveraged their power to reject any plan proposed by the Debtors to obtain extraordinary fees and recoveries beyond that of other similarly situated creditors. *Id.* ¶ 34 (noting that the Debtors acknowledge that "throughout the negotiation process" the Commitment Creditors maintained they "could vote down any plan."); *Id.* ¶ 34 n.42 (quoting Jan 29, 2022 Alfonsín Dep. Tr. at 96:14–97:22.).

In opposing the Backstop Agreements, the A&P Ad Hoc Group and others argued that because the Debtors seek to enter into the Backstop Agreements in connection with the Plan, the agreements must meet the standards of section 1129(a)(4). *See* Backstop Opinion at 29, 83. The Court disagreed and, instead, the Court found that sections 363 and 503 governed the Backstop Motion, and that section 1129(a)(4) was not relevant to the motion. *Id*. at 84. In support of the objection to the Backstop Motion, the objecting parties argued that (i) "the Backstop [Fee] is unreasonable and unnecessary because the economics of the Plan guarantee full participation of the Class C Notes," (ii) "even if the Debtors are correct that there is a risk that the Class C Notes would not be fully subscribed, then . . . the New Convertible Notes Offering Procedures should be altered to permit oversubscription by all parties entitled to subscribe," and (iii) "the Court should assess the reasonableness of the Backstop [Fees] by measuring it against the 'uncommitted portion' of the backstopped offering." *Id.* at 46. This Court applied the standards under sections 363 and 503 of the Bankruptcy Code and rejected those arguments, finding that "the Commitment Creditors are assuming the risk that they will be called upon to purchase the entire $3.669 billion in securities," that "the Commitment Creditors are subject to meaningful risk on the entire portion of the rights offering they are backstopping," and – on the basis of these and other findings – that "the Backstop [Fee] is reasonable." *Id*. at 48, 51, 85. The A&P Ad Hoc Group is raising the same arguments in support of this aspect of its objection to confirmation.

Whether a payment is "reasonable" depends on the "facts and circumstances of the payments," and takes account of, among other things, creditor support and whether the payments are "market." *See In re Journal Register Co.*, 407 B.R. 520, 537-38 (Bankr. S.D.N.Y. 2009). In assessing whether the Debtors have demonstrated that the Plan complies with section 1129(a)(4), the Court will apply the same standards under section 363(b) that it applied in approving the Backstop Fees as reasonable. The A&P Ad Hoc Group did not cite to a single case to support their argument that the Backstop Fees at issue should be analyzed for reasonableness under section 1129(a)(4) of the Bankruptcy Code.[77] The Court finds no basis for revisiting its findings and conclusions set forth in the Backstop Opinion. The Backstop Fees are reasonable under section 1129(a)(4) and support confirmation of the Plan.[78]

The A&P Ad Hoc Group contends that the Plan was not proposed in good faith, in violation of section 1129(a)(3) of the Bankruptcy Code, because the Debtors, under pressure from the Commitment Creditors, have engaged in "vote buying" to secure the Commitment Creditors' vote to accept the Plan. *See* A&P Ad Hoc Group Obj. ¶¶ 41-42; *see also id.* ¶¶ 1, 7,

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77 *Leiman v. Guttman*, 336 U.S. 1, 69 S. Ct. 371 (1949), is clearly inapplicable here. The question at issue in *Leiman* was whether the Supreme Court of New York had jurisdiction over an action to recover for legal services that were not compensable out of the Debtor's estate. *Id.* at 4. The court held that Section 221(4) places under the control of the bankruptcy judge "all payments made or promised . . . by the debtor." *Id.* at 5 (internal quotation marks omitted). Rather than supporting the argument that the Backstop Fees should be analyzed under Section 1129(a)(4), *Leiman* only supports the narrow holding that it is the realm of the bankruptcy court, rather than a state court, to evaluate and approve any fees paid in connection with a bankruptcy proceeding – a point of law on which there is no disagreement in this case.

78 As part of the Backstop Opinion, the Court approved the reimbursement of fees to the Parent GUC Ad Hoc Group, the majority shareholders, and their professionals and advisors under section 503(b) of the Bankruptcy Code. *See* Backstop Opinion at 57-58. The Court will not revisit that determination herein. *See In re Adelphia Commc'ns. Corp.*, 441 B.R. 6, 12 (Bankr. S.D.N.Y. 2010) ("[T]he applicant need only satisfy section 503(b) requirements. There are no other provisions of the Code that authorize payment of fees of this character as expressly.").

26, 34. They made the same argument in objecting to the Backstop Motion. They contended that the Debtors "settled for an unreasonable deal with the Commitment Creditors which vastly overcompensates them with special treatment, generous fees, and steep discounts to divert money to the Debtors' controlling shareholders and procure votes by the Commitment Creditors in favor of the Plan." Backstop Opinion at 31. They urged "that the Debtors blindly accepted all of their terms in an effort to gain their support for the Plan." *Id*. at 36. The Court found no merit to those arguments. Rather, the Court found that the Plan negotiations were conducted in "good faith" and unfolded pursuant to a "vigorous, hard-fought and lengthy" mediation process overseen by the Mediator. *Id.* at 33-34, 80. In sum, the Court was "satisfied that the evidence demonstrates that the Debtors engaged in arm's-length negotiations with the Commitment Creditors and employed a fair and reasonable process in negotiating and executing the Backstop Agreements." *Id.* at 37; *see also id*. at 81 ("[T]he Debtors followed a fair process both internally and externally in seeking sources of capital and, ultimately, negotiating the terms of the RSA and Backstop Agreements, with the assistance of the Mediator."). The Court adheres to those rulings herein.

All bankruptcy plans are the product of formal and informal settlements. In that context, without more, a creditor's exercise of leverage to obtain concessions in plan negotiations is not grounds for finding bad faith under section 1129(a)(3) of the Bankruptcy Code. *See In re Chemtura Corp.*, 439 B.R. 561, 609 (Bankr. S.D.N.Y. 2010) ("As all settlements require compromise on both sides, the fact that the Debtors were willing to provide concessions to garner support for their low-leverage plan does not preclude a finding of good faith."); *In re AbitibiBowater Inc.*, No. 09–11296(KJC), 2010 WL 4823839, at *4, *8 (Bankr. D. Del. Nov. 22, 2010) (rejecting good faith objection, noting "[o]f course, plan negotiations among the various constituencies involved the making of concessions and agreements to achieve the level of consensus likely to result in the overwhelming creditor support attained here"). Here, the Debtors engaged in good faith, arm's-length negotiations overseen by the Mediator. The A&P Ad Hoc Group has failed to demonstrate that the Debtors engaged in "vote buying" or that the Plan otherwise was filed in bad faith.

To summarize, the Court finds no merit to the A&P Ad Hoc Group's contentions that (i) the Plan fails to meet the requirements of section 1129(a)(1) because the Debtors' treatment of General Unsecured Class 5 Claims violates section 1123(a)(4) of the Bankruptcy Code; (ii) the Plan violates section 1129(a)(3) of the Bankruptcy Code because it provides economics to the Commitment Creditors that amount to impermissible "vote buying"; and (iii) the Plan calls for the payment of an excessive and unreasonable Backstop Fees to the Commitment Creditors in violation of 1129(a)(4). The Court overrules those objections to confirmation. The Court also overrules as moot, the A&P Ad Hoc Group's objection that the Plan may violate the absolute priory rule under section 1129(b)(2) of the Bankruptcy Code. Each impaired class of creditors voted to accept the Plan. Accordingly, since the Plan satisfies section 1129(a)(8) of the Bankruptcy Code, the cramdown provisions are not applicable. *See* 11 U.S.C. § 1129(b)(2). Finally, the Court will address the A&P Ad Hoc Group's contentions that the Corporate Incentive Plan established under the Plan violates section 503(c) of the Bankruptcy Code, and that the Non-Debtor Releases and Exculpation Clause in the Plan violate the Bankruptcy Code in conjunction with its discussion of the U.S. Trustee's Plan objections.

<u>The U.S. Trustee Objection</u>

<u>The Corporate Incentive Plan</u>

The Backstop Agreements call for the Reorganized Debtors to implement a post-Effective Date employee incentive plan. *See* Commitment Creditors Backstop Agreement, Schedule 3 (Terms of Corporate Incentive Plan); Backstop Shareholders Backstop Agreement, Ex. C (Terms of Corporate Incentive Plan). Further, the RSA states that:

> The Debtors' management will be able to participate in a Management Incentive Plan the terms of which shall be agreed by the Debtors and the Commitment Parties at the time of the execution of the Backstop Agreements and which shall be consummated and implemented on the Effective Date.

RSA, Ex. A (Restructuring Term Sheet) at 13. It further provides that:

> At the time of the execution of the Backstop Agreements, the Debtors will seek to amend and assume up to approximately 40 executives' existing employment agreements, which amended agreements shall include management protection provisions (the "Management Protection Provisions") in the amount of up to $35mm in the aggregate.

Id. Through section 5.3 of the Plan, the Debtors seek to give effect to those commitments by obtaining authorization to implement a Corporate Incentive Plan, Management Protection Provisions and Short Term Cash Incentives, as follows:

> Certain Debtors' employees will be able to participate in the Corporate Incentive Plan the terms of which shall be consistent with those set forth in the term sheet attached as Schedule 3 to the Commitment Creditors Backstop Agreement and Exhibit C to the Backstop Shareholders Backstop Agreement and which shall be allocated and implemented post-Effective Date by the [New] Board.
>
> As set forth in that term sheet, the Debtors will seek to amend and assume up to approximately forty (40) executives' existing employment agreements, which amended agreements shall include management protection provisions (the "Management Protection Provisions") in the amount of no more than $35 million in the aggregate on terms acceptable to the Commitment Creditors and the Backstop Shareholders. The program implementing the Management Protection Provisions shall include a short-term cash incentive plan in the aggregate amount of $12 million, which shall be deemed earned as of the Effective Date. For the avoidance of doubt, any amounts paid pursuant to such short-term cash incentive

> plan shall be credited in full against any amounts that may subsequently become due and payable pursuant to the program implementing the Management Protection Provisions.

Plan § 5.3. The Reorganized Debtors will provide those benefits to its officers and employees, after the Effective Date. The Debtors address the terms of the Corporate Incentive Plan (the "CIP"),[79] Management Protections and Short Term Cash Incentives in the Corporate Incentive Plan Term Sheet (the "CIP Term Sheet") annexed as Exhibit H to the First Plan Supplement.[80] In part, the CIP Term Sheet states:

> CIP to be equivalent to 2.5% of fully-diluted, fully-converted post-reorg shares. Number of synthetic shares granted based on fully-diluted, fully-converted post-reorg shares.
>
> CIP to be implemented post-Effective Date by the board of directors to be elected post-Effective Date in accordance with the Shareholders' Agreement (as defined in the Plan) (the "New Board").

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[79] Under the Plan, the term "CIP" is defined as:

> [T]he employee incentive program to be established and implemented with respect to the Reorganized Debtors post-Effective Date, on the terms provided in Schedule 3 and Exhibit C, as applicable, to the Backstop Agreements (subject to the approval of the existing board of directors of LATAM Parent) the material terms of which will be filed as an Exhibit to the Plan Supplement, as acceptable to the Debtors, the Requisite Commitment Creditors and the Backstop Shareholders.

Plan § 1.1 (definition of "CIP"). On April 12, 2022, the Debtors filed the Plan Supplement that includes the CIP Term Sheet. *See* First Plan Supplement, Ex. H (CIP Term Sheet) [ECF No. 5014]. The term sheet is consistent with the provisions contained in Schedule 3 in the Commitment Creditors Backstop Agreement. *Compare* CIP Term Sheet, *with* Commitment Creditors Backstop Agreement, Schedule 3.

[80] As relevant, the CIP Term Sheet calls for:

> [The] Management Protection Plan to be implemented consistent with the Restructuring Plan Term Sheet (Exhibit A) to the Restructuring Support Agreement and Plan and subject to review and comment by the Backstop Parties' Advisors and good faith consideration of such comments by the Company, as provided for in the Backstop Commitment Agreement.
>
> The Management Protection Plan, as previously agreed in the Restructuring Plan Term Sheet (Exhibit A) to the Restructuring Support Agreement, shall include a short-term cash incentive plan in the aggregate amount of $12 million, which shall be deemed earned as of the Effective Date. For the avoidance of doubt, any amounts paid pursuant to such short-term cash incentive plan shall be credited in full against any amounts that may subsequently become due and payable pursuant to the Management Protection Plan.

CIP Term Sheet at 2.

> Subsequent awards will be determined by the New Board, in its sole discretion.
>
> The New Board shall determine individual grants for Effective Date awards under the CIP, consistent with the terms provided for herein.
>
> Compensation consultant selected by and acceptable to the Backstop Shareholders and the Parent GUC Ad Hoc Group shall be retained pre-Effective Date to advise the New Board, including on performance vesting criteria.

CIP Term Sheet at 1. The term sheet identifies the following three groups as eligible to receive awards under the CIP:

> "Senior Executives" consisting of all members of the "Global Executive Meeting" (the "GEM Group"), which consists of the CEO, Vice Presidents and Directors. The Executive Committee ("ExCom") is a subset of the GEM Group and consists of all Vice Presidents and one Director, each of whom reports directly to the CEO.
>
> "Other Executives" consisting of any Senior Managers that are not considered Senior Executives (*i.e.*, Senior Managers that do not directly report to the ExCom Members), as well as Managers and Junior Managers.
>
> "Other Employees" consisting of current employees that (i) were employees of the company in 2020, (ii) have not been furloughed and re-hired and (iii) remain employed by the company as of the vesting date for any CIP awards.

Id. at 1-2. Only the awards under the CIP provided for the Senior Executives are subject to dispute. The CIP Term Sheet describes those awards, as follows:

> Awards to be in the form of phantom (synthetic) shares to be awarded pursuant to a contract and paid in cash.
>
> Vesting dates shall occur at 8, 12, 24, 36 and 42 months post-Effective Date consistent with the terms herein.
>
> Awards vesting at 8 months and 12 months post – Effective Date will fully cover the Management Protection Plan amount.

Id. at 1. The CIP Term Sheet includes a chart that discloses that for the first twelve months post-Effective Date, payments under the CIP to Senior Executives' awards are tied only to the retention of those executives. *Id.* After twelve months, those payments are tied to both retention (28% of the payment) and performance (72% of the payment), based on metrics to be determined and approved by the New Board and the compensation consultant selected by and acceptable to the Backstop Shareholders and the Parent GUC Ad Hoc Group. *Id*.

A condition to plan confirmation under section 1129(a)(1) of the Bankruptcy Code is that the Court find that the plan "complies with the applicable provisions of [the Bankruptcy Code]." 11 U.S.C. § 1129(a)(1). With certain irrelevant exceptions, chapters 1, 3 and 5 of the Bankruptcy Code apply in a case under chapter 11 of the Bankruptcy Code*. See* 11 U.S.C. § 103(a). The A&P Ad Hoc Group and U.S. Trustee contend that the Plan fails to satisfy section 1129(a)(1) because the Debtors have not sought approval of the CIP under section 503(c) of the Bankruptcy Code and the CIP does not comply with section 503 of the Bankruptcy Code. U.S. Trustee Obj. at 18; *see also* A&P Ad Hoc Group Obj. ¶ 46 ("Rather than seek approval of these incentive awards through the applicable sections of the Bankruptcy Code governing these types of payments, the Debtors seek approval through confirmation of the Plan without providing the legal basis for approval thereof.")

Section 503(c)(1) prohibits the allowance and payment of sums to "an insider . . . for the purpose of inducing such person to remain" with the business "absent a finding by the court based on the evidence in the record" that (1) the payment is "essential" to the retention of the individual "because the individual has a bona fide job offer from another business at the same or greater rate of compensation;" and (2) the services of that individual are "essential to the survival of the debtor's business." 11 U.S.C. § 503(c)(1).[81] For these purposes, and as relevant herein, the

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[81] Section 503(c)(1) of the Bankruptcy Code states, as follows:

> Notwithstanding subsection (b), there shall neither be allowed, nor paid –
>
> (1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtors' business, absent a finding by the court based on evidence in the record that

term "insider" includes a director, officer, or person in control of the Debtors, or a relative of any such person. 11 U.S.C. § 101(31).[82] There is no dispute that the Senior Executives are insiders for purposes of sections 503(c) and 101(31) of the Bankruptcy Code.

> (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
>
> (B) the services provided by the person are essential to the survival of the business; and
>
> (C) either –
>
> (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
>
> (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred; . . .

11 U.S.C. § 503(c)(1).

[82] As relevant section 101(31) of the Bankruptcy Code states:

> The term "insider" includes—
>
> *   *   *
>
> (B) if the debtor is a corporation--
>
> (i) director of the debtor;
>
> (ii) officer of the debtor;
>
> (iii) person in control of the debtor;
>
> (iv) partnership in which the debtor is a general partner;
>
> (v) general partner of the debtor; or
>
> (vi) relative of a general partner, director, officer, or person in control of the debtor

11 U.S.C. § 101(31).

Congress added section 503(c) to the Bankruptcy Code to "eradicate the notion that executives were entitled to bonuses simply for staying with the Company through the bankruptcy process." *In re Global Home Prods., LLC,* 369 B.R. 778, 783–84 (Bankr. D. Del. 2007). In enacting the section, Congress sought "to limit the scope of key employee retention plans and other programs providing incentives to management of the debtor as a means of inducing management to remain employed by the debtor." *In re Borders Group, Inc*., 453 B.R. 459, 470 (Bankr. S.D.N.Y. 2011) (internal quotations and citations omitted). Section 503(c)(1) "applies to those employee retention provisions that are essentially 'pay to stay' key employee retention programs." *In re Dana Corp.,* 358 B.R. 567, 571 (Bankr. S.D.N.Y. 2006); *see also In re Dana Corp*. 351 B.R. 96, 102 (Bankr S.D.N.Y. 2006) ("Without tying this portion of the bonus to anything other than staying with the company until the Effective Date, this Court cannot categorize a bonus of this size and form as an incentive bonus. Using a familiar fowl analogy, this compensation scheme walks, talks and is a retention bonus.") (footnote omitted). In the twelve months after the Effective Date, the Senior Executives will be eligible to receive two payments under the CIP–both of which are based solely on those Senior Executives remaining in the Debtors' employ. *See* CIP Term Sheet at 1. For that reason, the A&P Ad Hoc Group and U.S. Trustee describe the CIP as essentially a "pay to stay" program that runs afoul of section 503(c) of the Bankruptcy Code. *See* A&P Ad Hoc Group Obj. ¶ 50 ("As the awards are not tied 'to anything other than staying with the company,' the payments under the Corporate Incentive Plan are retentive."); U.S. Trustee Obj. at 18 (describing the CIP as "partially retentive"). They maintain that the Debtors have failed to demonstrate that the CIP meets the standards in section 503(c)(1) and, as such, that the Court cannot approve it.[83] *See* A&P Ad Hoc Group Obj. ¶ 44

[83] As relevant, the proposed Confirmation Order states, as follows: "The documents contained in the Plan Supplement (including, without limitation, . . . the Corporate Incentive Plan Term Sheet, . . . and the Shareholders'

("The Debtors have not met their burden of demonstrating that the Corporate Incentive Plan complies with the requirements [of section 503(c)(1)] of the Bankruptcy Code"); *see also* U.S. Trustee Obj. at 17-18 ("[the Plan] makes no attempt to establish that the requirements of Section 503(c)(1) have been met.").

Section 503 of the Bankruptcy Code governs the allowance of administrative expense claims. *See* 11 U.S.C. § 503. "The policy behind giving priority to administrative expenses in chapter 11 proceedings is to encourage creditors to supply necessary resources to debtors post-petition." *In re Climax Chem. Co.,* 167 B.R. 665, 667 (Bankr. D.N.M. 1994). Courts have established strict criteria for determining whether a claim should be afforded an administrative priority. *See In re Molnar Bros.,* 200 B.R. 555, 558 (Bankr. D.N.J. 1996) (noting that allowances for administrative expenses are "narrowly construed for [the] proper protection of other creditors."); *In re Grant Broad. of Phila., Inc*., 71 B.R. 891, 897–98 (Bankr. E.D. Pa. 1987) ("administrative claims should be narrowly construed to minimize prioritizing of a debtor's scarce resources to certain favored creditors"). Accordingly, section 503 has "two overriding policy objectives: (i) to preserve the value of the estate for the benefit of its creditors and (ii) to prevent the unjust enrichment of the estate at the expense of its creditors." *In re Journal Register Co.,* 407 B.R. 520, 535 (Bankr.S.D.N.Y.2009) (citations omitted). "This dual objective is embodied in the 'preserving the estate' language of the statute and requires that allowed administrative claims arise from transactions with the estate." *Id*.

In *Journal Register,* the debtors proposed a reorganization plan that established an incentive plan to take effect after the plan's effective date (the "JR Incentive Plan") for the

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Agreement) are integral to the Plan and are approved by the Bankruptcy Court." *See* Notice of Filing of Second Revised Proposed Order (I) Confirming Debtors' Joint Plan of Reorganization of LATAM Airlines Group S.A. et al. Under Chapter 11 of the Bankruptcy Code and (II) Granting Related Relief, Ex. A (proposed Confirmation Order) [ECF No. 5502].

benefit of certain employees of the reorganized debtors and pay them bonuses if they achieved certain goals that the debtors and a group of consenting creditors agreed to in a plan support agreement. *Id.* at 527. Certain creditors objected to plan confirmation on the grounds that the JR Incentive Plan violated section 503(c) and, as such, the Plan failed to satisfy section 1129(a)(1) of the Bankruptcy Code. *Id.* at 529. The court overruled the objection. It found that the Debtor did not seek allowance of the payments under the JR Incentive Plan as administrative expenses under section 503 of the Bankruptcy Code, and, in any event, the payment did not qualify as administrative expenses. It reasoned that "[t]he bonuses payable under the [JR] Incentive Plan are not being paid to preserve the value of the estate or to prevent unjust enrichment of the estate, as they are being paid subsequent to confirmation of the Plan and as a result of the confirmation order itself." *Id.* at 535 (citation omitted).

Like the JR Incentive Plan at issue in *Journal Register*, the CIP is a post-Effective Date employee incentive program, which will be established pursuant to the Plan and implemented by the New Board, for the benefit of the Reorganized Debtors. Although certain expected terms of the CIP are set forth in the CIP Term Sheet, including the contours of the awards the New Board (not the Debtors) would have the power to grant to certain employees (such awards, "CIP Grants"), the terms of the CIP will be determined by the New Board.[84] *See* CIP Term Sheet at 1.

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[84] The U.S. Trustee explained his position on corporate incentive plans at the hearing on May 20, 2022, stating –

> [W]e've made it clear to many debtors that if they wanted to–that any sort of corp [sic] incentive plan that a debtor or the reorganized debtor would want to implement with respect to any of the officers and directors and so forth could easily be done by the reorganized debtors' board. That what's an issue here is the attempt to have the Bankruptcy Court approve these corporate incentive plans . . . where payment will occur post-petition. And [the Debtors] don't want the post-petition reorganized debtors board to have the final say on the matter. . . What's being proposed here is somewhat of a hybrid. Rather than having specific amounts designated for specific employees, what's being proposed under the plan . . . is essentially a carve-out or a pot . . . So they're attempting to sort of straddle the requirements by indicating we want to lock in the amount.

The New Board, acting for the benefit of the Reorganized Debtors, not the Debtors, will need to consider the CIP and determine all individual CIP Grants. *See id.* The CIP will not exist prior to the Effective Date, and no CIP Grants will be considered, let alone issued, until after the Effective Date. By definition, the CIP Grants cannot qualify as administrative expenses. *See In re Bethlehem Steel Corp*., 479 F.3d 167, 172 (2d Cir. 2007) ("[A]n expense is administrative only if it arises out of a transaction between the creditor and the bankrupt's trustee or debtor in possession, and only to the extent that the consideration supporting the claimant's right to payment was both supplied to and beneficial to the debtor-in-possession in the operation of the business.") (internal quotation marks and citation omitted). Section 503 does not apply to the CIP and the CIP Grants.[85] The CIP does not violate section 503 and, as such, the Plan does not run afoul of section 1129(a)(1). The Court overrules the objections to the CIP.

May 20, 2022 Hr'g Tr. [ECF No. 5513] (the "May 20, 2022 Hr'g Tr. – Public Session") at 129:13-130:20 (Masumoto).

[85] In reaching this conclusion, the Court finds that the A&P Ad Hoc Group and U.S. Trustee misplace their reliance on *In re AMR Corp.,* 497 B.R. 690 (Bankr. S.D.N.Y. 2013); *In re Dana Corp*., 351 B.R. 96 (Bankr. S.D.N.Y. 2006) and *In re TCI 2 Holdings, L.L.C*., 428 B.R. 117 (Bankr. D.N.J. 2010). Those cases do not involve incentive/retention programs to be implemented after the effective date of a confirmed chapter 11 plan for the benefit of the reorganized debtor. In *In re AMR Corp*., as part of its reorganization plan, the debtor sought approval of a letter agreement by which the debtor's CEO, whose employment would be terminated on the plan's effective date, would receive a $20 million severance payment. 497 B.R. at 693. The approval of that payment by the debtor, without any action by the reorganized debtor, was a condition precedent to the plan's effectiveness. *Id.* Here, the Plan does not contain a condition precedent that the CIP will be implemented and administered by the Debtors, or the CIP Grants will be issued or paid prior to the Effective Date.

In *In re Dana Corp*., the Debtor filed a motion pursuant to sections 105, 363(b) and 365 of the Bankruptcy Code seeking approval of a proposed compensation plan for the Debtors' President and CEO, and five other executives. 351 B.R. at 98. The compensation plan was to take effect immediately upon receipt of court approval and all of the payments called for under the plan, save one, were payable prior to the debtors' emergence from bankruptcy. *Id.* at 99. The completion bonus payable under the plan included an amount payable to the executives upon the debtors' emergence from chapter 11. *Id.* The issue before the court was whether the compensation plan was subject to the limitations of section 503(c) of the Bankruptcy Code or could be evaluated pursuant to the business judgment test under section 363(b). The court held that the plan was subject to section 503(c) and denied the motion. *Id.* at 103. *Dana* is clearly distinguishable. The CIP does not contemplate any payments prior to emergence from chapter 11. Moreover, the *Dana* court did not consider whether post-effective date awards could qualify as administrative expenses.

In *In re TCI 2 Holdings, LLC*, the plan proponents sought approval of a severance package for certain officers and directors where the obligations under the package would be incurred and paid by the reorganized debtors after

Section 1129(a)(4) of the Bankruptcy Code, states that

> Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection 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). As such, it provides a mechanism for judicial review of payments made or to be made by the debtor in connection with a reorganization plan. *See In re Future Energy Corp.,* 83 B.R. 470, 488 (Bankr. S.D. Ohio 1988) ("Section 1129(a)(4) is designed to insure compliance with the policies of the Code that (1) the bankruptcy court should police the awarding of fees in title 11 cases and (2) holders of claims and interests should have the benefit of such information as might affect the claimants' decision to accept or reject the plan."). In *Journal Register*, the Court noted that "[b]y including the [JR Incentive Plan] in their Plan of Reorganization, the Debtors have subjected the Incentive Plan to the heightened disclosure, notice, and hearing requirements of the Plan confirmation process, and they have given the affected parties the opportunity to vote on it." 407 B.R. at 536–37. Judge Gropper found section 1129(a)(4) to be "directly applicable" to the post-effective date bonuses payable under the JR Incentive Plan because they were being made pursuant to the plan and because the statute is applicable to a "broad array of payments." *Id.* at 537 (citations omitted). In considering whether the payments under the incentive plan were reasonable, Judge Gropper found that "the issue of reasonableness will clearly vary from case to case and, among other things, will hinge to some degree upon who makes the payments at issue, who receives those payments, and whether the

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the effective date of the plan. 428 B.R. 117. The U.S. Trustee objected to the severance package on the grounds that it violated section 503(c) of the Bankruptcy Code. The plan proponents contended that the court should overrule the objection because any severance obligation would be incurred and paid by the reorganized debtors after the effective date of the plan, making section 503(c) inapplicable. *Id.* at 172-73. Without accounting for the source and timing of the severance payment, the court summarily sustained the objection. *Id.*

payments are made from assets of the estate." *Id.* (quoting *Mabey v. Southwestern Elec. Power Co. (In re Cajun Elec. Power Coop., Inc.),* 150 F.3d 503, 517 (5th Cir.1998), *cert. denied,* 526 U.S. 1144 (1999)). In approving the payments as reasonable under section 1124(a)(4), Judge Gropper noted (i) that incentive payments were to be paid from assets owned by the secured creditors – not the Reorganized Debtors, (ii) the disclosure statement and plan fully disclosed the incentive plan, (iii) the creditors' committee endorsed the incentive plan as reasonable, and (iv) the Debtors' chief operating officer, who was an experienced restructuring professional, testified without contradiction that the incentive plan was reasonable. *Id.* at 538.

The U.S. Trustee asserts that there is insufficient information to assess whether the payments under the CIP are reasonable. U.S. Trustee Obj. at 23. The payments under the CIP will be made after the Effective Date of the Plan from assets owned by the Reorganized Debtors. The Debtors fully disclosed all aspects of the CIP in the Disclosure Statement,[86] and in the Plan

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[86] As relevant, the Disclosure Statement provides, as follows:

> Backstop Agreements also provide for the terms of a [CIP] that the Debtors believe are consistent with market terms for a company the size and complexity of LATAM and the markets in which it operates. A summary of the CIP terms is set forth in a term sheet attached as Exhibit H to the Plan. Under the proposed CIP currently set forth in the Backstop Agreements and which the Debtors are seeking to have approved by the Court, employees will be eligible to receive either cash or "synthetic shares"—cash awards equivalent to the value of shares in the Reorganized Debtors. The CIP will be equivalent to dilution of 2.5% of the equity of the Reorganized Debtors. For synthetic share awards made to senior executives during the first year following the Debtors' emergence from bankruptcy, 100% of the contemplated awards will be retention based. Thereafter, awards under the CIP will, if approved by the Court, become increasingly more performance based. The criteria for performance-based awards will be determined by the New Board based on advice of compensation consultants that are being engaged to advise on such criteria.
>
> In addition, as set forth in Exhibit H to the Plan, the Debtors will seek to amend and assume up to approximately forty (40) executives' existing employment agreements, which amended agreements shall include management protection provisions (the "Management Protection Provisions") in the amount of no more than $35 million in the aggregate on terms acceptable to the Commitment Creditors and the Backstop Shareholders. The Management Protection Provisions currently described in the Backstop Agreements include $12 million in a short-term cash incentive plan that will be deemed fully earned as of the Effective Date.

Disclosure Statement at 60-61.

and Plan Supplement. The Holders of General Unsecured Class 5 Claims had the opportunity to factor the CIP and the CIP Grants thereunder into their decision to accept or reject the Plan. They voted overwhelmingly to accept the Plan. Moreover, the CIP metrics will be determined by the New Board but subject to the condition that the board consult with a compensation consultant selected by and acceptable to the Backstop Shareholders and the Parent GUC Ad Hoc Group. Moreover, there is no suggestion that CIP is not in line with the market for compensation of the Senior Executives of similar companies. The Court finds that the Debtors have complied with section 1129(a)(4) of the Bankruptcy Code.

The Non-Debtor Releases and Exculpation Provision

The Plan provides for the release and enjoinment of certain claims and causes of action by the Debtors (the "Debtor Releases") and by certain non-debtor third parties (the "Non-Debtor Releases") against a group of specified individuals and entities (the "Released Parties"). *See* Plan § 11.3.[87] It also includes Exculpation and Limitation of Liability and Injunction clauses. *See id.* §§ 10.6, 10.7. The Non-Debtor Releases are binding on the Holders of Claims against, and Equity Interests in, the Debtors and the Reorganized Debtors who

> (i) are entitled to vote to Accept or Reject this Plan and (x) vote to Accept this Plan or (y) either Reject this Plan or abstain from voting and do not timely submit

[87] For these purposes, the "Released Parties" consist of

> (i) each of the Debtor Released Parties, (ii) the Committee in its capacity as such, (iii) each of the Backstop Parties in their capacity as such, (iv) each of the DIP Secured Parties in their capacity as such, (v) the Eblen Group and CVL, each in their capacity as a party to the RSA and each of the Backstop Shareholders in their capacity as such, (vi) each of the Commitment Creditors in their capacity as such, (vii) each of the Prepetition Secured Parties in their capacities as such, (viii) the W&C Creditor Group Parties in their capacities as such, (ix) each agent, lender, or secured party under the Revised RCF Agreement, each in its capacity as such, (x) the Local Bond Trustee, in its capacity as such, (xi) the Joining Local Bondholders, in their capacities as such, and (xii) with respect to each of (ii)-(xi), such Person's predecessors, successors, assigns and for each of the foregoing, each of their present or former directors and officers, and any Person claiming by or through them, members, partners, equity-holders, employees, representatives, advisors, attorneys, notaries (pursuant to the laws of the United States and any other jurisdiction), auditors, agents and professionals, in each case acting in such capacity, and any Person claiming by or through any of them, for each of the foregoing in their capacity as such.

> a Ballot indicating their refusal to grant the releases in this paragraph (subject to subparagraph (iv) hereof),
>
> (ii) are presumed to have voted for this Plan under section 1126(f) of the Bankruptcy Code and do not timely opt out of the releases in this paragraph as provided for in the Notice of Non-Voting Status (as defined in the Disclosure Statement Order),
>
> (iii) exercise their preemptive rights to subscribe to either the ERO New Common Stock or the New Convertible Notes and do not timely opt out of the releases set forth in this paragraph in connection with the preemptive rights subscription process or
>
> (iv) elect to subscribe to New Convertible Notes Class C or New Local Notes (irrespective of how such Holder votes on this Plan).

Id. § 11.3(b). It is well settled that, as a general proposition, creditors may consent to third-party releases. *See Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142 (2d Cir. 2005); *see also In re Charter Commc'ns,* 419 B.R. 221, 258 (Bankr. S.D.N.Y. 2009) (stating that consensual releases are permissible); *In re Adelphia Commc'ns Corp.*, 368 B.R. 140, 268 (Bankr. S.D.N.Y. 2007) (adopting the view that third-party releases where the creditor consents, is permissible); *In re Oneida Ltd.,* 351 B.R. 79, 94 (Bankr. S.D.N.Y. 2006) (granting third-party releases where the creditor affirmatively

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Plan § 11.3(b); *see also id.* § 1.1 at 26-27 (definition of "Released Parties"). The term "Debtor Released Parties" means "the Debtors and each of their Related Persons excluding members, partners or Holders of Equity Interests." *See id*. § 1.1 at 8 (definition of "Debtor Released Parties").

[87] For these purposes, a "Related Person" means

> with respect to any Person, such Person's predecessors, successors, assigns and present and former subsidiaries and Affiliates (whether by operation of law or otherwise) and for each of the foregoing: each of their present or former directors and officers, and any Person claiming by or through them, members, partners, equity-holders, employees, representatives, present and former advisors and attorneys, notaries (pursuant to the laws of the United States and any other jurisdiction), auditors, agents and professionals, in each case acting in such capacity, and any Person claiming by or through any of them.

Id. § 1.1 at 26.

indicated their willingness to be bound by checking the box); *In re XO Commc'ns, Inc.,* 330 B.R. 394, 437 (Bankr. S.D.N.Y. 2005) (noting that consensual third-party releases are permissible).

The U.S. Trustee and the A&P Ad Hoc Group contend that to consent to such a release, the creditors and interest holders must affirmatively opt in to the release. *See* A&P Ad Hoc Group Obj. ¶ 57; U.S. Trustee Obj. 7-9.[88] They argue that silence on the part of a creditor or interest holder cannot be construed as consent to a release. U.S. Trustee Obj. at 9 (citing *In re SunEdison*, 576 B.R. at 458). They say that the Court should not authorize the Non-Debtor Releases because the Plan provides that creditors and interest holders will be bound by the Non-Debtor Release if they remain "silent" by failing to opt out of the release. *See id*. at 8. However, courts in this district routinely approve opt out release language in cases in which creditors and interest holders have been provided with "a clear and prominent explanation of the [opt out] procedure." *In re Avianca Holdings, S.A.,* 632 B.R. 124, 137 (Bankr. S.D.N.Y. 2021). That is because, "[i]naction is action under appropriate circumstances. When someone is clearly and squarely told if you fail to act your rights will be affected, that person is then given information that puts them on notice that they need to do something or else. That's not a trap." *Id.* at 137

[88] As support for that proposition, the U.S. Trustee and A&P Ad Hoc Group rely on *In re Chassix Holdings, Inc.*, 533 B.R. 64 (Bankr. S.D.N.Y. 2015) and *In re SunEdison, Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017)). In those cases, the reorganization plans provided for non-debtor releases that would be binding on unsecured creditors unless they took affirmative action not to grant the release. In both cases, the debtors projected that unsecured creditors would receive *de minims* distributions on account of their claims. The courts rejected the debtors' contentions that the non-debtor releases were consensual and enforceable. In substance, both courts reasoned that given the projected meager recovery on account of the creditor claims under the plans, it was likely that unsecured creditors did not focus on the fact that the plan called for them to take action not to grant the non-debtor releases and, in failing to act, they were not consenting to the releases. For that reason, the *Chassix* court directed the debtor to modify the plan to give unsecured creditors the right to opt into the non-debtor release, and the *SunEdison* court rejected the non-debtor release. *See In re Chassix Holdings, Inc.,* 533 B.R at 80 (the court required opt in elections largely due to the miniscule recovery proposed under the plan, which encouraged a "higher-than-usual degree of inattentiveness or inaction among affected creditors."); *In re SunEdison, Inc*., 576 B.R. at 461 (noting that the unsecured creditors received less than a 3% recovery, leading the court to assume that such "meager recoveries . . . may explain their inaction without regard to the Release."). Here, in contrast, releasing parties are receiving exponentially greater recovery than those at issue in *SunEdison* and *Chassix* (indeed, full recovery for a large number of claims). *See* Disclosure Statement § II.A. Moreover, the sufficiency of the Debtors' opt out process is apparent from the more than 250 opt outs the Debtors received.

(quoting *In re Cumulus Media Inc.*, No. 17-13381 (Bankr. S.D.N.Y. Feb. 1, 2018) (Tr. of Hr'g at 27–28) (Chapman, J)).

The Debtors have provided very clear and prominent notice and explanation of the Opt-Out Procedures applicable to the Non-Debtor Releases. Article XI of the Plan governs the "Effect of Plan Confirmation," and section 11.3(b) contains the Non-Debtor Release language in bold print. *See* Plan § 11.3(b). The Disclosure Statement includes a full discussion of the Debtor and Non-Debtor Releases, as well as the Exculpation and Limitation of Liability and Injunction clauses. *See* Disclosure Statement §§ I.B, I.F, XI.A-F. Moreover, in summarizing the terms of the Plan at the outset of the document, the Disclosure Statement provides that –

> **The Plan also contains third-party releases. If you are eligible to vote on the Plan and you (i) vote to accept the Plan or (ii) vote to reject the Plan or abstain from voting on the Plan and do not affirmatively opt out of the release provisions in the Plan, you will be deemed, as of the Effective Date, to have conclusively, absolutely, unconditionally, irrevocably and forever released, waived and discharged all claims and all causes of action (as set forth in Section 11.3 the Plan and as permitted by applicable law) against the Released Parties (as defined in the Plan), including third parties. *See* Section XI herein. Holders of claims are urged to carefully review the release provisions in Section 11.3 of the Plan as well as the opt-out procedures as detailed in the forms of ballots.**

Id. § I.B. In the Disclosure Statement Order, the Court approved the Debtors' proposed solicitation procedures, including the form of ballots (the "Ballots") and of the form of the Notice of Non-Voting Status to Holders of Unimpaired Claims Conclusively Presumed to Accept the Plan ("Notice of Non-Voting Status"). The Debtors conspicuously disclosed the Non-Debtor Releases in boldface type in the Ballots and the Notice of Non-Voting Status, together with instructions on how to opt out of the Non-Debtor Releases and expressly advised of the consequences of not doing so. Each of the Ballots for Classes 1, 5 and 7 and the Notice of Non-Voting Status, provided creditors an opportunity to opt out of the Non-Debtor Releases. The

Ballots and Notice of Non-Voting Status also include the exact language of the Debtor and Non-Debtor Releases set forth in the Plan. *See, e.g.,* Disclosure Statement Order, Ex. 3 (Form of Beneficial Owner Ballot for General Unsecured Claims against LATAM Parent) at 11-13.[89] Moreover, the Debtors offered claim and interest holders multiple options to effectuate their opt out, both via physical ballot and via the Solicitation Agent's online portal.[90] The voluntary "opt out" structure is routinely applied in chapter 11 cases in this and other districts.[91] The Court

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[89] The Ballots also provide that,

> Pursuant to Section 11.3 of the Plan, you will be deemed to have <u>conclusively, absolutely, unconditionally, irrevocably and forever released and discharged all Claims and Causes of Action (as set forth in the Plan and as permitted by applicable law), against the Released Parties (as defined in the Plan)</u> if you (a) vote to accept the Plan (whether or not you check the box in Item 3), (b) are presumed to have voted for the Plan under section 1126(f) of the Bankruptcy Code, or (c) reject the Plan or abstain from voting to 9 accept or reject the Plan without checking the box in Item 3 of the Ballot. You may check the box in Item 3 only if (a) you are entitled to opt out of the Releases in Section 11.3 of the Plan and (b) you submit the Beneficial Owner Ballot and either reject the Plan or abstain from voting to accept or reject the Plan.

See e.g., Disclosure Statement Order, Ex. 3 (Form of Beneficial Owner Ballot for General Unsecured Claims against LATAM Parent) at 8-9. Each Ballot also explained, as follows:

> PURSUANT TO THE PLAN, IF YOU RETURN A BALLOT THAT VOTES TO ACCEPT THE PLAN, YOU WILL BE DEEMED, AS OF THE PLAN EFFECTIVE DATE, TO HAVE CONCLUSIVELY, ABSOLUTELY, UNCONDITIONALLY, IRREVOCABLY AND FOREVER RELEASED AND DISCHARGED ALL CLAIMS AND ALL CAUSES OF ACTION (AS SET FORTH IN THE PLAN AND AS PERMITTED BY APPLICABLE LAW) AGAINST THE RELEASED PARTIES (AS DEFINED IN THE PLAN). IF YOU RETURN A BALLOT THAT VOTES TO REJECT OR ABSTAINS FROM VOTING ON THE PLAN AND DO NOT AFFIRMATIVELY OPT OUT OF THE RELEASE PROVISIONS IN SECTION 11.3 OF THE PLAN, YOU WILL BE DEEMED, AS OF THE EFFECTIVE DATE, TO HAVE CONCLUSIVELY, ABSOLUTELY, UNCONDITIONALLY, IRREVOCABLY, AND FOREVER RELEASED AND DISCHARGED ALL CLAIMS AND ALL CAUSES OF ACTION (AS SET FORTH IN THE PLAN AND AS PERMITTED BY APPLICABLE LAW) AGAINST THE RELEASED PARTIES (AS DEFINED IN THE PLAN).

See e.g., id. at 10.

[90] Disclosure Statement Order, Exs. 3, 4, 5 (form of the Ballots); *id.*, Ex. 6 (Notice of Non-Voting Status); Ex. 16 (Form of Beneficial Owner Ballot for LATAM 2024/2026 Bond Claims Against LATAM Finance and LATAM Parent); *see also* Order (A) Authorizing Service of Supplemental Solicitation Materials and (B) Scheduling Certain Dates and Deadlines in Connection with Confirmation of Plan of Reorganization [ECF No. 5221], Ex. C (RCF Ballots).

[91] *See, e.g.*, *In re China Fishery Grp. Ltd.*, Case No. 16-11895 (JLG), [ECF No. 2909] (Bankr. S.D.N.Y. Jan, 13, 2022) (confirming a plan with opt out third-party releases); *In re Philippine Airlines, Inc.*, Case No. 21-11569 (SCC) (Bankr. S.D.N.Y. Dec. 17, 2021) (same); *In re Avianca Holdings S.A.*, Case No. 20-11133 (MG), [ECF No. 2300]

overrules the A&P Ad Hoc Group's and U.S. Trustee's objection that an opt in rather than Opt-Out Procedure must be followed for a consensual release to be effective. [92]

The U.S. Trustee asserts that, assuming *arguendo,* that the creditors and equity holders have consented to the Non-Debtor Releases, consent alone is not sufficient support to warrant such releases. In *Metromedia* the Second Circuit set forth several circumstances in which courts have approved third-party releases, namely, (1) the importance of the releases to the plan, (2) whether the affected claims would be channeled to a settlement fund, (3) whether the bankruptcy estates would receive substantial consideration for the releases, (4) whether the released claims would impact the reorganization via indemnity or contribution, and (5) whether the plan otherwise provided for the full payment of the released claims. *In re Metromedia*, 416 F.3d at 141-42. The U.S. Trustee contends that the Debtors must demonstrate that application of those or similar factors supports that Non-Debtor Release. U.S. Trustee Obj. at 12. He asserts that the Debtors have failed to show that each Released Party is entitled to obtain a Non-Debtor Release. *Id*. at 12-13. He maintains that the definition of Released Parties in the Plan is unusually broad, encompassing many creditor groups and equity holders not typically included in the definition.

(Bankr. S.D.N.Y. Nov. 2, 2021) (same); *In re Stearns Holdings, LLC*, Case No. 19-12226 (SCC), [ECF No. 459] (Bankr. S.D.N.Y. Nov. 13, 2019) (same); *In re Ditech Holding Corp.*, Case No. 19-10412 (JLG), [ECF No. 1404] (Bankr. S.D.N.Y. Sept. 16, 2019) (same); *In re Nine West Holdings, Inc.*, Case No. 18-10947 (SCC), [ECF No. 1308] (Bankr. S.D.N.Y. Feb. 27, 2019) (same); *In re Tops Holding II Corp.*, Case No. 18-22279 (RDD), [ECF No. 765] (Bankr. S.D.N.Y. Nov. 9, 2018) (same); *In re Cenveo, Inc. et al.*, Case No. 18-22178 (RDD), [ECF No. 685] (Bankr. S.D.N.Y. Aug. 21, 2018) (same); *In re BCBG Max Azria Global Holdings, LLC et al.*, Case No. 17-10466 (SCC), [ECF No. 591] (Bankr. S.D.N.Y. July 26, 2017) (same); *In re Cumulus Media Inc.*, Case No. 17-13381 (SCC), [ECF No. 769] (Bankr. S.D.N.Y. May 10, 2018) (same); *In re 21st Century Oncology Holdings, Inc.*, Case No. 17-22770 (RDD) (Bankr. S.D.N.Y. Jan. 11, 2018) (same).

[92] The Non-Debtor Releases are consensual and apply only to those creditors and equity interest holders who affirmatively decide not to opt out of the release. As such, the U.S. Trustee misplaces his reliance on *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021) as support for his objection. There, the reorganization plan incorporated a broad, involuntary release of claims (including those predicated on fraud and willful misconduct) against non-debtors facing extensive liability stemming from the opioid crisis. *Id*. at 36. In contrast to the creditors and equity interest holders herein, the claimants in *Purdue Pharma* were afforded no opportunity to opt out of the releases. *See id.* at 81 (noting the claims at issue were "being finally disposed of pursuant to the Plan . . . without the claimants' consent and without any payment"). The holding of *Purdue Pharma* has no bearing on these Chapter 11 Cases.

He says that although certain of the Released Parties may have made a substantial financial contribution to the Plan, the Debtors have not shown that all of the Released Parties have done so. In particular, he asserts that the Debtors' officers and directors who simply performed their duties because they were paid to do so, or because they were under a fiduciary obligation to do so are not entitled to a release from claims of non-debtors. *Id*. at 13.

However, consideration of a non-debtor release is not "a matter of factors and prongs." *Metromedia*, 416 F.3d at 142. As noted, in *Metromedia* the Second Circuit identified "consent" as sufficient grounds for approving a non-debtor release. *Id.*; *see also In re Adelphia Commc'ns Corp.*, 368 B.R. at 268 (observing that the *Metromedia* court "did not quarrel with" other courts' approval of consensual non-debtor releases). Still, and in any event, application of the factors cited in *Metromedia* show that the Debtors have met their burden of demonstrating that the Released Parties are entitled to the Non-Debtor Release. The Plan is the culmination of two years of effort by the Debtors, their management, directors and employees, and their advisors, involving extensive negotiations with various stakeholders, including certain key creditor groups and holders of Equity Interests. *See* Alfonsín Decl. ¶ 5.[93] In connection with those negotiations, the Released Parties agreed to provide substantial consideration to the Debtors' estates and contributions to the restructuring, including by:

- providing billions of dollars in debtor-in-possession financing, providing the Debtors with critical liquidity that facilitated the administration of the Chapter 11 Cases and allowed the Debtors to continue their value-maximizing operations throughout the pendency of the cases and in the midst of an unprecedented, global pandemic, *see id*. ¶ 16;
- signing the RSA and agreeing to support the Plan, including by voting their respective claims and providing corporate approvals necessary to

[93] Debtors Tr. Ex. 22 (Decl. of Ramiro Alfonsín Balza in Supp. of the Debtors' Proposed Plan of Reorganization dated April 12, 2022) (the "Alfonsín Decl.").

effectuate the issuance of the Plan Securities, *see id*. ¶¶ 9, 10, 13, 16, 20-21;

- agreeing to backstop several billion dollars of Plan Securities, in order to ensure that the Debtors will be able to raise the capital they need to fund Plan distributions and emerge from the Chapter 11 Cases well capitalized, *see id*. ¶¶ 8-10, 13, 16, 20;

- waiving certain legal rights (including preemptive and corporate governance rights under Chilean law) and, with respect to the Prepetition Secured Parties, settling or waiving claims for default interest against the Debtors, both of which are essential to the global compromise embodied in the Plan, *see id*. ¶¶ 16, 20; and

- with respect to the Holders of RCF Claims, committing to provide a revolving credit facility to the Debtors post-emergence.

The Debtors assert and the Court agrees that these contributions were instrumental to the Debtors' ability to prosecute the Chapter 11 Cases in a manner that preserved value for their estates, and in the formation and consummation of the Plan, which provides meaningful value to the Debtors' creditors. These contributions were also made by the individuals whose labor or services furthered the Debtors' reorganization. *See* Findings of Fact at 20-21, Ex. A at 21, *In re Trident Holding Co., LLC*, Case No. 19-10384 (SHL) [ECF No. 928] (Bankr. S.D.N.Y Sept. 18, 2019) (approving third-party releases for parties who made a substantial contribution to the reorganization, including the debtors' officers, directors and employees); Findings of Fact at 20-26, *In re Millennium Lab Holdings II, LLC*, Case No. 15-12284 (LSS) [ECF No. 195] (Bankr. D. Del. Dec. 14, 2015) (same); *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1079-80 (11th Cir. 2015) (same); *In re Mercedes Homes, Inc.*, 431 B.R. 869, 881 (Bankr. S.D. Fla. 2009) (same).[94] Accordingly, the Court overrules the objections and approves the Non-Debtor Releases.

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[94] Additionally, certain of the Released Parties are owed indemnification and contribution by the Debtors under the Backstop Agreements or the A&R DIP Credit Agreement. *See* Plan § 3.1(f). Releasing claims against these

Section 11.6 of the Plan contains Exculpation and Limitation of Liability provisions. It provides that on the Effective Date, the Exculpated Parties:

> shall neither have nor incur any liability to any Holder of a Claim or Equity Interest, the Debtors, the Reorganized Debtors, or any other party-in-interest, or any of their Related Persons for any prepetition act taken or omitted to be taken in connection with, related to or arising from authorizing, preparing for or filing the Chapter 11 Cases or any postpetition act or omission in connection with, relating to, or arising out of the Chapter 11 Cases, the formulation, negotiation, or implementation of the Restructuring Support Agreement, Disclosure Statement, the Disclosure Statement Supplement, this Plan, the solicitation of acceptances of this Plan, the pursuit of confirmation of this Plan, the confirmation of this Plan, the consummation of this Plan or the administration of this Plan, except for acts or omissions that are the result of willful misconduct, gross negligence, fraud or criminal acts . . . .

Plan § 11.6. For these purposes, the term "Exculpated Parties" means:

> (i) each of the Debtors, non-Debtor Affiliates, Reorganized Debtors, and all of their respective Affiliates, (ii) the Backstop Parties, in their capacity as such, (iii) the DIP Secured Parties, in their capacity as such, (iv) the Commitment Creditors, in their capacity as such, (v) the Backstop Shareholders, in their capacity as such, (vi) the Eblen Group and CVL, each in their capacity as a party to the Restructuring Support Agreement, (vii) the Prepetition Secured Parties, each in their capacity as such, (viii) each agent, lender and secured party under the Revised RCF Agreement, each in its capacity as such, (ix) the W&C Creditor Group Parties, each in their capacity as parties to the Restructuring Support Agreement, (x) the Joining Local Bondholders and the Local Bond Trustee, each in its capacity as such, (xi) the Committee and each of the members of the Committee in its capacity as such, and (xii) with respect to the foregoing Persons in clauses (i)—(xi), each of their respective officers, directors, employees, representatives, advisors, attorneys, notaries (pursuant to the laws of the United States and any other jurisdiction), auditors, agents and professionals, in each case acting in such capacity on or any time after the Petition Date, and any person claiming by or through any of them but excluding any other Causes of Action preserved by the Debtors.

Id.

Released Parties will therefore ensure the Debtors are not burdened with the costs of indemnification or contribution, another basis for approving non-debtor releases. *See Metromedia*, 416 F.3d at 142.

Exculpation provisions in chapter 11 plans are not uncommon and "generally are permissible, so long as they are properly limited and not overly broad." *In re Nat'l Heritage Found., Inc.*, 478 B.R. 216, 233 (Bankr. E.D. Va. 2012) (citing *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3d Cir. 2000)). Moreover, courts in this district routinely approve exculpations of prepetition conduct that are tailored to the debtor's reorganization, as the Exculpation Provision is here. *See In re Stearns Holdings, L.L.C.,* 607 B.R. 781, 790 (Bankr. S.D.N.Y. 2019). The U.S. Trustee objects to the Exculpation clause on the grounds that the definition of "Exculpated Party" is overly broad. U.S. Trustee Obj. at 13. He maintains that an exculpation clause must be limited to estate fiduciaries like estate professionals, the committees and their members, and the Debtors' directors and officers who have served during the chapter 11 case and should not be extended to cover third parties like creditors, shareholders, and their advisors. *Id.* He also asserts that in addition to excepting willful misconduct, gross negligence, fraud, or criminal acts (as it does), the Exculpation clause should except attorneys' violations of New York Rules of Professional Conduct ("NYRPC"). *Id.* He maintains that as drafted, the Plan runs afoul of the NYRPC provision that restricts attorneys from making agreements limiting their liability to a client for malpractice. *See* N.Y. Comp. Codes R. & Res. Tit. 22 § 1200.8 Rule 1.8(h)(1).

It is well settled that an exculpation clause approved at confirmation may exculpate estate fiduciaries like a committee, its members, and estate professionals for their actions in the bankruptcy case except where those actions amount to willful misconduct or gross negligence. *In re PWS Holding Corp.*, 228 F.3d at 246; *see also In re Tribune Co.*, 464 B.R. at 126, 189 (Bankr. D. Del. 2011); *In re Washington Mut., Inc*., 442 B.R. 314, 350 (Bankr. D. Del. 2011). The Exculpation clause meets that standard. But that does not go far enough for purposes of these cases. "Exculpation provisions are frequently included in chapter 11 plans, because stakeholders all too often blame others for failures to get the recoveries they desire; seek vengeance against other parties; or simply wish to second guess the decisionmakers in the chapter 11 case." *In re DBSD North America, Inc.*, 419 B.R. 178, 217 (Bankr. S.D.N.Y. 2009). Accordingly, in that light,

> a proper exculpation provision is a protection not only of court-supervised fiduciaries, but also of court-supervised and court-approved transactions. If this Court has approved a transaction as being in the best interests of the estate and has authorized the transaction to proceed, then the parties to those transactions should [] not be subject to claims that effectively seek to undermine or second-guess this Court's determinations. In the absence of gross negligence or intentional wrongdoing, parties should not be liable for doing things that the Court authorized them to do and that the Court decided were reasonable things to do.

In re Aegean Marine Petroleum Network, Inc., 599 B.R. 717, 721 (Bankr S.D.N.Y. 2019). The Exculpated Parties who are not estate fiduciaries are entitled to benefit from a broad exculpation provision. They have been actively involved in all aspects of these Chapter 11 Cases and have made significant contributions to the success of these cases. In the absence of gross negligence or intentional wrongdoing on their parts, the Court will extend the Exculpation clause to the Exculpated Parties who are not estate fiduciaries, to bar claims against them as set forth in the Exculpation clause, and based on the negotiation, execution, and implementation of agreements and transactions that were approved by the Court. To that extent, the Court overrules the U.S. Trustee's objection to the breadth of the definition of Exculpated Parties. Finally, the Court finds no merit to the U.S. Trustee's request that the Court should carve out attorneys' violations of N.Y. Comp. Codes R. & Res. Tit. 22 § 1200.8 Rule 1.8(h)(1). That rule prohibits a lawyer from making an agreement prospectively limiting the lawyer's liability to a client for malpractice. However, it has no bearing on the standard of care established in the Exculpation Provision. Accordingly, the Court overrules the U.S. Trustee's objection.

The U.S. Trustee Supplemental Objection

On September 24, 2020, the Court entered an order (the "Bar Date Order") establishing December 18, 2020 at 4:00 p.m. prevailing Eastern Time as the last date and time for each person or entity to file proofs of claim based on prepetition claims or on section 503(b)(9) of the Bankruptcy Code (the "General Bar Date").[95] Additionally, the Bar Date Order establishes separate Bar Dates for claims arising from the Debtors' rejection of executory contracts and unexpired leases and claims that Debtors have amended in their Schedules.

Beginning after the General Bar Date, the Debtors and their advisors implemented a process to review and reconcile the many thousands of filed and scheduled claims (and supporting materials) in these Chapter 11 Cases. *See* Reply to U.S. Trustee Suppl. Obj. ¶ 1. Part of this process involved the Debtors and their creditors contacting each other to exchange supporting materials and address questions or seek resolutions regarding a creditor's claims. In a subset of these cases, where the Debtors and creditors agreed with the amounts asserted in a proof of claim, the parties entered into claim allowance agreements (the "Claim Allowance Agreements"). *Id.* Beginning in late December 2021–which is prior to the entry of the Disclosure Statement Order–the Debtors began to insert a Plan Support Provision in the Claim Allowance Agreements with the Class 5 Claim Allowance Creditors. *Id.* ¶ 3.[96] Pursuant to that provision, among other things, the creditor committed to vote in favor of the Plan. The typical Plan Support Provision provides that:

> **Support of the Plan.** Counterparty shall timely cast any and all votes in respect of the Claim to vote in favor of acceptance of the Plan. Counterparty shall not

[95] *See* Order (I) Establishing Bar Dates for Filing Proofs of Claim, (II) Approving Proof of Claim Form, Bar Date Notices, and Mailing and Publication Procedures, (III) Implementing Uniform Procedures Regarding 503(b)(9) Claims, and (IV) Providing Certain Supplemental Relief [ECF No. 1106].

[96] A copy of a representative Claim Allowance Agreement is annexed as Ex. A at 1-2 to the U.S. Trustee Supplemental Objection.

> oppose or object to approval of the Disclosure Statement and confirmation of the Plan. To the extent the Counterparty sells or otherwise transfers any portion of its interest in the Claim, including the right to vote on the Plan, such sale or transfer agreement (or any similar agreement) shall include a provision binding the purchaser or transferee, and any subsequent purchasers or transferees, to this Agreement.

Id. ¶ 5. By early January 2022, the Debtors created a Claim Allowance Agreement Template that included a Plan Support Provision, that they sent to Class 5 Claim Allowance Creditors as part of the negotiation on the allowance of their claims. *See id.* ¶ 8.[97] The U.S. Trustee contends that the Debtors aggressively sought out those agreements from the Class 5 Claim Allowance Creditors in an effort to ensure that they could satisfy the numerosity requirement under section 1126(c) of the Bankruptcy Code for Class 5's acceptance of the Plan. *See* U.S. Trustee Suppl. Obj. at 18. The Debtors obtained at least forty-one Claim Allowance Agreements (with the Plan Support Provision) from the Class 5 Claim Allowance Creditors covering ninety-five separate claims. *Id.* at 13, 15. The Debtors did not seek Court authorization to enter into the Claim Allowance Agreements or otherwise file the agreements with the Court. However, for each agreement, they separately executed a Claim Allowance Stipulation (which did not include the Plan Support Provision or mention the provision) and then sought Court approval of the stipulation. The Debtors treat the Claim Allowance Agreements as consisting of the Debtors' agreement to allow the claims, and the claimants' agreement to support the Plan. The Debtors explain that they sought Court approval of the Claim Allowance Stipulation, because under the Bankruptcy Code they must obtain such approval because they do not have the unilateral right to allow creditor claims. *See* Reply to U.S. Trustee Suppl. Obj. ¶ 11. They say that they did not believe that they needed to obtain Court authorization to enter into the Plan Support Provision because (i) they

[97] The prototype of the Claim Allowance Agreement Template is annexed as Ex. A at 3-4 to the U.S. Trustee Supplemental Objection.

"fully believed that these Plan Support Provision were agreed to with creditors who had every intention of supporting the Plan," and (ii) because they "never had any intention of seeking specific performance" of the Plan Support Provision. *Id*. They also contend that they did not intend to conceal the Plan Support Provision from the Committee, the U.S. Trustee, or the Court, and that they believed, and still believe, that entry into the Plan Support Provision is entirely proper, and accordingly did not think including these agreements on the docket was necessary. *Id.* ¶¶ 11-13.

The Claim Allowance Agreements do not contain confidentiality provisions and in January 2022, a third party provided a copy of one such agreement to counsel to the Committee. On January 20, 2022, the Committee's counsel sought informal discovery from the Debtors including: (1) all documents and communications between the Debtors, or their advisors, and any creditor seeking support for the Plan; (2) all documents and correspondence regarding any effort to secure a creditor's support of the plan, which the Committee referred to as the "Program"; (3) all communications regarding the Program; and (4) a list of the creditors that the Debtors had approached seeking support of the Program (the "Information Request"). *Id.* ¶ 16.[98] The U.S. Trustee joined in the Information Request. *Id.* At a chambers conference on February 8, 2022, the Court ordered the Debtors to produce all signed agreements containing the Plan Support Provision and external communications with counterparties regarding that provision. *Id*. ¶ 17.[99]

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[98] *See* Supplement to the Objection of the Official Committee of Unsecured Creditors to the Debtors Motion to Approve (I) the Adequacy of Information in the Disclosure Statement, (II) Solicitation and Voting Procedures, (III) Forms of Ballots, Notices and Notice Procedures in Connection Therewith, and (IV) Certain Dates With Respect Thereto, Exhibit B [ECF No. 4171].

[99] The Court did not direct the Debtors to produce other categories of documents, including internal correspondence, correspondence with creditors who did sign Claim Allowance Agreements with a Plan Support Provision or a list of creditors who were approached about potentially signing an agreement. Reply to U.S. Trustee Suppl. Obj. ¶ 17. The Court indicated that, if after review of the ordered discovery, the Committee or U.S. Trustee wanted further discovery, they could renew their requests.

Over the next three months, the Debtors produced more than 2,300 documents spanning over 18,000 pages, the vast majority of which were produced by the beginning of April 2022. *Id.* ¶ 18.[100]

In the wake of the disclosure of the Claim Allowance Agreements (with the Plan Support Provision), and their receipt of the discovery requests, the Debtors, without conceding any impropriety with respect to their position, took affirmative steps to disclaim any attempt to rely on or enforce the Plan Support Provision. They did this in three ways.

> First, the Debtors added language to the fifth revised Disclosure Statement [ECF No. 4727] in which they advised that they would not enforce or compel compliance with any provision in a Claim Allowance Agreement.[101]
>
> Second, the Debtors filed and served on all counterparties to agreements containing a Plan Support Provision a notice that expressly disclaimed the provision.[102]
>
> Third, all Claim Allowance Stipulations were entered (or re-entered) with language stating that the counterparty was not bound by the Plan Support Provision.

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[100] The Debtors assert that as ordered by the Court, these documents included all executed agreements with all counterparties who entered into agreements with the Plan Support Provision as well as all external correspondence with these counterparties concerning Claim Allowance Agreements. *Id*. ¶ 18. They say that they also produced extensive, invoice-by-invoice financial back-up proving that each claim that was subject to the Claim Allowance Agreements with a Plan Support Provision was reconciled in accordance with the Debtors' books and records, down to the cent. *Id*. They contend that parallel and subsequent to these productions, the Debtors continued to meet and confer with both the Committee and U.S. Trustee, where they continued to request the documents and communications that the Debtors say were the subject of the Information Request that the Court previously rejected. *Id.* ¶ 19. The Debtors say that notwithstanding their belief that these documents and communications were irrelevant to the legal issues at hand, they voluntarily produced an Excel document that served as the Debtors' informal means of tracking their outreach to claimants regarding Claim Allowance Agreements. *Id.*

[101] *See* Disclosure Statement § IV.L ("The Debtors have agreed that they will not enforce any provision in a 'Claim Allowance Agreement' that would require a creditor to vote to accept the Plan").

[102] *See* Notice Of Debtors' Position Regarding Certain Claim Allowance Agreements [ECF No. 4752] (the "Plan Support Notice"). The Plan Support Notice states:

> PLEASE TAKE FURTHER NOTICE that any provisions in any Claim Allowance Agreements, or any similar agreements between the Debtors and creditor counterparties, regarding a creditor counterparty's agreement to vote to accept the Plan shall not be binding on the creditor counterparty, and the Debtors expressly disclaim any attempt to enforce or compel compliance with respect thereto.

Plan Support Notice at 2.

Id. ¶ 20. The Debtors report that of the ninety-five Allowed General Unsecured Class 5 Claims originally subject to the Plan Support Provisions, only forty-five voted to support the Plan. *Id.*

Section 1125 of the Bankruptcy Code addresses matters relating to the solicitation of votes to accept or reject a chapter 11 plan. Section 1125(b) states, in pertinent part, as follows:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.

11 U.S.C. § 1125(b). This section is "designed to 'discourage the undesirable practice of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests.'" *In re Heritage Org., LLC,* 376 B.R. 783, 794 (Bankr. N.D. Tex. 2007) (quoting *In re Clamp-All Corp*., 233 B.R. 198, 208 (Bankr. D. Mass. 1999)). Section 1126 of the Bankruptcy Code governs the acceptance and rejection of chapter 11 plans. The default rule under the Bankruptcy Code is that the votes of all holders of claims or interests impaired by the plan are counted in determining whether the class of claims or interests has accepted or rejected the plan. *See* 11 U.S.C. § 1126(d). Section 1126(e) provides an exception to that rule. It authorizes the bankruptcy court to "designate" (i.e., disregard) the votes of "any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title." 11 U.S.C. § 1126(e).

In substance, the U.S. Trustee contends that in entering into the Claim Allowance Agreements, the Debtors improperly solicited the Class 5 Claim Allowance Creditors' votes for their Plan. *See* U.S. Trustee Suppl. Obj. at 1-2. He contends that the Debtors "[i]mproperly engaged in postpetition claims resolution process for the purpose of leveraging the claims resolution process in order to improperly solicit votes for the Debtors' Plan of Reorganization."

Id. at 1. To that end, he maintains that "the Debtor utilized this process to secure agreements with certain creditors to vote in favor of the plan based on the Debtors' agreement to allow the creditor's respective claim." *Id.* at 1-2. Although the Debtors have waived their rights, if any, to enforce the Plan Support Provisions in the agreements, the U.S. Trustee nonetheless contends that the Debtors' "clear violation" of section 1125(b) of the Bankruptcy Code provides grounds for the Court to designate the votes of the Class 5 Claim Allowance Creditors pursuant to section 1126(e), and to deny confirmation of the Plan under section 1129(a)(2) of the Bankruptcy Code. *Id.* at 18.

The Debtors deny that in entering into the Claim Allowance Agreements, they solicited acceptances of the Plan. They contend that sections 1125(b) and 1126(e) are not applicable to the Claim Allowance Agreements. *See* Reply to U.S. Trustee Suppl. Obj. ¶ 22. They also contend that in any event, the U.S. Trustee has not demonstrated grounds for designating the votes of the Class 5 Claim Allowance Creditors. *Id.* ¶ 27. Finally, they assert that, assuming *arguendo* that they violated section 1125(b), the sole remedy for such violation is the designation of the votes of the Class 5 Claim Allowance Creditors under section 1126(e). They content that section 1129(a)(2) does not provide grounds to deny Plan confirmation.

The U.S. Trustee notes that as applied to section 1125(b) of the Bankruptcy Code, the terms "solicit" and "solicitation" "do not encompass discussions, exchanges of information, negotiations, or tentative arrangements that may be made by the various parties in interest in a bankruptcy case which may lead to the development of a disclosure statement or plan of reorganization, or information to be included therein." U.S. Trustee Suppl. Obj. at 15 (quoting *In re Snyder*, 51 B.R. 432, 437 (Bankr. D. Utah 1985) (cited by *Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94, 101 (3d Cir. 1988)). He maintains that the negotiations with the

Class 5 Claim Allowance Creditors leading up to the execution of the Claim Allowance Agreements did not touch upon matters relating to the development of a confirmable plan of reorganization or the adequacy of the filed Disclosure Statement. *See id.* at 16. He asserts that instead "[t]he Debtors sole purpose in their communications with the creditors was to leverage the claims resolution process to extract a commitment from the creditors to vote for the Plan." *Id.* He notes that "[t]he Debtors' claims resolution communications with the creditors were accompanied by a form agreement that bound the claim to a vote for the Plan." *Id*.

The term "solicitation" is not defined under the Bankruptcy Code. In *Century Glove, Inc. v. First Am. Bank*, the Third Circuit said:

> "solicitation" must be read narrowly. A broad reading of § 1125 can seriously inhibit free creditor negotiations. . . . The purpose of negotiations between creditors is to reach a compromise over the terms of a tentative plan. The purpose of compromise is to win acceptance for the plan. We find no principled, predictable difference between negotiation and solicitation of future acceptances. We therefore reject any definition of solicitation which might cause creditors to limit their negotiations.

860 F.2d 94, 101–02 (3d Cir.1988). Moreover, as Judge Glenn noted, "[c]ase law indicates that the term . . . should relate to the formal polling process in which the ballot and disclosure statement are actually presented to creditors with respect to a specific plan, and the term should not be read so broadly as to chill the debtor's postpetition negotiations with its creditors." *In re Residential Capital, LLC,* Case No. 12–12020, 2013 WL 3286198 at * 19 (Bankr. S.D.N.Y. June 27, 2013) (quotations and citations omitted).

The U.S. Trustee maintains that the communications surrounding the negotiation and execution of the Claim Allowance Agreements are "fundamentally different" from the ones carved out from the definition of solicitation cited above in *In re Snyder*, 51 B.R. at 437. U.S. Trustee Suppl. Obj. at 16. He asserts that the Claim Allowance Agreements "were pre-drafted, with no room for negotiation with the creditors; all the creditors were required to sign it." *Id.* He argues that even if the Court adopts "the narrowest interpretation that only sending an official ballot constitutes solicitation," the Debtors' actions nonetheless qualify as "solicitation in substance," because a creditor's "signing this agreement, with no ability to reconsider the vote for the Plan, has the same effect as voting to accept the plan on a ballot." *Id.* at 16-17. He maintains that "[i]f the creditor signs the agreement, it is ***legally bound*** to vote for the plan, as opposed to a tentative agreement or informal promise to vote for the plan." *Id.*

The Debtors liken the Claim Allowance Agreements to post-petition plan support agreements that were "negotiated in good faith and at arm's length, between sophisticated commercial parties, and only after the Disclosure Statement and Plan had been filed." *See* Reply to U.S. Trustee Suppl. Obj. ¶¶ 26-27. However, the cases that the Debtors cite in support of that contention are inapposite and inapplicable to the Plan Support Provisions. As noted, these provisions call for the allowance of claims by the Debtors, and promises to vote in favor of the Debtors' reorganization plan, by the creditors. They bear no resemblance to the plan support agreements that the Debtors cite. First, in those cases, the debtors sought court approval of the agreements. Here, the Debtors did not seek Court approval of the Plan Support Provisions and maintain that they were not required to do so. Moreover, in those cases, the agreements were integral to the development of the plan and the respective debtors' path forward to exit chapter 11. That is not the case here. The only "plan support" provision in the Claim Allowance Agreement is the subject Class 5 Claim Allowance Creditors' unconditional commitment to support the Plan by, among other things, voting to accept the Plan. Further, while the plan support agreements cited by the Debtors were executed prior to approval of the disclosure statement and were executed in furtherance of a debtor formulating its plan—i.e., before the plan was filed in court—here that is clearly not the case.[103] Moreover, the U.S. Trustee notes that some courts have disallowed post-petition lock-up agreements. As support, he cites to *In re Stations Holding Co.*, Inc., Case No. 02-10882 (Bankr. D. Del. 2020) and *In re NII Holdings, Inc.*, Case No. 02-11505 (Bankr. D. Del. 2020). In those cases, the debtors and certain of their creditors had entered into plan support agreements that included specific performance as a remedy for breach of the agreement. In each case, the Delaware bankruptcy court found that the remedy rendered the provisions into votes to accept the plans, in violation of section 1125(b) and designated the votes at issue. *See In re Stations Holding Co., Inc.,* Case No. 02-10882 (Bankr. D. Del. Sept. 30, 2002) Order Granting Motion of the United States Trustee Pursuant to Sections 1125(b) and 1126(d) and (e) of the Bankruptcy Code to Designate All Persons Who Executed Post-Petition Lockup Agreements and to Direct that Their Ballots Not be Counted, and/or for

[103] In *In re Bally Total Fitness of Greater N.Y., Inc.,* Case No. 08-14818 (BRL) (Bankr. S.D.N.Y. July 9, 2009) the court approved a plan support agreement that required the prepetition senior secured lenders to vote in favor of the plan and not to exercise remedies under their loan documents. *Id.* Motion of Debtors for Entry of an Order Approving the Debtors' Entry into (I) A plan Support Agreement and (II) Exit Financing Commitment Letters [ECF No. 1041] ¶ 14. In exchange, the secured lenders received payment of the claim as well as common stock in the reorganized debtor. *Id.* ¶ 16. The secured lenders also agreed to provide the exit finance which includes, among other fees, a commitment fee, closing fee and payment of lenders' expenses. *Id.* ¶ 19. The debtors sought approval of the agreement under sections 105(a), 363(b), 364(c)(1), 503 and 507 of the Bankruptcy Code and claimed that these agreements were a "very critical component" of the plan. The court agreed. *Id.;* July 9, 2009 Hr'g Tr. at 5:9-6:21 [ECF No. 1248].

In *In re Almatis B.V.,* Case No. 10-12308 (MG) (Bankr. S.D.N.Y. Aug. 3, 2010) [ECF Nos. 309, 349], the court granted the debtors' motion to enter in plan support agreements with prepetition lenders and provide exit financing in exchange for full payment in cash to senior lenders as well as issuance of warrants in reorganized debtor in exchange for the lender's support of the plan. *Id.* [ECF No. 309] ¶¶ 17, 20. Thus, the plan support agreement was integral to the revised plan. *Id.* ¶ 3. The debtors sought approval of the plan support agreement under section 105(a), 363(b) and 1125(b) of the Bankruptcy Code, which the court approved. *Id.* [ECF No. 349] ¶ 2.

In *In re Lehman Bros. Holdings Inc.,* Case No. 08-13555 (JMP) Hr'g Tr. at 54:2-5 (Bankr. S.D.N.Y. Aug. 30, 2011) [ECF No. 19935] the court approved plan support agreements entered prior to the approval of the disclosure statement that resulted in "achieving a highly desirable purpose, orderliness in lieu of unnecessary litigation." The plan support agreement provided the framework for a chapter 11 plan of reorganization and specified the treatment of claims including the floating rate debt, mezzanine debt, fixed rate debt, other secured debt, general unsecured claims, intercompany claims, section 510(b) claims, deficiency claims, administrative claims as well as priority claims. *Id.* [ECF No. 10465] ¶ 26. The debtors sought approval of the plan support agreement under section 363 of the Bankruptcy Code. *Id.* at 1. The court approved the agreement. *Id.* [ECF No. 10877].

Sanctions or Other Relief [ECF No. 177], and *In re NII Holdings, Inc.,* Case No. 02-11505 (Bankr. D. Del. Oct. 25, 2002), Order dated October 25, 2002) [ECF No. 367].[104]

The Claim Allowance Agreements obligate the Debtors to file a Claim Allowance Stipulation with the Court seeking to allow the subject claim as a general unsecured claim, and simultaneously to file a notice withdrawing the objection to the subject claim. *See* Claim Allowance Agreement Template. The Plan Support Provisions obligate the Class 5 Claim Allowance Creditors: (i) to timely cast any and all votes in respect of the Claim to vote in favor of acceptance of the Plan; (ii) to not oppose or object to approval of the Disclosure Statement and confirmation of the Plan; and (iii) to include a provision in any claim transfer document binding the purchaser or transferee, and any subsequent purchasers or transferees, to the agreement. *Id.* at 4. The Claim Allowance Agreements are not "plan support agreements" in the conventional sense. They are agreements by Class 5 Claim Allowance Creditors to vote their claims in favor of the Debtors' Plan (even as it may be amended from time to time), conditioned only on the Court's allowance of the claims as Allowed General Unsecured Class 5 Claims against the Debtors. Each agreement was entered prior to the Court's approval of the Disclosure Statement. The specific performance provision in the agreements at issue in *Stations Holdings* and *NII Holdings* appear to have been the key provision in the Delaware court's determination that, for purposes of section 1125(b), the agreements in those cases were deemed equivalent to votes in favor of the subject plans. Although the Claim Allowance Agreement does not include specific performance as a remedy for breach of the agreement, on its face it is an enforceable

[104] These orders are not available on Westlaw, Lexis, or PACER. The description here relies on the summary of the orders contained in Collier. *See In re Residential Cap., LLC*, No. 12-12020, 2013 WL 3286198, at *20 n.5 (Bankr. S.D.N.Y. June 27, 2013) (same).

agreement obligating the counterparty Class 5 Claim Allowance Creditor to vote in favor of the Debtors' Plan, that was executed prior to the Court's approval of the Disclosure Statement.

The Debtors have disclaimed any right to enforce the Plan Support Provisions and entered into new agreements with the Class 5 Claim Allowance Creditors that did not include the Plan Support Provisions. Moreover, it is undisputed that only forty-five of the ninety-five Allowed General Unsecured Class 5 Claims originally subject to the Plan Support Provisions, voted to accept the Plan. Still, the U.S. Trustee seems to contend that the Debtors cannot "un-ring the bell" as he maintains that the Debtors nonetheless should be sanctioned for their alleged breaches of section 1125(b) of the Bankruptcy Code. Moreover, although he acknowledges that the remedy called for under the Bankruptcy Code for a section 1125(b) violation is the designation of votes of the claims at issue under section 1126(e) of the Bankruptcy Code, he maintains that the only appropriate remedy, and the one he is seeking herein, is for the Court to deny Plan confirmation under section 1129(a)(2) of the Bankruptcy Code.

The U.S. Trustee reasons that the Debtors launched their allegedly improper bid to solicit votes from the Class 5 Claim Allowance Creditors in violation of section 1125(b) to ensure that Holders of Allowed General Unsecured Class 5 Claims vote to accept the Plan. He asserts that "because the disallowance of votes would only increase the likelihood of the acceptance of Class 5, thereby imposing no penalty on the Debtors' misconduct, the only appropriate remedy is to deny confirm of the Debtors' Plan." U.S. Trustee Suppl. Obj. at 14-15. In his view:

> [t]he problem with designating the votes needs to be considered in the context of the circumstances of this case. The [Class 5 Claim Allowance Creditors] are members of Class 5, which also includes unsecured noteholders. The Debtors no doubt anticipate that it has sufficient support from noteholders to satisfy the 2/3 in amount, quantitative requirement, for achieving acceptance by Class 5. The Debtors' undisclosed efforts to secure the votes of creditors appears to have been intended to ensure the satisfaction of the 1/2 numerosity requirement for class acceptance. Therefore, the usual remedy of designating votes by removing the

> votes from consideration only increases the likelihood that the Debtors' goal of obtaining the acceptance of Class 5 will be achieved. That approach rewards the Debtors for their misconduct. A more equitable and appropriate solution is to deny confirmation of the Plan.

Id. at 18.

The Court disagrees. Assuming, *arguendo,* that the Debtors violated section 1125(b) in entering into the Claim Allowance Agreements, a denial of Plan confirmation is neither an equitable nor appropriate resolution to the objection. By its terms, section 1126(e) provides the exclusive remedy for violations of section 1125(b). *See In re Texaco, Inc*., 81 B.R. 813, 816 (Bankr. S.D.N.Y. 1988) (holding that in the event of improper solicitation of votes, the exclusive relief afforded under the Code is to have improper votes disregarded for voting purposes); *In re WorldCom, Inc.*, No. 02-13533 (AJG), 2003 Bankr. LEXIS 2192, *35-36 (Bankr. S.D.N.Y. May 16, 2003) (holding that even if the Debtors had improperly solicited acceptances of the plan, appointment of a chapter 11 trustee was not an appropriate remedy because Section 1126(e) of the Code provides an exclusive remedy for improper solicitation). Section 1126(e) "grants the bankruptcy court discretion to sanction any conduct that taints the voting process, whether it violates a specific provision or is in 'bad faith.'" *Century Glove, Inc.,* 860 F.2d at 97. *See also In re Adelphia Commc'ns Corp.,* 359 B.R. 54, 60 (Bankr. S.D.N.Y. 2006) ("Section 1126(e) is permissive in nature, and a bankruptcy judge has discretion in designating votes."). The statute applies equally to actions by debtors and creditors. As relevant, "it provides a basis to designate, without regard to the creditor's motive, where the vote is 'solicited or procured' in bad faith." *In re Quigley Co., Inc*. 437 B.R. 102, 130-31 (Bankr. S.D.N.Y. 2010); *see also In re Sandia Resorts, Inc.,* No. 11-15-11532 JA, 2016 WL 6879249, at *5 (Bankr. D.N.M. Nov. 4, 2016) (noting same). It also applies on an "entity specific" basis. Thus, on the facts of the case, if the U.S. Trustee sought relief under section 1126(e) (which he does not) at best, only the votes of the

Claim Allowance Creditors who voted to accept the Plan could be designated under section 1126(e). The designation of those votes would have no impact on the votes cast by the remaining Class 5 creditors. It is undisputed that if the U.S. Trustee successfully designated the votes of the Claim Allowance Class 5 Creditors, and the Court disallowed their votes, Class 5 would nonetheless vote to accept the Plan by the requisite majorities called for under section 1126(c) of the Bankruptcy Code.

Section 1129(a)(2) requires that "[t]he proponent of the plan complies with the applicable provisions of [the Bankruptcy Code]." 11 U.S.C. § 1129(a)(2). The U.S. Trustee invokes this provision to remedy the Debtors' alleged breach of section 1125(b). He maintains that for the reasons set forth above, the Debtors actions in entering into the Claim Allowance Agreements violated section 1125(b) and, so under section 1129(a)(2), the Plan is not confirmable because it does not comply with "applicable provisions" of the Bankruptcy Code. There is no merit to that position. As noted, section 1126(e) is the exclusive remedy available to the U.S. Trustee. Moreover, in any event, section 1129(a)(2) does not provide for an affirmative grant of authority. It cannot provide any relief to remedy the Debtors' alleged breach of section 1125(b), let alone relief that is greater than the relief available under section 1126(e). As the court stated in *In re Adelphi Commc'ns Corp:*

> Section 1129(a) of the Code lists requirements that need be satisfied to secure confirmation—conditions for confirmation, if you will. Section [1129(a)(2)] is one of those requirements. But like the other requirements for confirmation that appear in section 1129(a), section [1129(a)(2)] is still no more than a requirement or condition. It does not provide for an affirmative grant of authority. It does not give permission to do anything.

441 B.R. 6, 13 (Bankr. S.D.N.Y. 2010).

The Court overrules the U.S. Trustee's Supplemental Objection.

Conclusion

Based on the foregoing, the Court overrules the Plan Objections and finds that the Plan satisfies the requirements of section 1129 of the Bankruptcy Code. An appropriate Confirmation order will be entered herewith.

Dated: New York, New York
June 18, 2022

/s/ *James L. Garrity, Jr.*
Hon. James L. Garrity, Jr.
U.S. Bankruptcy Judge

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Appeal Filed by In Re: LATAM Airlines Group S.A., 2nd Cir., September 2, 2022

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United States District Court, S.D. New York.

IN RE: **LATAM** AIRLINES GROUP, S.A., Debtor.
TLA Claimholders Group, Appellant,
v.
Latam Airlines Group S.A., Appellee.

22cv5891 (DLC)
|
Signed August 31, 2022

Attorneys and Law Firms

For appellant TLA Claimholders Group: Christopher Matthew Guhin, Daniel Alexander Fliman, John Iaffaldano, Paul Hastings LLP, 220 Park Avenue, New York, NY 10166, Matthew D. McGill, David Casazza, Gibson, Dunn & Crutcher, LLP, 1025 Connecticut Avenue, N.W., Washington, DC 20036.

For appellee **LATAM** Airlines Group S.A.: Albert Togut, Amanda Carolyne Glaubach, Bryan Kotliar, Jared Casden Borriello, Kyle James Ortiz, Patrick Daniel Marecki, Togut, Segal & Segal LLP, One Penn Plaza, New York, NY 10119, Lisa Maria Schweitzer, Luke Ashe Barefoot, Richard James Cooper, Thomas S. Kessler, David H. Herrington, Cleary Gottlieb, One Liberty Plaza, New York, NY 10006.

For intervenor-appellee Banco del Estado de Chile: Pedro Alfonso Jimenez, Paul Hastings LLP, 200 Park Avenue, New York, NY 10166.

For intervenor-appellee Parent Ad Hoc Claimant Group: Rachael Lynn Ringer, David Ellis Blabey, Jr., Douglas Patrick Buckley, Kenneth H. Eckstein, Kramer Levin Naftalis & Frankel, 1177 Avenue of The Americas, New York, NY 10036.

For intervenor-appellee Ad Hoc Group of **LATAM** Bondholders: John K. Cunningham, Richard Kebrdle, Varoon Sachdev, White & Case LLP, 200 South Biscayne Blvd., Suite 4900, Miami, FL 33131, Gregory M. Starner, Kathryn Sutherland-Smith, White & Case LLP, 1221 Avenue of the Americas, New York, NY 10020.

OPINION AND ORDER

DENISE **COTE**, District Judge:

*1 TAM Linhas Aéreas S.A. ("TLA"), also known as **LATAM** Airlines Brasil, is an indirect wholly owned subsidiary of **LATAM** Airlines Group, S.A. ("**LATAM**"). The Ad Hoc Group of TLA Claimholders (the "appellant" or the "TLA Claimholder Group") holds certain loans made to TLA. In 2020, **LATAM** and several of its affiliates (together, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the **Bankruptcy** Code (the "Code").

The TLA Claimholder Group has appealed a ruling by the Honorable James L. Garrity, Jr., U.S. **Bankruptcy** Judge, confirming the Debtors' plan of reorganization (the "Plan"). **LATAM** opposes the appeal, as do intervenors Parent Ad Hoc Claimant Group, Ad Hoc Group of **LATAM** Bondholders, Official Committee of Unsecured Creditors, and Banco del Estado de Chile. The TLA Claimholder Group has also filed a motion to stay the **Bankruptcy** Court's order confirming the Plan. For the following reasons, the appeal is denied, and the **Bankruptcy** Court's confirmation of the Plan is affirmed. The motion to stay the order confirming the Plan is also denied.

Background

The Court assumes familiarity with today's Opinion and Order in the related appeal, In re **LATAM** Airlines Group, S.A., 22cv5660. Only the facts relevant to this appeal are summarized below.

LATAM is Latin America's leading airline group and is the ultimate parent company of TLA. **LATAM** holds the equity of TLA through **LATAM's** wholly owned subsidiary, TAM S.A. In 2020, **LATAM** and several of its affiliates filed voluntary petitions for relief under Chapter 11 of the Code in the U.S. **Bankruptcy** Court for the Southern District of New York.

In late 2021, the Debtors entered mediation and ultimately reached an agreement with certain creditors and shareholders on the restructuring and recapitalization of the Debtors. In spring of 2022, the Debtors solicited votes on the Plan, which was accepted by the classes designated as impaired under the Plan. On June 18, 2022, the **Bankruptcy** Court entered an opinion confirming the Plan over the objections of certain creditors including the objection of the TLA Claimholder Group. In re **LATAM** Airlines Group S.A., No. 20BK11254 (JLG), 2022 WL 2206829, at *56 (Bankr. S.D.N.Y. June 18, 2022).

I. Treatment of the TLA Claimholder Group Under the Plan
The TLA Claimholder Group holds approximately $300 million in allowed claims against TLA, which are evidenced by four debt instruments (the "Debt Instruments"). Each of the Debt Instruments provides for (1) interest at specified pre-default rates, (2) post-default rates of interest of 1% per month, (3) a 2% post-default late payment charge, and (4) certain fees and expenses, including attorneys' fees. TLA's obligations under the Debt Instruments are unsecured. TLA defaulted on the Debt Instruments in mid-2020.

Under the Plan, the TLA Claimholder Group is classified in Class 6, which includes all the general unsecured claims against all Debtors except **LATAM**, Piquero Leasing Limited, and **LATAM** Finance. Class 6 creditors are classified as unimpaired and, as a result, were not entitled to vote on the Plan. The Plan provides that Class 6 creditors must receive:

> ***2** (x) [c]ash equal to the amount of [their] Allowed Class 6 Claim; (y) such other less favorable treatment as to which the Debtors and the Holder of such Allowed Class 6 Claim shall have agreed upon in writing or (z) such other treatment such that the applicable Allowed Class 6 Claim will be rendered Unimpaired pursuant to section 1124 of the **Bankruptcy** Code.

The amount of the Allowed Class 6 Claims does not include post-petition interest ("PPI").

II. The Confirmation Proceedings
During the **Bankruptcy** Court proceedings, the TLA Claimholder Group objected to the Plan because it failed to provide the group with roughly $150 million in PPI even though TLA, it argued, was solvent. The TLA Claimholder Group contended that "to unimpair an unsecured creditor of a solvent debtor, a plan must provide for the payment of PPI to the creditor.... Absent payment of PPI at the contract rate ..., the legal, equitable, and contractual rights of unsecured creditors of a solvent debtor do not remain unaltered by a plan." The TLA Claimholder Group acknowledged that "although section 502(b)(2) of the **Bankruptcy** Code (and pre-Code law) generally disallows unmatured interest as part of an unsecured creditor's claim, the solvent debtor exception requires that unsecured creditors of a solvent debtor receive their full contractual rights, including PPI on their claims." Further, they argued that the law "entitle[s] holders of unsecured claims of solvent debtors to receive PPI on their claims at the applicable contract rate," rather than the federal judgment rate.

On June 18, 2022, following a three-day hearing, the **Bankruptcy** Court issued a 125-page opinion (the "Confirmation Opinion") confirming the Plan over several objections, including the objection of the TLA Claimholder Group. **LATAM** Airlines Group, 2022 WL 2206829, at *56. The **Bankruptcy** Court considered and rejected the TLA Claimholder Group's objection that TLA was solvent, thereby entitling it to PPI.

The **Bankruptcy** Court acknowledged that the Plan treated the TLA Claimholder Group's claims as unimpaired because, under § 502(b)(2) of the Code, those claimholders were not entitled to PPI and the Plan provided that their claims were otherwise paid in full. The **Bankruptcy** Court accordingly considered whether the "solvent debtor exception" applied. Id. at *10–18. Under that exception, the **Bankruptcy** Court explained, "unimpaired creditors of solvent debtors may nevertheless be entitled to PPI." Id. at *8.

To resolve the question of solvency, the **Bankruptcy** Court looked to the Code's definition of "insolvent" -- "the financial condition such that the sum of [an] entity's debts is greater than all of such entity's property, at a fair valuation." Id. at *10 (quoting 11 U.S.C. § 101(32)). The **Bankruptcy** Court found both that the TLA Claimholder Group had not presented meaningful evidence of TLA's solvency and that the proponents of the Plan, by contrast, had affirmatively proved that TLA was insolvent. Id. at *8.

The TLA Claimholder Group had presented, through expert testimony, two methodologies for calculating TLA's purported solvency, both of which the Court rejected. One of these methods, a "distributable value waterfall" method, calculated TLA's purported equity value after satisfying certain identified claims. Id. at *12. The second method, a "discounted cash flow" analysis, calculated the present value of TLA's projected future cash flows. Id. at *13.

*3 The **Bankruptcy** Court accorded "little to no weight" to these methodologies because "insolvency is determined, in part, by the fair market price that a debtor could obtain through the sale of its assets in a prudent manner." Id. (citing In re SunEdison, Inc., 556 B.R. 94, 104 (Bankr. S.D.N.Y. 2016)). The TLA Claimholder Group's two methodologies failed to apply this standard because "neither assesses the aggregate price TLA could obtain for its assets." Id. at *13–16. Thus, the **Bankruptcy** Court held that the TLA Claimholder Group failed to prove that TLA was solvent. Id.

By contrast, the **Bankruptcy** Court held that the proponents of the Plan had presented two methodologies for calculating TLA's insolvency that satisfied the relevant standard. Id. at *16–18. The Plan proponents' expert used a "liquidation analysis" method and a "balance sheet test." Id. at *16. Under the liquidation analysis, the proponents' expert "analyze[d] the funds that would be raised if each item of property (i.e., each asset) of TLA were sold at market value in an orderly sale process, and then compare[d] that total amount to the total amount of TLA's claims and liabilities." Id. (footnote omitted). Under the balance sheet test, the Plan proponents' expert compared TLA's total liabilities and assets as reflected on TLA's audited 2021 financial statements and TLA's unaudited 2022 balance sheet and concluded that the value of TLA's assets was inadequate to cover its liabilities. Id. at *17.

The **Bankruptcy** Court found that, unlike the TLA Claimholder Group's methodologies, both the liquidation analysis and the balance sheet test complied with the relevant standard for solvency because "they measure TLA's assets on an asset-by-asset basis." Id. at *18. Thus, the **Bankruptcy** Court found that not only had the TLA Claimholder Group failed to prove TLA's solvency, but the Plan proponents had affirmatively shown that TLA was insolvent. As a result, the **Bankruptcy** Court held that the solvent debtor exception could not apply. Id.

The **Bankruptcy** Court next considered whether, assuming that TLA were solvent, the TLA Claimholder Group would be entitled to PPI at the rate set forth in the Debt Instruments or at the federal judgment rate. Id. at *18–25. The **Bankruptcy** Court held that, assuming the TLA Claimholder Group could claim the benefit of the solvent debtor exception, it would at most be entitled to PPI at the federal judgment rate. Id.

Finally, the **Bankruptcy** Court considered whether "the balance of the equities separately entitle[d]" the TLA Claimholder Group to PPI. Id. at *25. The court held that it did not because

> it would not be equitable to allow the TLA Claimholders to receive approximately $150 million more to satisfy [their claims] given the context of the Plan. The Plan represents a delicate, intricate, and integrated compromise of myriad claims, arguments, and rights.... As such, providing the TLA Claimholders with an additional recovery would reduce the recoveries to impaired creditors under the Plan and risk disrupting the delicate balance set forth in it.

Id.

III. Subsequent Proceedings

On June 23, 2022, the TLA Claimholder Group filed a motion to the **Bankruptcy** Court to stay the confirmation order pending an appeal. On July 8, the **Bankruptcy** Court, after a hearing, issued a 32-page opinion denying the motion to stay (the "Stay Opinion"). In re **LATAM** Airlines Group S.A., No. 20BK11254 (JLG), 2022 WL 2657345 (Bankr. S.D.N.Y. July 8, 2022). The **Bankruptcy** Court reasoned that any risk of harm to the TLA Claimholder Group in denying a stay was outweighed by the risk of harm to the Debtors in granting a stay. Id. at *4–9.

*4 The **Bankruptcy** Court also explained that the TLA Claimholder Group could not show a substantial possibility of success on appeal. Id. at *9–11. Specifically, the **Bankruptcy** Court noted that a reviewing court would likely not overturn the finding that TLA was insolvent due to the "clear error" standard applicable to findings of fact. Id. at *10. Further, "[b]ecause proving that TLA is solvent [was] the lynchpin of their objection to the Plan," the TLA Claimholder Group did not have a substantial possibility of success on appeal. Id. at *10 (citation omitted).

In seeking the stay, the TLA Claimholder Group argued to the **Bankruptcy** Court that the factual question of TLA's solvency was not the threshold issue for resolving the TLA Claimholder Group's claim to PPI. It argued that the threshold issue was instead a legal one, namely whether the TLA Claimholder Group was impaired by the Plan under § 1124. Id. The TLA Claimholder Group contended that this was the threshold question because it was the first issue considered in the **Bankruptcy** Court's Confirmation Opinion.

See **LATAM** Airlines Group, 2022 WL 2206829, at *9. The **Bankruptcy** Court disagreed. The court explained that, although it

> held that the TLA Claimholders are unimpaired under the Plan before finding that TLA was insolvent, that does not alter the fact that solvency is the lynchpin of the TLA Claimholders' objection. Put differently, the crux of the objection is that the TLA Claimholders are entitled to PPI at the rate set forth in the Debt Instruments because the solvent debtor exception applies through the **Bankruptcy** Code in section 1124(1). If a debtor is not solvent, there is no need to consider or apply the solvent debtor exception whatsoever and, in turn, no need to assess section 1124(1).

LATAM Airlines Group, 2022 WL 2657345, at *11.

Finally, the court found that the public interest in consummating the Plan outweighed the public interest in correcting any alleged legal errors in the Confirmation Opinion. Id. at *11–15. The **Bankruptcy** Court noted in this portion of the Stay Opinion that

> [a]mong other things, the Plan, as modified, will have to be feasible in order to go effective. The Plan is a product of a series of interrelated compromises, settlements, and other agreements among the Debtors and certain of its principal unsecured creditors and certain of its equity holders. It is undisputed that if the TLA Claimholders were to succeed on their claim, the sole impact would not necessarily be payment of $145 million of PPI. Instead, the Debtors and their stakeholders would need to consider how and whether to develop and incorporate a new plan and a new set of underlying agreements that account for such an obligation.... The Debtors have demonstrated that if they are required to pay PPI to the TLA Claimholders, they will be required, among other things, to attempt to formulate, negotiate and execute a new restructuring support agreement, a new set of backstop agreements, a new set of financing agreements, and a new plan, and then seek Court approval of the new agreements and plan and obtain voting approval by the various constituents of the Debtors' estates.

Id. at *14. For all these reasons, the Court held that a stay of the Plan was unwarranted.

Meanwhile, on July 8, 2022, the TLA Claimholder Group, represented by new counsel, filed a motion to the **Bankruptcy** Court to certify their appeal to the Second Circuit Court of Appeals. The **Bankruptcy** Court issued a 34-page opinion on July 26 denying this motion (the "Certification Opinion"). In re **LATAM** Airlines Group S.A., No. 20BK11254 (JLG), 2022 WL 2962948 (Bankr. S.D.N.Y. July 26, 2022).

*5 In the Certification Opinion, the **Bankruptcy** Court explained that the TLA Claimholder Group's proposed arguments on appeal were not presented below and were thus not a proper basis for appeal. Id. at *5. In seeking certification, the TLA Claimholder Group asserted that its "arguments on appeal do not depend on the debtors' solvency -- i.e., that as a matter of law, unsecured creditors are entitled to contract-rate PPI to be rendered unimpaired under section 1124(1)." Id. at *4 (citation omitted). The **Bankruptcy** Court rejected this attempt to insert a new legal issue into the proceedings. It explained that "at each juncture of these Chapter 11 Cases, the TLA Claimholders' arguments in opposition to the Plan were predicated on the Court finding that TLA was solvent and, in turn, that the solvent debtor exception" applied. Id. at *5. "As such," the **Bankruptcy** Court reasoned, "there [was] no basis for an appellate court to consider whether the [TLA Claimholder Group] must be paid PPI to be rendered unimpaired outside of the context of TLA's solvency -- the only basis in which they raised this issue in their Plan objection." Id. at *9.

On July 11, the TLA Claimholder Group filed its appeal to the Southern District of New York. The case was assigned to this Court on July 12. On July 13, the parties agreed to an expedited briefing schedule for the appeal. In accordance with the agreed-upon schedule, the appellant filed its brief on July 18. The appellee and four intervenors [1] filed their responsive briefs in the appeal on August 8. The appellant filed its reply on August 15.

On August 1, the appellant also filed a motion before this Court to stay the **Bankruptcy** Court's order confirming the Plan pending the resolution of the appeal. The appellee and two intervenors, the Parent Ad Hoc Claimant Group and the Ad Hoc Group of **LATAM** Bondholders, each filed responses to this motion on August 12. The appellant filed its reply on August 19.

Separately, on July 1, different creditors filed an appeal of two rulings of the **Bankruptcy** Court -- the confirmation of the **bankruptcy** plan and the approval of certain backstop agreements. Briefing on this related appeal was fully submitted on August 5. Oral argument in both appeals was held on August 26.

Discussion

The TLA Claimholder Group contends on appeal that it is entitled to PPI constituting approximately $150 million. In bringing this appeal, it relies on the solvency exception to the ordinary bar against a claim for PPI and argues that the **Bankruptcy** Court erred in finding TLA insolvent. It also argues, however, that it has a claim for PPI even if TLA is insolvent. This second issue was not included in the appellant's objection to the Plan and will be addressed second. The TLA Claimholder Group also moves to stay the **Bankruptcy** Court's order confirming the plan pending resolution of the appeal. The stay motion is addressed last.

I. Appeal

The standard for review of an appeal from a **bankruptcy** court's decision is well established. A **bankruptcy** court's factual findings are accepted on appeal unless they are clearly erroneous, and its conclusions of law are reviewed de novo. In re DiBattista, 33 F.4th 698, 702 (2d Cir. 2022). "A finding of fact is clearly erroneous when the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." In re Lehman Bros. Holdings Inc., 855 F.3d 459, 469 (2d Cir. 2017) (citation omitted). "[I]f the **bankruptcy** court's account of the evidence is plausible in light of the record viewed in its entirety, the [reviewing court] may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently." In Matter of Motors Liquidation Co., 829 F.3d 135, 158 (2d Cir. 2016) (citation omitted).

1. Solvency of TLA

*6 On appeal, the TLA Claimholder Group challenges the **Bankruptcy** Court's finding that TLA was solvent. In its objection to the Plan, the appellant had argued that it was entitled to roughly $150 million in PPI because TLA was solvent. The **Bankruptcy** Court found that TLA was insolvent and rejected the TLA Claimholder Group's claims for PPI. The appellant has failed to show that the rejection was in error.

Under both pre- and post-Code **bankruptcy** law, the rule on PPI is unequivocal: PPI for unsecured or undersecured creditors is generally unavailable. See, e.g., Nicholas v. United States, 384 U.S. 678, 682 (1966); Bruning v. United States, 376 U.S. 358, 362 (1964); Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 163 (1946); Sexton v. Dreyfus, 219 U.S. 339, 344 (1911). Today, this rule is codified in § 502(b)(2) of the Code. Section 502(b)(2) states that a claim is disallowed "to the extent that ... such claim is for unmatured interest." 11 U.S.C. § 502(b)(2). See also S. Rep. No. 95-989, at 63 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5849 ("[I]nterest stops accruing at the date of the filing of the petition, because any claim for unmatured interest is disallowed under [Rule 502] ...."); United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 373 (1988) (citing § 502(b)(2) for the "general rule disallowing postpetition interest").

There is a limited exception to this rule in the rare cases in which a debtor proves to be solvent. As the Court explained in Vanston, "where an estate [is] ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations [are] invoked to permit payment of [post-petition] interest" to the creditor rather than the debtor. 329 U.S. at 164; see also Ruskin v. Griffiths, 269 F.2d 827, 831 (2d Cir. 1959) (noting that the general rule against PPI should not "be applied in the case of a solvent debtor"). Courts have concluded that this solvent debtor exception survived the enactment of the Code. See, e.g., In re PG&E Corp., No. 21-16043, slip op. at 19 (9th Cir. Aug. 29, 2022); In re Hertz Corp., 637 B.R. 781, 800 (Bankr. D. Del. 2021); In re Ultra Petroleum Corp., 624 B.R. 178, 203 (Bankr. S.D. Tex. 2020).[2] Thus, based on the general prohibition on a claim for PPI and the exception for solvent debtors, an unsecured creditor's entitlement to PPI in a Chapter 11 proceeding turns on whether the debtor is solvent.

The Code does not define "solvent," but defines "insolvent" in relevant part as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. § 101(32). "Fair value, in the context of a going concern, is determined by the fair market price of the debtor's assets that could be obtained if sold in a prudent manner within a reasonable period of time to pay the debtor's debts." In re Roblin Indus., Inc., 78 F.3d 30, 35 (2d Cir. 1996). The Second Circuit has instructed that a **bankruptcy** court "has broad discretion" when considering evidence to support a finding of insolvency. Id.

***7** Here, the **Bankruptcy** Court found that TLA was insolvent, and this finding was not clearly erroneous. In holding that TLA was insolvent, the **Bankruptcy** Court applied the Code's definition of insolvency, which the appellant agreed below was the proper standard. **LATAM** Airlines Group, 2022 WL 2206829, at *10 (citing 11 U.S.C. § 101(32)). The court also applied the correct rule for assessing fair value in the context of a going concern. Id. at *13. Under this framework, the court carefully considered four different methods for evaluating TLA's solvency. Id. at *12–18.

As the **Bankruptcy** Court reasoned, only the methods presented by the Plan proponents -- the liquidation analysis and the balance sheet test -- properly measured TLA's assets for the purposes of determining solvency under the agreed-upon standard. These methods each evaluated TLA's assets on an asset-by-asset basis. Since "fair value" must be determined with reference to the fair market price that could be obtained by selling the assets in a prudent manner and a reasonable period of time, see Roblin Indus., 78 F.3d at 35, such asset-by-asset valuation is appropriate.

By contrast, the alternative methods presented by the TLA Claimholder Group -- a distributable value waterfall analysis and a discounted cash flow analysis -- both suffered from infirmities. The **Bankruptcy** Court found that the distributable value waterfall method was not relevant to the question of solvency because it relied on a valuation of TLA's equity in a different context and "d[id] not speak to whether 'the sum of [TLA's liabilities] is greater than all of [TLA's property] ....' " **LATAM** Airlines Group, 2022 WL 2206829, at *15 (quoting 11 U.S.C. § 101(32)). The discounted cash flow analysis was similarly flawed. This methodology relied on measurements of "the current value of future cash flows -- amounts that are inherently subjective, indefinite, and do not speak to the value of the assets TLA holds today or held at the Petition Date." Id. at *16.

Thus, as the lower court found, the Plan proponents' methods for calculating solvency are more persuasive than those provided by the TLA Claimholder Group. Even if this Court disagreed with the lower court's findings on solvency -- which it does not -- it is not this Court's role to offer an independent opinion on TLA's solvency. See Motors Liquidation Co., 829 F.3d at 158. It is enough to say that this Court is not "left with the definite and firm conviction that a mistake has been committed" in the **Bankruptcy** Court's solvency analysis. Lehman Bros., 855 F.3d at 469.

On appeal, the appellant does not offer a full-throated critique of the **Bankruptcy** Court's solvency analysis. Rather than dispute the factual findings, the appellant primarily argues that the **Bankruptcy** Court applied the wrong legal standard for assessing solvency. The appellant contends that "the analysis should look to what a willing buyer would pay to acquire the entire business" rather than considering the aggregate value of individual assets and liabilities. The appellant similarly argues that "because TLA has value as an operating business, any fair valuation of its assets must take into account its worth as a going concern."

These arguments lack merit. The Second Circuit has explained that "[f]air value, in the context of a going concern, is determined by the fair market price of the debtor's assets that could be obtained if sold in a prudent manner within a reasonable period of time to pay the debtor's debts." Roblin Indus., 78 F.3d at 35 (emphasis added). This is precisely the inquiry undertaken by the **Bankruptcy** Court, and its conclusions are not clearly erroneous. The other cases cited by the appellant, Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941), and Associates Commercial Corp. v. Rash, 520 U.S. 953 (1997), did not address valuation in the context of solvency. See Consol. Rock, 312 U.S. at 525–26 (valuation of "prospective earnings" when assessing fairness of reorganization plan); Assocs. Com. Corp., 520 U.S. at 965 (valuation of an asset in the context of § 506(a)). Therefore, those decisions are not controlling here.

***8** The appellant also briefly suggests in a footnote that the valuation performed by the **Bankruptcy** Court did not adequately take into account TLA's frequent flyer program. When the appellant raised the frequent flyer program below, however, the **Bankruptcy** Court found that the program did not move the needle towards solvency. **LATAM** Airlines Group, 2022 WL 2206829, at *25, n.55. The **Bankruptcy** Court noted that, contrary to the arguments of the TLA Claimholder Group, the program did not affect the assumptions underlying the Plan proponents' solvency analysis. Id.

Therefore, the determination that TLA was insolvent was not clearly erroneous. Because TLA is insolvent, the TLA Claimholder Group was not entitled to PPI. As explained above, the longstanding rule in **bankruptcy** law is that PPI is generally prohibited. The only exception, as the appellant itself recognized below, applies in cases where the debtor proves to be solvent. As a result, the appellant cannot demonstrate an entitlement to PPI and was, as the **Bankruptcy** Court confirmed, an unimpaired creditor.

2. Entitlement to PPI When the Debtor is Solvent

The TLA Claimholder Group, with new counsel, has largely abandoned in this appeal its argument that TLA was solvent. Instead, it now contends -- contrary to foundational principles in **bankruptcy** law -- that solvency is irrelevant to its claim to PPI. Relying on the absolute priority rule and a complex and novel reading of §§ 726(a)(5), 1124(1), and 1124(2) of the Code (informed by Congress's decision in 1994 to strike § 1124(3) from the Code), the appellant asks this Court to revolutionize **bankruptcy** law and find that it is entitled to PPI even if TLA is insolvent.

"It is a well-established general rule that an appellate court will not consider an issue raised for the first time on appeal." In re Nortel Networks Corp. Secs. Litig., 539 F.3d 129, 132 (2d Cir. 2008) (citation omitted).

> Although [a reviewing court] may exercise discretion to consider waived arguments where necessary to avoid a manifest injustice, the circumstances normally do not militate in favor of an exercise of discretion to address new arguments on appeal where those arguments were available to the parties below and they proffer no reason for their failure to raise the arguments below.

Id. at 133 (citation omitted); see also Doe v. Trump Corp., 6 F.4th 400, 410 (2d Cir. 2021).

The appellant's arguments regarding the absolute priority rule and the interpretation of §§ 726, 1124, and 1129 to support its claim to PPI are forfeited. [3] The appellant's entire position below hinged on its contention that TLA was solvent. It said: "although section 502(b)(2) of the **Bankruptcy** Code (and pre-Code law) generally disallows unmatured interest ..., the solvent debtor exception requires that unsecured creditors of a solvent debtor" receive PPI. (Emphases added.)

Appellant, citing to certain remarks made in a few filings and hearings during the **Bankruptcy** Court proceedings, tries to reconfigure its arguments below to suggest that the arguments on appeal are not new. But the cited remarks are just cherry-picked comments stripped of their full context. As the **Bankruptcy** Court observed in its decision denying the appellant's motion to certify the appeal to the Court of Appeals, solvency was always "the lynchpin of the TLA

Claimholders' objection." **LATAM** Airlines Group, 2022 WL 2962948, at *6.

***9** Citing United States v. Harrell, 268 F.3d 141, 146 (2d Cir. 2001), the appellant argues that its arguments are not forfeited because they were "pressed or passed upon below," even if only briefly. Harrell itself, however, makes clear that "[a] claim is 'pressed or passed upon' when it fairly appears in the record as having been raised or decided." Id. The only thing that fairly appears in the record in this case is that the appellant's objection was litigated exclusively with reference to solvency. The appellant did not raise arguments about impairment outside the context of solvency, and the **Bankruptcy** Court did not decide any issues outside the context of solvency.

Any suggestion that solvency was irrelevant to the analysis was, as the **Bankruptcy** Court noted, never raised to that court in any more than a "perfunctory" manner. **LATAM** Airlines Group, 2022 WL 2962948, at *6. Such perfunctory comments are inadequate to preserve an issue for appeal. See, e.g., Trump Corp., 6 F.4th at 410; 23-34 94th St. Grocery Corp. v. New York City Bd. of Health, 685 F.3d 174, 184 n.8 (2d Cir. 2012).

Finally, the appellant points to the Supreme Court's opinion in Lebron v. National Railroad Passenger Corp., 513 U.S. 374, 379 (1995), to argue that as long as a claim is in general pressed below, parties can make any argument in support of that claim on appeal. At the outset, the appellant does not explain why a self-imposed prudential rule governing the Supreme Court, see id. (discussing "[o]ur traditional rule" and "[o]ur practice"), is applicable to this Court's review of the **Bankruptcy** Court's decision. In the Second Circuit, a party "must present the relevant legal arguments in [the lower court] in order to preserve them for appellate review." Trump Corp., 6 F.4th at 410 (quoting Poupore v. Astrue, 566 F.3d 303, 306 (2d Cir. 2009)). Moreover, the appellant's claim on appeal is starkly different from its claim below. Below, the appellant claimed that the Plan was invalid and had to be rejected because it failed to provide the appellant with PPI. Now the appellant embraces the Plan and argues that the Plan itself requires payment of PPI. So, even under the appellant's proposed rule, its arguments were not preserved.

To be sure, the rule against considering new issues on appeal is prudential, not jurisdictional. Nortel Networks, 539 F.3d at 133. But in a case such as this, prudence dictates against entertaining this forfeited argument. The appellant's reading of the Code would revolutionize **bankruptcy** law. It flies in the face of the plain meaning of § 502(b)(2) and the long line of authority disallowing claims of PPI. Any argument of this importance should not be presented for the first time on appeal. Because the appellant's reasoning represents such a radical departure from well-established **bankruptcy** law, it should first be presented to a **bankruptcy** court where that court will have assistance from all **bankruptcy** counsel to consider fully the ramifications of the appellant's complex reading of the interplay of several Code provisions.

This is particularly important here, where the lower court carefully managed an international **bankruptcy**, juggling diverse interests and even legal systems that are in tension with each other. The result was the confirmation of a Plan representing "a delicate, intricate, and integrated compromise of myriad claims, arguments, and rights." **LATAM** Airlines Group, 2022 WL 2206829, at *25. Were this Court to follow the appellant's new reasoning and grant PPI without any consideration of solvency, the Court would disrupt not only the long-standing traditions of **bankruptcy** law, but also "the delicate balance set forth in" the Plan. Id.

***10** Trying to minimize the enormity of the impact its reading of **bankruptcy** law would have on the Plan and the Debtors' timely emergence from **bankruptcy**, the appellant argues that the Debtors can simply pay $150 million in PPI to the TLA Claimholder Group without revising the Plan or submitting the revised Plan to a vote. Not so. The same treatment must be given to each claim or interest of a particular class. 11 U.S.C. § 1123(a)(4). Thus, no court can award PPI to a single claimant without regard to the duty to provide equal treatment. As the **Bankruptcy** Court explained, acceptance of the appellant's new theory of entitlement to PPI would require the Debtors to renegotiate and execute a new plan and submit that new plan to a vote of all impaired creditors. See **LATAM** Airlines Group, 2022 WL 2657345, at *14.

Finally, entertaining forfeited arguments is unwarranted here since the appellant has presented no satisfactory reason why "manifest injustice" would result by declining to consider the new arguments. If the appellant felt that it was entitled to PPI without regard to solvency, it certainly could have argued as much below. But it did not. Instead, the appellant chose to follow the traditions of **bankruptcy** law and argue that it was entitled to PPI only by virtue of TLA's alleged solvency.

II. Stay Motion

The TLA Claimholder Group has also moved to stay the **Bankruptcy** Court's June 18 Order pending an appeal. The appellant's motion to stay is denied.

> The four factors to be considered in issuing a stay pending appeal are well known: (1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies.

In re World Trade Center Disaster Site Litig., 503 F.3d 167, 170 (2d Cir. 2007) (citation omitted).

The first factor weighs heavily against a stay. As discussed above, the appellant has not shown that it is likely to succeed on appeal. The appellant's position below was premised on TLA's solvency, and the **Bankruptcy** Court's conclusion that TLA was insolvent is not clearly erroneous. Any new arguments are forfeited, and the circumstances of the case counsel strongly against the exercise of discretion to consider them.

The second factor -- irreparable injury to the appellant in the event a stay is not granted -- weighs, at most, slightly in favor of a stay. The potential harm identified by the appellant is the loss of its appellate rights should the appeal become equitably moot. Courts are divided as to whether a risk of mootness, standing alone constitutes irreparable harm. In re Adelphia Commc'ns Corp., 361 B.R. 337, 347 (S.D.N.Y. 2007) (collecting cases). The Debtors are taking steps to consummate the Plan as quickly as possible, which could make its consummation irreversible as soon as September 2022. Thus, it is assumed that the threat of equitable mootness creates at least some injury in this case.

The third factor, which considers harm to other parties should a stay be granted, weighs strongly against a stay. The Debtors identify various financial harms that would occur if a stay were granted. For example, a stay could jeopardize their ability to close on certain financing agreements supporting their exit from **bankruptcy**. A stay would also increase the risk that the commitments in certain backstop agreements would need to be extended until at least November 30, at a cost of $73 million.

The fourth factor also weighs heavily against a stay. The public interest lies in favor of consummation of the Plan. The Plan represents a carefully negotiated agreement balancing a multitude of conflicting interests. Moving forward with the Plan enables **LATAM** to emerge from **bankruptcy** and continue providing services to the public.

***11** Balancing these factors, the Court finds that a stay is not warranted. It is particularly inappropriate to forestall consummation of the Plan where the only harm to the appellant absent a stay is the possibility that the appellant may be unable to pursue a second appeal that is almost certain to fail.

Conclusion

The appeal by the TLA Claimholder Group is denied, and the **Bankruptcy** Court's June 18, 2022 confirmation of the Plan is affirmed. The appellant's request for a stay is also denied.

All Citations

Slip Copy, 2022 WL 3910704

Footnotes

1 On July 27, the Parent Ad Hoc Claimant Group moved to intervene as an appellee. The following day, Banco Del Estado de Chile also moved to intervene. Those motions to intervene were granted on August 4. Also on

August 4, the Official Committee of Unsecured Creditors moved to intervene as an appellee. This motion was granted on August 5. Finally, on August 8, the Ad Hoc Group of **LATAM** Bondholders moved to intervene, and its motion was granted the following day.

2 There is some debate among courts about how exactly the exception operates under the Code. See, e.g., PG&E Corp., slip op. at 29–30 (concluding that the solvent debtor exception survived through the equitable prong of § 1124); Ultra Petroleum, 624 B.R. at 203 (same); Hertz, 637 B.R. at 800 (concluding that the Code "expressly codified the solvent debtor exception in section 506(b) as to oversecured creditors and in section 1129(a)(7) and 726(a)(5) as to unsecured creditors"). It is unnecessary to resolve that debate here, however, because there is nothing clearly erroneous with the **Bankruptcy** Court's finding that TLA was insolvent.

3 The Court of Appeals has instructed that the terms "waiver" and "forfeiture" have distinct meanings even though courts sometimes use the terms interchangeably. The "term 'waiver' is best reserved for a litigant's intentional relinquishment of a known right. Where a litigant's action or inaction is deemed to incur the consequence of a loss of a right, or [argument], the term 'forfeiture' is more appropriate." Trump Corp., 6 F.4th at 409 n.6 (quoting Hamilton v. Atlas Turner, Inc., 197 F.3d 58, 61 (2d Cir. 1999)).

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and the like are kept in New York. These facts plainly indicate to us that it would not be vexatious or oppressive to entertain this suit in New York, whether the availability of witnesses or any other aspect of a trial be considered. We accordingly conclude that, the requirements of jurisdiction and venue being satisfied (Judicial Code, §§ 24, 51, 28 U.S.C. §§ 41(1), 112, 28 U.S.C.A. §§ 41(1), 112), the District Court should not have declined to hear and decide the case.

Reversed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

326 U.S. 536

MASON v. PARADISE IRR. DIST.

No. 306.

Submitted Dec. 4, 1945.

Decided Jan. 7, 1946.

Rehearing Denied Feb. 4, 1946.

See 327 U.S. 813, 66 S.Ct. 519.

1. Bankruptcy ⚷38

The principle of equality between creditors governs compositions of indebtedness of local taxing agencies, and fact that the Reconstruction Finance Corporation holds a great majority of all outstanding bonds of an irrigation district does not entitle it to preferred treatment. Bankr.Act § 83, subs. a, b, d, e, j, as amended, 11 U.S.C.A. § 403, subs. a, b, d, e, j.

2. Bankruptcy ⚷38

Where on failure of all bondholders of irrigation district to surrender their bonds for 52.521 cents on the dollar so that district could procure loan from R.F.C. the district filed petition for composition of its debts and the R.F.C. instead of making loan acquired 92 per cent. of the bonds at 52.521 cents on the dollar and approved in advance composition plan to issue 4 per cent. refunding bonds for 6 per cent. bonds so acquired by R.F.C. and other advances and to pay in cash 52.521 cents on the dollar to nonassenting bondholders a nonassenting bondholder could not complain that plan discriminated unfairly in favor of R.F.C. Bankr.Act § 83, subs. a, b, d, e, j, as amended, 11 U.S.C.A. § 403, subs. a, b, d, e, j.

3. Bankruptcy ⚷38

Those who put new money into distressed enterprise may be given a participation in the reorganization plan that is reasonably equivalent to their contribution.

4. Bankruptcy ⚷38

Where the R.F.C. acquired securities of irrigation district pursuant to plan of composition, it was an "agency" of the United States within the statute requiring that any agency of the United States be treated as a creditor, and the bonds so acquired prior to filing of petition were not extinguished but remained affected by the plan of composition and could be computed in determining the percentage of consenting creditors necessary for filing of petition. Bankr.Act § 83, subs. a, b, d, e, j, as amended, 11 U.S.C.A. § 403, subs. a, b, d, e, j.

See Words and Phrases, Permanent Edition, for all other definitions of "Agency".

5. Bankruptcy ⚷38

The statutory provision that in composition plan holders of all claims shall be put into one class and paid without preference out of funds from same source is the general rule, but the bankruptcy court may make a different classification to avoid inequitable results. Bankr.Act, § 83, sub. b, as amended, 11 U.S.C.A. § 403, sub. b.

6. Bankruptcy ⚷38

Where R.F.C. which acquired 92 per cent. of outstanding 6 per cent. bonds of irrigation district at 52.521 cents on the dollar pursuant to plan of composition and prior to filing of petition therefor accepted plan to issue 4 per cent. refunding bonds for bonds so acquired by R.F.C. and other advances and to pay in cash 52.521 cents on the dollar to nonassenting bondholders, the acceptance of the R.F.C. was sufficient under statute requiring acceptance by creditors holding at least two-thirds of the aggregate amount of claims of all classes affected by plan, since not two-thirds of each class, but two-thirds of the total amount of all claims in all classes was all that was required, so far as nonassenting bondholders were concerned, particularly in view of finding that cash offered to them was fair and equitable. Bankr.Act § 83, sub. d, 11 U.S.C.A. § 403, sub. d.

Mr. Justice FRANKFURTER dissenting.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

Proceeding in the matter of the composition of the indebtedness of Paradise Irrigation District. There was a judgment of the Circuit Court of Appeals affirming a decree approving composition plan, 149 F.2d 334, and J. R. Mason brings certiorari.

Affirmed.

Mr. J. R. Mason, pro se.

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Mr. P. M. Barceloux, of Chico, Cal., for respondent.

Mr. Justice DOUGLAS delivered the opinion of the Court.

Respondent is organized under the laws of the State of California and located in the County of Butte of that State. It experienced financial difficulties in the 1930's. It had outstanding $476,000 principal amount of bonds bearing interest at the rate of 6 per cent. Being unable to collect taxes sufficient to service the bonds, it tried to work out a debt readjustment program. It applied for a loan from the Reconstruction Finance Corporation. A loan of $252,500 was arranged, provided all the holders of the outstanding bonds agreed to the refinancing program.

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The offer to the bondholders was that they surrender their bonds for 52.521 cents on each dollar of principal, exclusive of interest—an amount which respondent deemed fair to the bondholders and to the owners of the land in the district. The holders of about 92 per cent of the principal amount of the outstanding bonds agreed. Respondent, being unable to obtain the assent of the holders of the remaining bonds, filed its petition under Ch. IX of the Bankruptcy Act late in 1937. 50 Stat. 653, 52 Stat. 939, 54 Stat. 667, 11 U.S.C. § 401 et seq., 11 U.S.C.A. § 401 et seq. It submitted with its petition its plan of composition or debt readjustment and prayed, *inter alia*, that the plan be approved. The plan provided that the holders of the outstanding bonds be paid in cash 52.521 cents on each dollar of principal, exclusive of interest; that the cash was to be supplied from the proceeds of a loan of $252,500 from the Reconstruction Finance Corporation; that the Reconstruction Finance Corporation was to receive new or refunding 4 per cent bonds in the principal amount of its loan, and 4 per cent on all disbursements from the date thereof until the new or refunding bonds were issued to it. The petition recited that the creditors owning not less than 92 per cent in amount of the bonds had accepted the plan and consented to the filing of the petition.[1] It appears that the consenting bondholders had deposited their bonds under the plan; that the Reconstruction Finance Corporation did not advance the funds to respondent but, acting through a bank, purchased the bonds at the composition figure and registered the bonds in its name; that in accordance with the terms of the contract between respondent and the Reconstruction Finance Corporation,

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the old bonds so acquired remained obligations of respondent, were held by the Reconstruction Finance Corporation as security for its advances and are to be exchanged under the plan for 4 per cent refunding bonds. The Reconstruction Finance Corporation, as holder of about 92 per cent of the bonds, approved the plan prior to the filing of the petition under Ch. IX.

The District Court found that all of the outstanding bonds were of one and the same class,[2] that the requisite percentage

[1] Sec. 403, sub. a requires the petition to state, *inter alia*, that "creditors of the petitioner owning not less than 51 per centum in amount of the securities affected by the plan (excluding, however, any such securities owned, held, or controlled by the petitioner), have accepted it in writing."

[2] Sec. 403, sub. b provides that "the holders of all claims, regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors."

of bondholders had approved the plan,[3] that respondent was unable to meet its debts as they matured,[4] and held that the plan was fair, equitable and for the best interests of its creditors and did not unfairly discriminate in favor of any creditor.[5] It accordingly approved the plan.[6]

Petitioner is the owner of $29,000 principal amount of the old bonds who opposed the plan of composition. His objections were not sustained in the District Court. The Circuit Court of Appeals likewise overruled them. 149 F.2d 334. The case is here on a petition for a writ of certiorari which we granted because of a conflict among

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the Circuit Courts of Appeals,[7] limited to the question whether it was proper to approve a plan which treated petitioner differently from the Reconstruction Finance Corporation.

Petitioner argues that since he and the Reconstruction Finance Corporation were put in the same class, the rule of "equality between creditors" applicable in bankruptcy proceedings, Clarke v. Rogers, 228 U.S. 534, 548, 33 S.Ct. 587, 591, 57 L.Ed. 953, required that they be treated alike. In other words, he contends that instead of being required to take 52.521 cents in cash on each dollar of principal, he should receive 4 per cent refunding bonds.

[1-4] We held in American United Mutual Life Ins. Co. v. Avon Park, 311 U.S. 138, 147, 61 S.Ct. 157, 162, 163, 85 L.Ed. 91, 136 A.L.R. 860, that the principle of equality between creditors governed compositions under Ch. IX as it did compositions under the old § 12, 11 U.S.C.A. § 30. The fact that the Reconstruction Finance Corporation holds the vast majority of all the bonds and therefore is in a dominant position in the reorganization does not mean that it is entitled to preferred treatment. It is clear that it is not. American United Mutual Life Ins. Co. v. Avon Park, supra, 311 U.S. page 148, 61 S.Ct. 163, 85 L.Ed. 91, 136 A.L.R. 860. The Reconstruction Finance Corporation has not by purchasing bonds in the market acquired merely a speculative position in the plan of composition. Nor is it merely in the position of a holder of a majority of the bonds. By contract with the debtor it has underwritten the whole refinancing program. It has ventured the capital necessary to effectuate the plan of composition. It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent

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to their contribution. Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 117, 121-122, 60 S.Ct. 1, 10, 84 L.Ed. 110, and cases cited; Ecker v. Western Pacific R. Corp., 318 U.S. 448, 486-487, 63 S.Ct. 692, 713, 714, 87 L.Ed. 892. That rule is based on practical necessities. Without the inducement new money could not be obtained.

It is said, however, that the Reconstruction Finance Corporation when it becomes the holder of bonds must be treated on the basis that it is a creditor and not an outside lender of money. It is clear that Congress intended the Reconstruction Finance Corporation to be treated in situations like the present as a creditor. Sec. 402 of the Act provides that "Any agency of the United States holding securities acquired pursuant to a contract with any petitioner under this chapter shall be deemed a creditor in the amount of the full face value thereof." The Reconstruction Finance Corporation is such an agency. Sec. 403, sub. j gives securities acquired, as here, pursuant to a

3 Sec. 403, sub. d provides that a plan of composition shall not be confirmed, with exceptions not material here, "until it has been accepted in writing, by or on behalf of creditors holding at least two-thirds of the aggregate amount of claims of all classes affected" by the plan, excluding "claims owned, held, or controlled by the petitioner."

4 Sec. 403, sub. a requires the petition to state that the petitioner is "insolvent or unable to meet its debts as they mature." Among the findings required by § 403, sub. e for confirmation of a plan is that it "complies with the provisions of this chapter."

5 That finding is required by § 403, sub. e.

6 November, 1943.

7 Texas v. Tabasco Cons. Ind. School Dist., 132 F.2d 62, 133 F.2d 196, decided by the Fifth Circuit Court of Appeals, is to be contrasted to the decision below and to West Coast Life Ins. Co. v. Merced Irrig. Dist., 114 F.2d 654, decided by the Ninth Circuit Court of Appeals and also to Luehrmann v. Drainage Dist., 104 F.2d 696, decided by the Eighth Circuit Court of Appeals.

plan of composition prior to the filing of a petition the same recognition as any other securities.[8] It is thus apparent that securities acquired by the Reconstruction Finance Corporation, pursuant to a plan of composition, are not extinguished, remain securities "affected by the plan",[9] and may be computed in determining the
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percentage of consenting creditors necessary for the filing of a petition under Ch. IX.[10] If the Act were construed as requiring the Reconstruction Finance Corporation in situations like the present to be treated as every other creditor of the same class, the fact that it had underwritten the whole refinancing program would be considered irrelevant. But as we have seen, he who furnishes new capital to a distressed enterprise has long been accorded preferred treatment. The Reconstruction Finance Corporation contributes something that Mason does not. It furnishes the underwriting which makes the refinancing possible. It gives something of value for the preferred treatment which it receives. The other security holders of the same class give nothing new. That difference warrants a difference in treatment. Case v. Los Angeles Lumber Products Co., supra; Ecker v. Western Pacific R. Corp., supra. The plan, of course, must be fair and equitable and it must "not discriminate unfairly" in favor of any creditor. § 403, sub. e. A secret advantage would not meet that test. American United Mutual Life Ins. Co. v. Avon Park, supra. But here there was full disclosure to the security holders and to the court. Petitioner receives 52.521 cents on each dollar of principal amount of his bonds. The Reconstruction Finance Corporation receives new and refunding bonds in the face amount of its cash advances. It is, of course, possible that 52.521 cents in cash may not be as advantageous an offer as 52.521 cents in new and refunding bonds. But there is no showing that it is not. Hence it is impossible for us to say that, although a difference in treatment was warranted, any discrimination in favor of the Reconstruction Finance Corporation was so great as to be unfair.

[5, 6] A different question arises when we come to the classification of creditors for voting on a plan of composition.
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Sec. 403, sub. b provides that there shall be put in one class holders of all claims payable without preference from the same source.[11] While this provision states the general rule, we said in American United Mutual Life Ins. Co. v. Avon Park, supra, 311 U.S. page 146, 61 S.Ct. 162, 87 L.Ed. 91, 136 A.L.R. 860, that the bankruptcy court has the power to make a different classification where inequitable results would otherwise obtain. We assume that a majority bondholder who was receiving preferred treatment under a plan by reason of his underwriting or otherwise would normally have to be put in a different class when it came to voting on the plan. But we see no reason why Congress could not provide otherwise. As we have seen, § 402 allows the Reconstruction Finance Corporation to be treated as a creditor in the amount of the full face value of the securities it acquired. By reason of § 403, sub. j, those securities may be included in the percentage of consenting securities necessary for the filing of a petition under Chapter IX. Those provisions were inserted to make these refinancing programs possible and practical. They give statutory sanction to this particular method of refinancing. Sec. 403, sub. d requires approval by creditors "holding at least two-thirds of the aggregate amount of claims of all classes" affected by the plan.[12] If this is construed to mean not

8 Sec. 403, sub. j reads as follows: "The partial completion or execution of any plan of composition as outlined in any petition filed under the terms of this title by the exchange of new evidences of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition occurred before or after the filing of said petition, shall not be construed as limiting or prohibiting the effect of this title, and the written consent of the holders of any securities outstanding as the result of any such partial completion or execution of any plan of composition shall be included as consenting creditors to such plan of composition in determining the percentage of securities affected by such plan of composition."

9 For a discussion of the history of § 403, sub. j see West Coast Life Ins. Co. v. Merced Irrig. Dist., supra note 7, 114 F.2d pages 667–668.

10 See note 1, supra.

11 See note 2, supra.

12 See note 3, supra.

two-thirds of each class but two-thirds of the total amount of all claims in all classes, the separate classification of the Reconstruction Finance Corporation would make no difference in result in the present case. For all of the bonds held by it are more than two-thirds of the aggregate amount of all claims affected by the plan. Only if the Act were construed to mean that two-thirds of each class is necessary for approval of a plan would the separate classification of the Reconstruction Finance Corporation produce a different result in this case. Such a construction, however, would place the success of these refinancing programs
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at the mercy of the minority interests. If it were necessary in this type of case to put non-assenting bondholders in a separate class, they could block the refinancing program even though it were fair and equitable and the only feasible one which the debtor could work out. In designing this legislation Congress was solicitous not only to protect the position of the Reconstruction Finance Corporation in these refinancing programs [13] but also to give this class of debtors a workable and practical method of obtaining relief from oppressive debt burdens. That purpose would be thwarted or impeded if we gave Ch. IX a construction which placed the fate of these plans in the hands of minority, non-consenting bondholders. The aim to provide a method of forcing "recalcitrant minority creditors into agreement" (H. Rep. No. 517, 75th Cong., 1st Sess., p. 3) would be defeated. For once such a rule were announced minority bondholders would have a great nuisance value, making it worthwhile for them to lie back until they got their price.[14] It is suggested that the plan might be approved without the consent of the minority if, as provided in § 403, sub. d "provision is made in the plan for the protection of the interests, claims, or lien of such creditors or class of creditors." Provision "for the protection" of the claims of non-assenting
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creditors could be made by leaving them undisturbed. But the purpose of Ch. IX is to provide taxing agencies with a method of scaling down their debt structures and reducing their debt service requirements when the need for relief is shown. If the non-assenting creditors had the option to come in under the plan or to retain their old securities, the debtor would be unable to get the relief which Ch. IX affords, or could do so only on such terms as the minority dictated. The other alternative would be to abandon this type of refinancing. But as we have seen, it has statutory sanction. It is said, however, that provision "for the protection" of the claims of non-assenting creditors could be made in ways other than leaving the claims undisturbed. If, *arguendo*, we assume that is true, we see no reason why payment in cash of the full value of the claims would not be adequate. That is permissible in connection with reorganizations under Ch. X, 11 U.S.C.A. § 501 et seq., 52 Stat. 840, 11 U.S.C. § 616(7), 11 U.S.C.A. § 616(7). It is indeed the historic method of dealing with dissenters under plans of reorganization. Case v. Los Angeles Lumber Products Co., supra, 308 U.S. page 121, 60 S.Ct. 10, 84 L.Ed. 110, note 15. No reason is apparent why under our assumption, the same could not be done under Ch. IX. Yet, even in that view, the present plan was properly confirmed. For there is no showing whatsoever that the full value of Mason's claims is more than 52.521 cents on the dollar which he receives in cash. The District Court, indeed, found that the cash offer was fair and equitable and we are unable to say that that finding was not warranted.

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

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13 That the Reconstruction Finance Corporation would play an important role in these refinancing programs was in the forefront when this legislation was before Congress. See H. Rep. No. 517, supra, p. 4; 81 Cong.Rec. 6322.

14 Congressman Sumners, Chairman of the House Judiciary Committee, stated during the debate: "The force of the bill is directed against that minority present in every effort of debtors and creditors to bring the total of amounts payable within the ability of the debtor to pay. It is the minority who try to take advantage of the general desire to settle to compel an advantage to themselves in order to remove their selfishly interposed obstruction. They are hold-up men operating within the law." 81 Cong.Rec. 6313. The same view was expressed by Senator Pepper who managed the legislation on the floor of the Senate. 81 Cong.Rec. 8543.

Mr. Justice FRANKFURTER, dissenting.

The Court holds that the Reconstruction Finance Corporation is not to be treated as an ordinary bondholder-creditor but is entitled to preferred treatment because it
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acquired the bonds of the debtor as part of an arrangement which made possible financing of the plan of composition. With this I agree. But I find nothing in Chapter IX, 11 U.S.C.A. § 401 et seq., which, while permitting the R.F.C. to be considered a preferred creditor for purposes of distribution, allows it to be classified among ordinary creditors for purposes of voting. Nor do considerations of policy require that the R.F.C. be given such a two-faced character. It is suggested that if the votes of a preferred creditor in the position of the R.F.C. could not be counted with the votes of the ordinary creditors that class might not furnish the necessary two-thirds of the aggregate amount of claims of that class. It must be remembered, however, that the mere failure of a class like that of ordinary creditors, *e. g*, those having no preferred position in the scheme for distribution, to accept a plan of composition does not prove that its resistance is improperly or unfairly recalcitrant. Cf. American Insurance Co. v. Avon Park, 311 U.S. 138, 148, 61 S.Ct. 163, 85 L.Ed. 91. And recognition that bondholders may exercise their statutory rights as common creditors not to assent does not, of course, make of them a separate class of non-assenting bondholders with a veto power over the plan. But if the recalcitrancy does represent a dog-in-the-manger attitude, Chapter IX would seem to have provided for the contingency. According to § 83, sub. d of the Act, 50 Stat. 653, 657, 11 U.S.C. § 403, sub. d, 11 U.S.C.A. § 403, sub. d, a plan might be approved without the otherwise necessary vote, not only where the claims of the creditors "are not affected by the plan," but also where "provision is made in the plan for the protection of the interest, claims, or lien of such creditors or class of creditors." But, though the bankruptcy court has the power of dispensing with the need of an approving vote by a class of creditors, by protecting that class' interests, it is not available where the court has not in fact determined, as it has not in this case, that the dissent of that class was an abusive exercise of their right to veto a plan.

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To give such flexible scope to § 83, sub. d,[1] though, like other provisions of Chapter IX, it is not free from ambiguity, is the more pertinent if, as suggested, Chapter IX requires approval of two-thirds not of each class of claims but of the total amount of all claims. See Remington, Bankruptcy (1939) § 4364. On the other hand, if approval of the plan by two-thirds of each

[1] That this is a reasonable interpretation of § 83, sub. d is indicated by the cumbersome but more detailed form in which the purpose of § 83, sub. d is explained in an earlier draft of the Act: "* * * (3) shall, with respect to creditors whose acceptance is not required under the provisions of subdivision (e) of this section if their interests, claims, or liens, is dealt with by the manner provided in this clause (3), provide adequate protection for the realization by them of the value of their interests, claims, or liens, if the property or revenue affected by such interests, claims, or liens is dealt with by the plan, either as provided in the plan, (a) by the transfer or sale of such property subject to such interests, claims, or liens, or such property shall continue to be held by the taxing district subject to such interests, claims, or liens, or (b) by a sale free of such interests, claims, or liens, at not less than a fair upset price in the transfer of such interests, claims, or liens, to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such interests, claims, or liens, or, at the objecting creditors' election, of the securities allotted to such interests, claims, or liens under the plan, if any shall be so allotted or (d) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case equitably and fairly provide such protection: *Provided*, That if provision therefor is made in the plan, the judge may require objecting creditors to accept, in lieu of any cash payment under this subdivision such security, of any kind, in payment of their interests, claims or liens, as shall, in the opinion of the judge, upon the consummation of the plan, represent the fair and equitable shares of such creditors in the property and revenue of the taxing district available for the payment of its debts. * * *" H.R. 5267, 73rd Cong., 1st Sess. (1933) § 81(b) (3), as it appears in the Hearings on that Bill, at page 17.

class is required, such a requirement can only mean that a group of more than one-third of any class is capable of exercising the veto power, except when § 83, sub. d, can be invoked. In establishing these classes, creditors are not properly grouped who, on

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the face-value of the same bonds, get different equivalents, and are, as to the only thing that matters, not bound together by the same ties but separated by antagonistic interests. To put these groups with such antagonistic interests into the same class is to contradict the very notion of a class. Reason rejects such classification and nothing in the statute indicates that Congress intended to define a class as a group with inconsistent interests.

326 U.S. 490

MARKHAM, Alien Property Custodian v. ALLEN et al.

No. 60.

Argued and Submitted Dec. 5, 1945.
Decided Jan. 7, 1946.

1. Courts 🔑296

Action by Alien Property Custodian for a judgment declaring his right to the interest of German legatees in an estate by virtue of a vesting order is a "suit of a civil nature in equity", brought by an officer of the United States authorized to sue, of which district courts are given jurisdiction. Jud.Code § 24(1), 28 U.S.C.A. § 41(1); Trading With the Enemy Act § 5(b) (1) (B), as amended by First War Powers Act 1941, § 301, 50 U.S.C.A.Appendix § 616; Executive Order March 11, 1942, No. 9095, as amended by Executive Order July 6, 1942, No. 9193, 50 U.S.C.A. Appendix, § 6 note.

See Words and Phrases, Permanent Edition, for all other definitions of "Suit of a Civil Nature in Equity".

2. Courts 🔑260

A federal court has no jurisdiction to probate a will or administer an estate, since equity jurisdiction conferred by Judiciary Act of 1789, which is that of the English court of chancery in 1789, did not extend to probate matters. Judiciary Act of 1789, 1 Stat. 73; Jud.Code § 24(1), 28 U.S.C.A. § 41(1).

3. Courts 🔑262(3), 489(13)

Federal courts of equity have jurisdiction to entertain suits in favor of creditors, legatees and heirs and other claimants against a decedent's estate, to establish their claims so long as federal courts do not interfere with probate proceedings or assume general jurisdiction of the probate or control of property in custody of state courts. Judiciary Act of 1789, 1 Stat. 73; Jud.Code § 24(1), 28 U.S.C.A. § 41(1).

4. Courts 🔑497

While a federal court may not exercise its jurisdiction to disturb the possession of property in custody of a state court, it may exercise its jurisdiction to adjudicate rights in such property where final judgment does not undertake to interfere with state court's possession save to extent that state court is bound by judgment to recognize right adjudicated by federal court. Jud.Code § 24(1), 28 U.S.C.A. § 41(1).

5. Courts 🔑489(13), 505

Federal District Court judgment determining that Alien Property Custodian, by virtue of order vesting in him interest of German legatees in a California estate which had been left entirely to such legatees, was entitled to receive net estate in distribution after payment of expenses of administration, debts and taxes, thereby leaving undisturbed the orderly administration of estate in state probate court, was not an improper exercise of probate jurisdiction by federal court or an interference with property in possession or custody of state court. Jud.Code § 24(1), 28 U.S.C.A. § 41(1).

6. Courts 🔑489(1)

The mere fact that federal District Court, in exercise of jurisdiction which Congress has conferred upon it, is required to interpret state law is not in itself a sufficient reason for withholding relief and remitting a petitioner to his remedy in state courts.

7. Courts 🔑489(1)

The provision of the Trading With the Enemy Act specially conferring on federal District Court, independently of statutes governing generally jurisdiction of

Faculty

Hon. Robert D. Drain is a retired U.S. Bankruptcy Judge for the Southern District of New York in White Plains, currently serving on recall as a mediator in the Puerto Rico Electric Power Authority PROMESA case. At the time of his appointment in 2002, he was a partner in the Bankruptcy Department of the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison, where he represented debtors, trustees, secured and unsecured creditors, official and unofficial creditors committees, and buyers of distressed businesses and distressed debt in chapter 11 cases, out-of-court restructurings and bankruptcy-related litigation and also was actively involved in several transnational insolvency matters. Judge Drain is a Fellow of the American College of Bankruptcy and an ABI Board member. he also is a member of the International Insolvency Institute, a member and former Secretary of the National Conference of Bankruptcy Judges, and a founding member and chair of the Judicial Insolvency Network. For several years, Judge Drain chaired the Bankruptcy Judges Advisory Group established through the Administrative Office of the U.S. Courts and was appointed to the FDIC's Systemic Resolution Advisory Committee through Dec. 31, 2024. He also was an adjunct professor for several years at St. John's University School of Law's LL.M. in Bankruptcy Program and currently is an adjunct professor at Pace University School of Law, and he has lectured and written on numerous bankruptcy-related topics. Judge Drain presided over such chapter 11 cases as *Loral, RCN, Cornerstone, Refco, Allegiance Telecom, Delphi, Coudert Brothers, Frontier Airlines, Star Tribune, Reader's Digest, A&P, Hostess Brands, Christian Brothers, Momentive, Cenveo, 21st Century Oncology, Tops, G A&T, Sears, Standard Amusements (Playland), Full Beauty Brands, Sungard, Windstream, Purdue Pharma, Jason Industries, OneWeb* and *Frontier Communications*, as well as many mid-sized and small chapter 11 cases and an active consumer docket. He also has presided over the ancillary or plenary cases of *Corporacion Durango, Satellites Mexicanas, Parmalat S. p. A.* and its affiliated United States debtors, *Varig S.A., Yukos (II), SphinX, Galvex Steel, TBS Shipping, Excel Maritime, Nautilus, Landsbanki Islands, Roust* and *Ultrapetrol*. Judge Drain has served as the court-appointed mediator in a number of chapter 11 cases, including *New Page, Cengage, Quicksilver, Advanta, LightSquared, Molycorp, Breitburn Energy* and *China Fishery*. He also authored a novel, *The Great Work in the United States of America*. Judge Drain received his B.A. *cum laude* from Yale University and his J.D. from Columbia University School of Law, where he was a Harlan Fiske Stone Scholar for three years.

Hon. Craig Goldblatt is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, where he has served since his appointment in April 2021. rior to his appointment, he was a bankruptcy litigator in the Washington, D.C. office of WilmerHale, where his practice primarily involved the representation of financial institutions and other commercial creditors in complex bankruptcy litigation and appeals. Earlier in his career, Judge Goldblatt clerked for Hon. Richard D. Cudahy of the U.S. Court of Appeals for the Seventh Circuit and Hon. David H. Souter of the U.S. Supreme Court. He is a Conferee in the National Bankruptcy Conference (for which he serves as Secretary) and is a vice president of the American College of Bankruptcy. He also has been active on the Business Bankruptcy Committee of the American Bar Association's Business Law Section. Judge Goldblatt has served on the Education Committee of the National Conference of Bankruptcy Judges and as an adjunct professor at Georgetown University Law Center and George Washington University Law School, where he teaches classes focused on bankruptcy law. He received his Bachelor's degree *magna cum laude* from Georgetown University in 1990 and his J.D. with honors from the University of Chicago Law School in 1993, where he served as comment editor of the *University of Chicago Law Review*.

Hon. Marvin P. Isgur is a U.S. Bankruptcy Judge for the Southern District of Texas in Houston, appointed Feb. 1, 2004, and reappointed on Feb. 1, 2018. He also served as Chief Judge from 2009-2012. Judge Isgur serves as adjunct faculty at the University of Houston Law Center. Between 1978 and 1990, he was an executive with a large real estate development company in Houston. From 1990 until 2004, he represented trustees and debtors in chapter 11 and chapter 7 cases, as well as various parties in 14 separate chapter 9 bankruptcy cases. Judge Isgur has written over 500 memorandum opinions. He was one of the first judges to issue opinions interpreting the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. Judge Isgur is a volunteer with the Houston Urban Debate League, a nonprofit organization that works in partnership with the Houston Independent School District to bring policy debate to high school students. He is one of the principal organizers of the annual University of Texas Consumer Bankruptcy Conference and is a frequent speaker at continuing education programs. Judge Isgur received his bachelor's degree from the University of Houston in 1974, his M.B.A. with honors from Stanford University in 1978, and his J.D. with high honors from the University of Houston in 1990.

Hon. Christopher M. Lopez is a U.S. Bankruptcy Judge for the Southern District of Texas in Houston, appointed on Aug. 14, 2019. He previously was in private practice in Houston from 2003-19. Judge Lopez received his B.A. in psychlogy in 1996 from the University of Houston, his M.A. in theology in 1999 from Yale University and his J.D. from the University of Texas School of Law in 2003.

Hon. Pamela W. McAfee is a U.S. Bankruptcy Judge for the Eastern District of North Carolina in Raleigh, appointed on Jan. 7, 2022. Prior to taking the bench, she was a creditors' rights attorney, commercial litigator and mediator for 13 nonconsecutive years and served as a law clerk or career law clerk for four bankruptcy judges over 14 nonconsecutive years. Judge McAfee is an adjunct professor of bankruptcy law at Campbell University School of Law and coached its Duberstein Bankruptcy Moot Court Competition teams from 2018-21 and ABA National Appellate Advocacy Competition teams from 2014-17. She has served on the Local Rules Committee for the U.S. Bankruptcy Court for the Eastern District of North Carolina and on the Local Civil Rules Subcommittee for the U.S. District Court for the Eastern District of North Carolina, and is active in the North Carolina Bar Association, having served on the councils of both the Bankruptcy Section and the Dispute Resolution Section. In 2016, she was recognized by the North Carolina Bar Association with the Citizen Lawyer Award for her work with HopeLine, a suicide-prevention hotline, and for her mentoring activities with law students and young lawyers. Judge McAfee received her undergraduate degree from the University of Pennsylvania and her J.D. with honors from the University of North Carolina School of Law.