



AMERICAN
BANKRUPTCY
INSTITUTE

2019 Delaware Views from the Bench

Experienced Practitioners Track

Hot Topics and Trends in Chapter 11 Plans

Regina Stango Kelbon, Moderator

Blank Rome LLP; Wilmington

Jessica C.K. Boelter

Sidley Austin LLP; New York

Kelly DiBlasi

Weil, Gotshal & Manges LLP; New York

Hon. Karen B. Owens

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

Brian Trust

Mayer Brown LLP; New York



MAYER | BROWN

Can You Still Buy Peace? Gifting after *Jevic*

Hot Topics and Trends in Chapter 11 Plans

Delaware Views from the Bench

3:00-4:00 p.m. October 17, 2019, Hotel du Pont, Wilmington, DE

Brian Trust

Partner
Mayer Brown LLP

[Draft – August 23,
2019]



Outline

1. Absolute Priority Rule
2. Gifting Provisions
3. Setting the Stage: Notable Prior Gifting Cases
4. *Jevic*: Gifting in the Context of Structured Dismissal
5. Is Gifting Over? Decisions after *Jevic*
6. Unresolved Issues

1. Absolute Priority Rule

- **“Absolute priority rule”**: the requirement that a set order of distributions among creditors and shareholders be followed in Chapter 7 liquidations and Chapter 11 plans
 - Secured
 - Administrative
 - Priority unsecured
 - General unsecured
 - Equity
- Bedrock restructuring principle; guides dynamics in virtually all complicated cases

3

MAYER | BROWN

1. Absolute Priority Rule (cont'd)

- §1129(b)(2) of the Bankruptcy Code incorporates the absolute priority rule into the requirement that a Chapter 11 plan be **“fair and equitable”** in its treatment of dissenting classes
 - If a class objects to a plan, that plan may not distribute any value to junior classes of creditors until the dissenting class receives full value for its claim
 - e.g., a plan is “fair and equitable” with respect to an impaired, dissenting class of unsecured claims if (1) the plan pays the class’ claims in full or (2) the plan does not allow holders of any junior claims or interests to receive any distribution under the plan on account of such claims or interests
- §1129(b)(2) is not implicated where all classes vote in favor of the plan despite a priority-violating distribution

4

MAYER | BROWN

2. Gifting Provisions

- A classic example of “**Gifting**”: a senior creditor class agrees to “gift” distribution value it otherwise would have received to a junior class of creditors or equity holders, while an intermediate class is not paid in full
- Problematic because of potential deviations deviates from the absolute priority rule (i.e., lower-priority creditors receive distributions prior to and/or greater than higher-priority creditors)
- Rationale:
 - Can be an important structuring tool, both as a stick and carrot
 - Often used in negotiating acceptable terms with junior classes (who often have critical roles in ensuring post-restructuring success)

5

MAYER | BROWN

3. Setting the Stage: Notable Prior Gifting Cases

- Gifting doctrine approved in:
 - ***In re SPM Manufacturing Corp.***, 984 F.2d 1305 (1st Cir. 1993)
 - Key Facts: Secured creditors agreed to share (or “gift”) a portion of liquidation proceeds with the unsecured creditors, while not satisfying priority tax claims
 - Ruling: “[C]reditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors”
 - The restructuring community relied on this decision for a multitude of gifting provisions and structures
 - Created tension with the absolute priority rule

6

MAYER | BROWN

3. Setting the Stage: Notable Prior Gifting Cases (cont'd)

- Gifting doctrine approved in:

In re World Health Alternatives, Inc., 344 B.R. 291 (Bankr. D. Del. 2006)

- Key Facts: Proposed settlement agreement provided that the secured lender would grant the general unsecured creditors a \$1.625 million carve-out from its lien, a distribution which came before priority tax claims were paid in full
- Ruling: Approved the settlement, reasoning that payout to the general unsecured creditors is a carve out of the secured creditor's lien and not estate property, and therefore did not implicate the absolute priority rule

7

MAYER | BROWN

3. Setting the Stage: Notable Prior Gifting Cases (cont'd)

- Gifting doctrine subject to question and criticism in:

In re Armstrong World Industries Inc., 432 F.3d 507 (3d Cir. 2005)

- Key Facts: Under the proposed Chapter 11 plan, an unsecured creditor class of asbestos claimants would receive and automatically transfer warrants to the holder of equity interests over the dissenting vote of other unsecured creditors
- Ruling: Applying the plain meaning of the statute, Third Circuit concluded that the plan could not be confirmed because a plan is in violation of the absolute priority rule if it gives property to junior claimants over the objection of a more senior class that is impaired

8

MAYER | BROWN

3. Setting the Stage: Notable Prior Gifting Cases (cont'd)

- Gifting doctrine subject to question and criticism in:

In re DBSD North America Inc., 634 F.3d 79 (2d Cir. 2011)

- Key Facts: Proposed Chapter 11 plan channeled bulk of the reorganized debtor's equity to second lienholders, while simultaneously gifting equity to an existing shareholder. Unsecured creditor, who was not receiving full value on its claim under the plan, objected
- Ruling: Applied absolute priority rule to the facts in a straightforward manner and denied confirmation of the plan, because the existing shareholder received property on account of its interest

4. *Jevic*: Gifting in the Context of Structured Dismissal

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

- Key Facts: Truck drivers with priority wage claims against bankrupt employer challenged a structured dismissal that relied on a settlement favoring lower-priority unsecured creditors
 - **"Structured dismissal"**: case dismissed without a confirmed plan, with court approving settlement providing for final distributions or transactions that could vary from the absolute priority rule
- Challenged as a post-liquidation gifting scheme

4. *Jevic*: Gifting in the Context of Structured Dismissal (cont'd)

Rulings:

- Bankruptcy court approved settlement and ordered structured dismissal over objection of truck drivers because of “dire circumstances” that would result (e.g., conversion of case to Chapter 7)
 - Argued that truck drivers might not be paid their priority claims in other scenarios
- Upheld on appeal to Delaware District Court and US Court of Appeals for Third Circuit
- Supreme Court reversed:
 - A bankruptcy court may not “approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors’ consent”

11

MAYER | BROWN

4. *Jevic*: Gifting in the Context of Structured Dismissal (cont'd)

- Primary effect of *Jevic*: Structured dismissals much less useful as a strategy to wrap up cases quickly without a plan if there are disputes among parties regarding priority
- Structured settlements:
 - Issue remains whether settlement agreements not resulting in dismissal of the case itself but that depart from the absolute priority rule can be approved by a bankruptcy court

12

MAYER | BROWN

5. Is Gifting Over? Decisions after *Jevic*

In re Short Bark Industries, Case No. 17-11502 (KG) (Bankr. D. Del. Sept 11, 2017), ECF No. 209

- Key Facts: Settlement agreement entered into to resolve dispute over DIP financing asked for certain proceeds of § 363 sale to be held in escrow for payment to general unsecured creditors while bypassing administrative or priority claimholders
- Ruling: Judge Kevin Gross, distinguishing the facts from *Jevic*, approved the settlement because
 - (1) no structured dismissal was involved,
 - (2) payment resulted from DIP financing order, not a case-ending transaction, and
 - (3) offsetting bankruptcy-related justifications of preserving business entity supported the priority-skipping distributions

13

MAYER | BROWN

5. Is Gifting Over? Decisions after *Jevic* (cont'd)

In re Nuverra Environmental Solutions Inc., 590 B.R. 75, 98 (D. Del. 2018)

- Allowed the use of “**horizontal gifting**”
- Key Facts: Proposed Chapter 11 plan involved unequal gifting by secured creditors to two classes of unsecured creditors
 - Trade and business-related unsecured classes would receive larger distributions than noteholder class
- Ruling: Judge Richard G. Andrews from Delaware district court upheld bankruptcy court’s ruling that such disparate treatment among separate classes of the same level of creditors was not an “unfair discrimination,” thereby not violating the requirements of plan confirmation under §1129
 - Noteholders not harmed by the disparate recovery because they could not have otherwise been entitled to any recovery
 - Judge Andrews noted that the 3rd Cir. has not foreclosed horizontal gifting

14

MAYER | BROWN

6. Unresolved Issues

- Determination of whether a gift to junior classes is made “on account of” a pre-petition interest continues to be an exceptionally fact-based analysis, with determinations made on a case-by-case basis

Unresolved issues include:

- Viability of gifting Chapter 11 plans
- Validity of vertical gifting that serves other Bankruptcy Code objective
- Alternative avenues of distributions outside of a plan
 - Gifting settlements (not resulting in dismissal)
 - Weighed under bankruptcy settlement approval standards rather than §1129(b)(2) “fair and equitable” standard?
 - Use of escrows in §363 sales
- Possible to make gifts using property no longer estate property v. property of the estate?

15

MAYER | BROWN

Speaker Biography

“He is inventive, creative and knows how to keep people on track.”

– *Chambers USA 2018*



Brian Trust

Partner
+1 (212) 506-2570
btrust@mayerbrown.com

Brian Trust leads Mayer Brown's Global Restructuring, Bankruptcy & Insolvency practice. He focuses on representing large institutional creditors, including agent banks, lending syndicates, insurance companies and other investors. Brian has extensive experience in complex Chapter 11 reorganizations, out-of-court restructurings and recapitalizations, mergers and acquisitions of financially distressed companies, acquisition and divestiture of claims against and equity interests in distressed companies, debtor-in-possession and exit financings, and cross-border insolvencies.

Ranked year after year by *Chambers USA* and *Chambers Global*, clients praise Brian for his “wealth of restructuring experience” and “superior ability to thoroughly analyze complex issues from both the legal and the business sides,” and applaud him for doing a “fantastic job on complex work.” Brian is lauded for his “great reputation in the bankruptcy and restructuring community,” described as “very bright, client-oriented, attentive and very practical,” and viewed as “very strategic, a great communicator, and talented on a myriad of levels.” *The Legal 500 USA* highlights Brian for his corporate restructuring work, commending Brian for being “extremely responsive” and “technically very strong,” and noting that he “knows the issues important to banks” and has “excellent judgment.” Additionally, Brian is listed in the *Best Lawyers in America* in Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law, identified as a Notable Practitioner in *IFLR1000* and, for over ten years, *New York Super Lawyers* has recognized Brian as a top lawyer in the area of “Creditor Debtors Rights: Business.” Recognized as a thought leader, Brian is a frequent lecturer and author on novel and complex bankruptcy and reorganization issues. The media often interviews Brian for his views on innovative and timely reorganization topics.

16

MAYER | BROWN

[Americas](#) | [Asia](#) | [Europe](#) | [Middle East](#)

mayerbrown.com

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Taill & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website. "Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown. © Mayer Brown. All rights reserved.

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...



KeyCite Yellow Flag - Negative Treatment

Declined to Extend by In re Together Development Corp., Bankr.D.Mass., June 4, 2001

984 F.2d 1305

United States Court of Appeals,
First Circuit.

In re SPM MANUFACTURING
CORPORATION, Debtor.
OFFICIAL, UNSECURED
CREDITORS' COMMITTEE, Appellant,
v.
Peter M. STERN, Chapter 7 Trustee of
SPM Manufacturing Corporation, and
Robert and Frances Shaine, Appellees.

No. 92-1379.

|
Heard Sept. 15, 1992.|
Decided Jan. 21, 1993.|
Rehearing and Rehearing En
Banc Denied Feb. 24, 1993.**Synopsis**

Chapter 11 debtor objected to distribution of proceeds following secured creditor's liquidation of estate. The United States District Court for the District of Massachusetts, [Frank H. Freedman](#), J., affirmed bankruptcy court's order that secured creditor pay portion of proceeds over to estate for distribution according to Bankruptcy Code priorities, and appeal was taken. The Court of Appeals, [Levin H. Campbell](#), Senior Circuit Judge, held that bankruptcy court lacked equitable authority to compel secured creditor, which had entered into agreement with unsecured creditors to split monies realized under its security interest, to pay unsecured creditors' portion of proceeds over to estate for distribution pursuant to Bankruptcy Code priorities.

Reversed, vacated in part, and remanded.

West Headnotes (11)

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

On appeal from district court review of bankruptcy court order, Court of Appeals independently reviews bankruptcy court's decision, applying clearly erroneous standard to findings of fact and de novo review to conclusions of law.

[41 Cases that cite this headnote](#)**[2] Bankruptcy** [Conclusions of Law; De Novo Review](#)

Where language of contract is unambiguous, bankruptcy court's interpretation of it is subject to de novo review.

[26 Cases that cite this headnote](#)**[3] Bankruptcy** [Equitable Powers and Principles](#)

Bankruptcy court has no equitable power to deprive creditors of rights or remedies available to them under Bankruptcy Code. Bankr.Code, [11 U.S.C.A. § 105\(a\)](#).

[7 Cases that cite this headnote](#)**[4] Bankruptcy** [Equitable Powers and Principles](#)

Bankruptcy court's equitable powers do not authorize it to create substantive rights that are otherwise unavailable under Bankruptcy Code, or to expand contractual obligations of parties. Bankr.Code, [11 U.S.C.A. § 105\(a\)](#).

[21 Cases that cite this headnote](#)**[5] Bankruptcy** [Equitable Powers and Principles](#)

Bankruptcy court lacked equitable authority to compel secured creditor, which had entered into agreement with unsecured creditors to split monies realized under its security interest, to pay unsecured creditors' portion of proceeds over to estate for distribution pursuant to Bankruptcy Code priorities; because secured claim exceeded

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

estate's assets, agreement did not deprive priority claimants of any estate assets to which they would otherwise have been entitled. Bankr.Code, 11 U.S.C.A. § 105(a).

[68 Cases that cite this headnote](#)

[6] **Bankruptcy**

 Order of Distribution

While debtor and trustee are not allowed to pay nonpriority creditors ahead of priority creditors, creditors are generally free to do whatever they wish with bankruptcy dividends they receive, including to share them with other creditors.

[28 Cases that cite this headnote](#)

[7] **Bankruptcy**

 Transfer or Assignment

Assigned claim may be limited if assignment involves breach of fiduciary duty or fraud and such breach or fraud enables assignee to acquire claim for inadequate consideration.

[3 Cases that cite this headnote](#)

[8] **Bankruptcy**

 Transfer or Assignment

Absent some effect on administration of estate or diminution of estate property, neither Bankruptcy Code nor Rules prohibit or discourage creditors from receiving cash from nondebtors in exchange for their claims.

[14 Cases that cite this headnote](#)

[9] **Bankruptcy**

 Creditors' and Equity Security Holders' Committees and Meetings

While creditors' committee and its members must act in accordance with provisions of Bankruptcy Code and with proper regard for bankruptcy court, committee is fiduciary for those whom it represents, not for debtor or estate generally.

[33 Cases that cite this headnote](#)

[10] **Bankruptcy**

 Presentation of Grounds for Review

Issues not raised in bankruptcy court are ordinarily not considered for first time on appeal; though parties are sometimes permitted, in interest of justice, to offer unraised alternative rationales for affirming judgment, rationales which require factual findings not made below may not be raised.

[1 Cases that cite this headnote](#)

[11] **Assignments**

 Effect of Transfer in General

Assignments

 Priorities

Under Massachusetts law, valid assignment of debt does not divest claim of its priority or alter debtor's obligation to pay debt; assignee steps into shoes of assignor for portion of claim assigned. M.G.L.A. c. 106, § 9-302(2).

[3 Cases that cite this headnote](#)

Attorneys and Law Firms

***1307** William C. Penkethman with whom David J. Noonan and Kamberg, Berman, P.C., Springfield, MA, were on brief, for appellant.

Peter M. Stern with whom Cynthia J. Gagne and Law Office of Peter M. Stern, Springfield, MA, were on brief, for appellee Peter M. Stern, Chapter 7 Trustee of SPM Mfg. Corp.

J. Daniel Marr with whom Hamblett & Kerrigan P.A., Nashua, NH, was on brief, for appellees Robert and Frances Shaine.

Before TORRUELLA, Circuit Judge, CAMPBELL, Senior Circuit Judge, and BRODY, * District Judge.

LEVIN H. CAMPBELL, Senior Circuit Judge.

The district court affirmed a bankruptcy court order which compelled a secured creditor to pay to the debtor's estate a portion of the proceeds it had received in satisfaction of its allowed secured claim. The bankruptcy court's order contravened an agreement between the secured creditor and

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

the general, unsecured creditors to share in the proceeds from the former's secured interest. The bankruptcy court believed, and the district court agreed, that such an agreement violated Bankruptcy Code policy. Appellant, the Official Unsecured Creditors' Committee which entered the agreement on behalf of the general, unsecured creditors, argues that the bankruptcy court's order to pay over the disputed funds to the estate was an error of law. We agree with appellant, and so reverse the district court judgment, vacate the order in part and remand to the bankruptcy court.

I. BACKGROUND

Debtor SPM Manufacturing Corporation ("SPM" or "Debtor"), a family-owned manufacturer of photo albums and related products based in Springfield, Massachusetts, filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code ("Code") on April 3, 1989, in the United States Bankruptcy Court for the District of Massachusetts. See 11 U.S.C. § 1101 *et seq.* SPM management continued to operate the company as a debtor in possession ("DIP") pursuant to 11 U.S.C. §§ 1101(1) and 1107. Appellee Robert Shaine continued to serve as president of SPM and was an unsecured "insider" creditor. Appellee Frances Shaine continued on as chair of the board of SPM, in addition to being a stockholder and having responsibility for the general administrative functions of SPM.

Appellant Official Unsecured Creditors' Committee ("Committee") was appointed by the bankruptcy court pursuant to 11 U.S.C. § 1102(a) on April 13, 1989. When SPM filed for bankruptcy protection, the company owed approximately \$5.5 million to the general, unsecured creditors represented by the Committee, including International Paper Company and other suppliers.¹ Approximately \$9 million was owed to Citizens Savings Bank ("Citizens" or "Bank"), which held a perfected, first security interest in all of SPM's assets except certain real estate. Unsecured debts that had priority under section 507(a) of the Code, 11 U.S.C. § 507(a), consisted primarily of a tax claim of approximately \$750,000 held by the Internal Revenue Service ("I.R.S.") for unpaid withholding taxes. The Shaines are personally liable for whatever portion of that tax claim is not paid out of the estate.²

Chapter 11 proceedings to reorganize SPM were contentious and unproductive. Though the DIP filed a plan for reorganization in September 1989, later amended in

November 1989, the plan was never confirmed. The Committee decided at about the same time that reorganization under *1308 current management was unfeasible, but that a liquidation of SPM's assets would leave nothing for any creditor besides Citizens, whose secured claim exceeded the value of its collateral (substantially all of SPM's assets). Consequently, the Committee began discussions with Citizens about cooperating in the bankruptcy proceedings to maximize the value of SPM's assets and provide some return to the general, unsecured creditors.

On October 12, 1989, the Committee and Citizens executed the agreement ("Agreement") which is the subject of this appeal. The Agreement recites the opinion of Citizens and the Committee that, "through their mutual cooperation ... in order to maximize recovery on their respective debts it is in their mutual interest to enter into this Agreement." The contract explicitly states that the Committee negotiated and executed the Agreement on behalf of the general, unsecured creditors, "[e]xclusive of the Internal Revenue Service and potential 'insider' creditors."

Citizens and the Committee agreed to cooperate in the following manner: (1) to "take all actions reasonably necessary, including, without limitation, initiation of motions and filing of other pleadings in the Proceeding, to replace Debtor's current CEO with [a] New Manager"; (2) "to work together to formulate a joint plan of reorganization"; and (3) to "negotiate with one another in good faith to reach mutually acceptable agreements" with respect to a number of details of the joint plan for reorganization.

Citizens and the Committee also agreed to share whatever proceeds they received as a result of the reorganization or liquidation of the Debtor. Section 2.4 of the Agreement specified the terms of the "sharing arrangement":

Any and all net proceeds of the sale, refinancing or other disposition of the assets of SPM and also North American Album Corporation or any other entity whose assets are subject to Citizens' security interest (net proceeds is defined as those proceeds remaining after payment of administrative expenses as so defined by 11 U.S.C. § 503, specifically including attorney's fees and expenses incurred by the Committee and by Citizens) received by Citizens and/or the Creditors' Committee from Debtor's operations in whatever form said proceeds make [sic] take (including proceeds from the operation of any successor entity's business) or from the sale or disposition of the Debtor's or

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

a successor's assets and/or stock shall be divided between Citizens and the Creditors' Committee as follows:

1. The first \$3,000,000 of such proceeds shall be shared 90% to Citizens and 10% to the Creditors' Committee ...;
2. The second \$3,000,000 shall be shared by citizens [sic] and the Creditors' Committee with 80% going to Citizens and 20% to the Creditors' Committee;
3. The next \$3,000,000 shall be shared 70% to Citizens and 30% to the Creditors' Committee;
4. The next \$3,000,000 shall be shared 60% to Citizens and 40% to the Creditors' Committee; and
5. All proceeds in excess of \$12,000,000 shall go to the Creditor's Committee.

The Agreement contained a standard savings clause which provided that “[i]n the event of any term or provision hereof is invalid or unenforceable [the] remainder of this Agreement shall be valid and enforceable to the extent permitted by law.”

Thereafter, the Committee and the Bank filed numerous motions, both independently and jointly, seeking unsuccessfully a change in SPM's management, a grant of relief from the automatic stay for Citizens, the appointment of a Chapter 11 trustee, and conversion of the case from Chapter 11 to Chapter 7. At a motion hearing in December 1989, the Agreement was filed with the court as an exhibit. The court expressed concern about the Agreement's sharing provision, characterizing it as a “tax-avoidance” scheme.³ However, at no *1309 time during the reorganization proceedings did any creditor, the Shaines or other interested party⁴ object to the mutual promises by Citizens and the Committee to cooperate during the reorganization proceedings. The court never formally approved or disapproved the Agreement before January 1991.

After it became apparent that SPM could not be successfully reorganized, the bankruptcy court granted a motion by Citizens on April 16, 1990, to appoint a receiver with the power to negotiate a sale of all of SPM's assets pursuant to 11 U.S.C. § 363(b). On December 19, 1990, SPM's assets were sold to Heritage Albums, Inc. for a purchase price of \$5,000,000.00. On December 21, 1990, a previously entered order went into effect granting Citizens relief from the automatic stay, *see* 11 U.S.C. § 362, and converting the case into a Chapter 7 liquidation proceeding, *see* 11 U.S.C. §

1112(b). After conversion to Chapter 7, appellee Trustee Stern was appointed. *See* 11 U.S.C. § 701(a).

On December 24, 1990, the Committee and Citizens filed a joint motion for “Entry of Order Requiring Delivery of Proceeds and Requiring Expedited Determination” which requested distribution of the sale proceeds to Citizens. The motion recited that the entire amount was subject to Citizens' security interest pursuant to 11 U.S.C. § 506 and announced that, after receiving the \$5 million and paying various administrative fees, “Citizens will distribute a portion of the net proceeds to Kamberg, Berman, P.C. [Committee's counsel] in accordance with its October 12, 1989 agreement with the Committee.” At a hearing before the bankruptcy court on January 3, 1991, the Debtor and the Shaines objected to the motion, arguing that the Agreement distributed proceeds to general, unsecured creditors ahead of the priority tax creditors in violation of the statutory scheme for distribution. *See* 11 U.S.C. §§ 724–726. Citizens and the Committee responded that the \$5 million belonged to Citizens and that the Bank had a right to share its proceeds with the Committee without paying the I.R.S. or other creditors first.

The bankruptcy court granted Citizens' and the Committee's motion to the extent it requested satisfaction of Citizens' allowed secured claim for \$5 million, but rejected the motion to the extent it requested approval of the Agreement's sharing provision.⁵ The bankruptcy judge explained that he viewed the Agreement as a form of proceeds distribution which did not comply with the Code.

I am not approving any distribution that is not in accordance with the priority of the bankruptcy code, and I think I made that abundantly clear a long time ago. I'm not going to have the bankruptcy code, have an end-run around it in this court. The law sets out certain priorities, and your committee has absolutely no authority to short-circuit those priorities, and I want to make that clear.

Furthermore, the bankruptcy court explained, the Committee has a duty to the bankruptcy estate.

I rule that the committee, although it certainly had authority to negotiate something for the benefit of the bankruptcy estate, that authority was just that, for the benefit of the entire bankruptcy estate, and the committee had no authority, never thought it had—and if it did [ask for court approval], it would not have been given it—to negotiate something for the benefit of some sets of creditors of the bankruptcy estate.

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

***1310** It is perfectly true that without the agreement the bankruptcy estate would get nothing, but once the committee was in operation it had to, it's required by law, to act for the benefit of the entire estate....

In accordance with its ruling at the hearing, the bankruptcy court issued a Disbursement Order on January 8, 1991, ordering the following:

1. Citizens is the holder of a valid, perfected and enforceable first security interest in all assets of the Debtor excepting only the real estate owned by the Debtor;
2. Citizens has a first priority lien and security interest in all of the post-petition accounts receivable and inventory of the Debtor;
3. Citizens' claim is allowed as a secured claim in the amount of \$5,000,000.00, with the remainder allowed as an unsecured claim;
4. The net cash proceeds from the sale of the Debtor's assets held by Goldstein & Manello [Debtor's counsel], after payment of its fee and expenses and the fee and expenses of Kamberg, Berman P.C. [the Committee's counsel], shall be paid over to Citizens by Goldstein & Manello in partial satisfaction of Citizens' claim.
5. Citizens shall pay from the net cash proceeds paid over to it by Goldstein & Manello as aforesaid such fees of the Examiner and any other party as shall be approved by order of this court after notice and hearing.⁶

Although the court acknowledged that Citizens' allowed secured claim was \$5 million, paragraph six compelled Citizens to pay part of that amount to the Chapter 7 trustee for distribution to other creditors:

6. After payment of all fees, Citizens shall compute the amount due to the Committee under the agreement of October 12, 1989 between Citizens and the Committee. Citizens shall then pay such amount to the trustee in bankruptcy of SPM Manufacturing Corporation, who shall administer the same in accordance with the provisions of the Bankruptcy

Code including the Code's provisions concerning priority for tax claims.

The effect of paragraph six of the order is to deprive the general, unsecured creditors of any amount they would have received under the Agreement and to benefit the I.R.S., the other priority creditors, and the Shaines who, as principals of SPM, would be personally liable for the underlying tax obligations.

Citizens and the Committee made timely objections to the order and appealed to the United States District Court for the District of Massachusetts. Trustee Stern and the Shaines appeared as appellees, and the funds were placed in escrow pending outcome of the appeal. The district court affirmed the bankruptcy court order, reasoning that it was a proper exercise of the bankruptcy court's equitable powers under [section 105\(a\)](#) of the Code. "[T]he Disbursement Order furthers the legislative distribution scheme in Chapter 7 cases and [] the Sharing Agreement, in its original form, thwarts that scheme." The district court explained that, in accordance with the Code and Massachusetts contract law, the bankruptcy court "reformed" the Agreement to comply with the distribution scheme of the Code.

The Committee filed a timely appeal from the district court's order. The Bank, conceding that the funds in escrow belong either to the Committee or to the estate, does not join the appeal. This court has jurisdiction over this appeal pursuant to [28 U.S.C. § 158\(d\)](#).

II. DISCUSSION

[1] [2] The facts are essentially undisputed. The issue on appeal is whether the bankruptcy court erred as a matter of law in ordering Citizens to pay to the Trustee that portion of the Bank's secured interest which, according to the terms of the Agreement, was due to the Committee. In an ***1311** appeal from district court review of a bankruptcy court order, the court of appeals independently reviews the bankruptcy court's decision, applying the clearly erroneous standard to findings of fact and de novo review to conclusions of law. [In re LaRoche](#), 969 F.2d 1299, 1301 (1st Cir.1992); [In re G.S.F. Corp.](#), 938 F.2d 1467, 1474 (1st Cir.1991). Where the language of a contract is unambiguous, the bankruptcy court's interpretation of it is subject to de novo review. [In re Sublett](#), 895 F.2d 1381, 1384 (11th Cir.1990). No special deference is

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

owed to the district court's determinations. *In re G.S.F. Corp.*, 938 F.2d at 1474.

[3] [4] Appellees argue that the order was a proper exercise of the bankruptcy court's equitable powers under [section 105\(a\)](#) of the Code. The bankruptcy court has the equitable power "to issue any order, process, or judgment that is necessary or appropriate to carry out provisions" of the Code. 11 U.S.C. § 105(a). However, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S.Ct. 963, 969, 99 L.Ed.2d 169 (1988) (unanimous decision); see also *In re Plaza de Diego Shopping Ctr., Inc.*, 911 F.2d 820, 830–31 (1st Cir.1990) ("[T]he bankruptcy court's equitable discretion is limited and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code."). That is, the bankruptcy court has no equitable power to deprive creditors of rights or remedies available to them under the Code. See *Norwest Bank*, 485 U.S. at 206–07, 108 S.Ct. at 968–69; *In re Grissom*, 955 F.2d 1440, 1449 n. 8 (11th Cir.1992). Nor does [section 105\(a\)](#) authorize courts to create substantive rights that are otherwise unavailable under the Code, or to expand the contractual obligations of parties. *United States v. Pepperman*, 976 F.2d 123, 131 (3d Cir.1992); *United States v. Sutton*, 786 F.2d 1305 (5th Cir.1986).

Appellees portray the bankruptcy court's order as a mere "reform" of the Agreement. In their view, the court simply substituted the bankruptcy estate for the Committee as the proper beneficiary of the sharing provision of the Agreement. Appellant responds that transferring the contractual right to receive payment from one party to a third party goes beyond mere "reform." The question now before us is whether an order compelling Citizens to pay to the estate from monies realized under its secured interest the amount required by the Agreement to be paid to the Committee is within the equitable powers of the bankruptcy court.⁷ Because [section 105\(a\)](#) is not a source of substantive rights, the bankruptcy court's order was legitimate only to the extent that some other provision of the Code or other applicable law entitled the estate to receive the disputed funds. See *In re Morristown & Erie R.R. Co.*, 885 F.2d 98, 100 (3d Cir.1989).

Appellees argue that the order was authorized on three different grounds: (1) the Agreement attempted to distribute property not in accordance with the priorities and distribution scheme of Code [sections 507](#) and [726](#); (2) the Committee had a duty to negotiate on behalf of all creditors, not just

the general, unsecured creditors; and (3) the Agreement altered the balance of power in the Chapter 11 reorganization proceedings. We consider each argument separately.

A. Distribution Scheme of the Code

[5] Appellees argue that allowing the general, unsecured creditors to receive money under the Agreement while priority tax creditors receive nothing would conflict with the statutory scheme for distribution of bankruptcy estate property. See 11 U.S.C. §§ 507, 726. Thus, they contend, the bankruptcy court properly acted in equity to prevent a violation of the Code's distribution scheme. [Section 726](#) provides, in relevant part, that:

***1312** [P]roperty of the estate shall be distributed—

- (1) first, in payment of claims of the kind specified in, and in the order specified in, [section 507](#) of the title;
- (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is [timely filed.]

11 U.S.C. § 726(a). [Section 507](#) of the Code identifies those expenses and claims which have priority over other claims, including administrative expenses allowed under [section 503\(b\)](#), claims for wages, and unsecured tax claims. See 11 U.S.C. § 507(a)(1), (3), (7).

However, the distribution scheme of [section 726](#) (and, by implication, the priorities of [section 507](#)) does not come into play until all valid liens on the property are satisfied. See *United States v. Speers*, 382 U.S. 266, 269 n. 3, 86 S.Ct. 411, 413 n. 3, 15 L.Ed.2d 314 (1965); *Goggin v. Division of Labor Law Enforcement*, 336 U.S. 118, 126–127, 69 S.Ct. 469, 474, 93 L.Ed. 543 (1949). If a lien is perfected and not otherwise invalidated by law, it must be satisfied out of the assets it encumbers before any proceeds of the assets are available to unsecured claimants, including those having priority (such as priority tax creditors). *In re Darnell*, 834 F.2d 1263, 1265 (6th Cir.1987). Citizens held a valid lien on all of the SPM assets; these were sold for \$5 million. The bankruptcy court allowed Citizens' secured claim in that amount. Clearly, then, absent the order, the entire \$5 million belonged to Citizens in satisfaction of its lien, leaving nothing for the estate to distribute to the other creditors, including the I.R.S. The bankruptcy court's order forced Citizens to transfer to the estate a portion of its own \$5 million notwithstanding

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

the court's recognition of Citizens' right to receive that sum in full.

Because Citizens' secured claim absorbed all of SPM's assets, there was nothing left for any other creditor in this case. Ordinarily, in such circumstances, the distributional priorities of [sections 726](#) and [507](#) would have been mooted. Appellees defend the outcome below on the ground that the Agreement improperly syphoned proceeds to the general, unsecured creditors "at the expense of priority creditors." However, it is hard to see how the priority creditors lost anything owed them given the fact there would have been nothing left for the priority creditors after the \$5 million was distributed to Citizens. The "syphoning" of the money to general, unsecured creditors came entirely from the \$5 million belonging to Citizens, to which no one else had any claim of right under the Bankruptcy Code.

Appellees point to the Agreement's sharing formula and ask how the parties could contemplate sharing over \$12 million when Citizens' claim was worth only \$9 million. The Agreement, it is said, could not contemplate dividing property that did not belong to the parties to the contract. But appellees' assertion is based on a misreading of the Agreement. The Agreement merely states that Citizens and the general, unsecured creditors will pool whatever *they received* from the bankruptcy estate (either in a reorganization or liquidation) and will then divide the pooled funds among themselves. Any sharing between Citizens and the general, unsecured creditors was to occur *after* distribution of the estate property, having no effect whatever on the bankruptcy distributions to other creditors.

This crucial fact remains true under any scenario. When the Agreement was signed in October 1989, the value of a reorganized or liquidated SPM was unknown. Assume a liquidation would have produced \$15 million after payment of the various administrative expenses. If that had happened, the first \$9 million would have gone to Citizens in satisfaction of its lien, and the rest of the money would have been distributed pursuant to [section 726](#) (assuming the case had already been converted to Chapter 7). Hence, the next \$800,000 or so would have been distributed to the I.R.S. and other priority creditors, and the remaining \$5.2 million would have gone to the general, unsecured creditors in virtual satisfaction of their \$5.5 million claim, leaving nothing for "insiders" and other subordinated creditors. By its terms, the sharing ***1313** formula in the Agreement is to take effect only after a proper distribution under the Code. Citizens and the Committee

would have pooled only their own bankruptcy dividends for a combined \$14.2 million and then split this sum according to the Agreement's formula. Distributions to the I.R.S. and all other creditors under [section 726](#) would be unaffected. Under any set of assumptions, then, the Agreement does not distribute property of the estate "at the expense of" priority creditors nor does it violate the distribution scheme of [section 726](#) or the priorities of [section 507](#).

[6] Appellees argue, in the alternative, that the Agreement conflicts with the spirit of the Code's distribution scheme, under which priority creditors always get paid in full before general, unsecured creditors receive anything. Appellees contend that Congress never wanted unsecured creditors—especially creditors represented by the official creditors' committee—to be able to "circumvent" this scheme by negotiating with secured creditors to increase the return received for their claims against the debtor. Appellees' theory, however, goes beyond anything appearing expressly or by implication in the Code. [Section 726](#) and the other Code provisions governing priorities of creditors apply only to distributions of property of the estate. The Code does not govern the rights of creditors to transfer or receive nonestate property. While the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors, *see King v. United States*, 379 U.S. 329, 85 S.Ct. 427, 13 L.Ed.2d 315 (1964), creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors. *Cf. In re Allegheny Int'l, Inc.*, 100 B.R. 241, 243 (Bankr.W.D.Pa.1988) (remarking that the Code "does not permit a debtor to pay its pre-petition debts to suppliers, at a discount or otherwise, before confirmation of the plan, but it appears to allow third parties to purchase the claims of those suppliers").

In this case, the proceeds of the sale of SPM's assets pursuant to [11 U.S.C. § 363](#) were property of the estate and thus the Code governed their use and distribution. However, once the court lifted the automatic stay and ordered those proceeds distributed to Citizens in proper satisfaction of its lien, that money became the property of Citizens, not of the estate. Appellees concede that the bankruptcy court has no authority to control how Citizens disposes of the proceeds once it receives them. There is nothing in the Code forbidding Citizens to have voluntarily paid part of these monies to some or all of the general, unsecured creditors after the bankruptcy proceedings finished.

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

Thus, appellees' argument reduces to contending that although a secured creditor is free to share its proceeds with nonpriority creditors after bankruptcy proceedings have concluded, it may not enter into a contract *during* bankruptcy in which it promises to do the same thing. Again, appellees' argument lacks statutory support for it confuses estate property and nonestate property. The parties' agreement to share the proceeds could be seen as a partial assignment by Citizens and the general, unsecured creditors of their rights to receive bankruptcy dividends.⁸ See David Gray Carlson, *A Theory of Contractual Debt Subordination and Lien Priority*, 38 Vand.L.Rev. 975, 996–1004 (1985). A right to receive payment is freely transferable and assignable in Massachusetts without the consent of the debtor and without affecting the debtor's obligation to pay the underlying debt. See Mass.Gen.L. ch. 106, § 9–318; *Graves Equipment, Inc. v. M. DeMatteo Constr. Co.*, 397 Mass. 110, 489 N.E.2d 1010, 1012 (1986) (“Section 9–318(1)(a) incorporates the common law rule that an assignee of contract rights stands in the shoes of the assignor...”). The Agreement did not affect estate property, i.e., the sale proceeds, but only concerned the contracting parties' *claims* against the estate, i.e., their rights to be paid by the estate. We find no support in the Code for *1314 banning this type of contractual assignment in all cases.

[7] [8] Appellees suggest the policy of the Code is that, regardless of the source of the payments, nonpriority creditors should never receive a return on their claims if priority creditors receive nothing. This theory of Code policy is directly contradicted by the fact that nonpriority creditors routinely receive payment from third parties for their claims without interference by the bankruptcy court. Unsecured creditors often sell their claims to third parties, e.g., for 30 cents on the dollar, in order to avoid the uncertainty and delay of bankruptcy proceedings. See Chaim J. Fortgang & Thomas Moers Mayer, *Trading Claims and Taking Control of Corporations in Chapter 11*, 12 Cardozo L.Rev. 1, 2–3 (1990). The Code does not speak to the validity of claim transfers, and the Bankruptcy Rules provide only procedures for the filing of notice required for a transferee to be recognized as the holder of the claim. See Bankr.Rule 3001(e)⁹; *In re Odd Lot Trading, Inc.* 115 B.R. 97, 100 (Bankr.N.D. Ohio 1990); Fortgang & Mayer, *Trading Claims*, at 19–25. The circumstances in which claims transfers are expressly said to be invalid are limited. For example, the purchasing of claims by an affiliate or insider of the debtor for the sole purpose of blocking the confirmation of competing plans may constitute “bad faith” for the purposes

of section 1126(e), 11 U.S.C. § 1126(e). See *In re Applegate Property, Ltd.*, 133 B.R. 827, 834–35 (Bankr.W.D.Tex.1991). An assigned claim may be limited if the assignment involves a breach of fiduciary duty or fraud and the breach of duty or fraud enables the assignee to acquire the claim for inadequate consideration. *In re Executive Office Centers, Inc.*, 96 B.R. 642, 649 (Bankr.E.D.La.1988). However, absent some effect on the administration of the estate or diminution of estate property, neither the Code nor the Rules prohibit or discourage creditors from receiving cash from nondebtors in exchange for their claims.

While the Agreement in this case might not be categorized as a “transfer” under Rule 3001(e),¹⁰ the financial outcomes produced *1315 by the Agreement and by outright claim transfers are analogous. If the general, unsecured creditors in this case had sold their claims to Citizens (or another third party) for cash, e.g., for ten cents on the dollar, after all was said and done the priority creditors would have received nothing and the general, unsecured creditors would have received approximately \$550,000 (10% of their \$5.5 million total claim). The bankruptcy court would have had no authority to prevent the general, unsecured creditors from transferring their claims. In comparison, under the Agreement's sharing arrangement the general, unsecured creditors would receive, under the parties' calculations, see note 7, approximately \$700,000 (about 12.5% of their claims) while priority creditors receive nothing. Given authority in the Bankruptcy Code and Rules to permit outright transfers resulting in general, unsecured creditors receiving some money for their claims, we see nothing to prohibit the same result if produced by a partial assignment or sharing of claims such as accomplished by the Agreement in this case.

Because Code provisions governing priorities and distribution of estate property gave the estate no right to share in proceeds from Citizens' secured claim, the bankruptcy court derived no right under those same provisions to order Citizens to pay a portion of its own claim proceeds to the estate.

B. No Fiduciary Duty to the Estate

Appellees argue that the bankruptcy court had the equitable power to order Citizens to pay to the estate the amount due to the Committee under the Agreement because, as the bankruptcy court ruled:

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

[T]he committee, although it certainly had authority to negotiate something for the benefit of the bankruptcy estate, that authority was just that, for the benefit of the entire bankruptcy estate, and the committee had no authority ... to negotiate something for the benefit of some sets of creditors of the bankruptcy estate.

Appellees do not contest the bankruptcy court's ruling that the Committee had the general power to enter contracts. The Code expressly authorizes a committee to "perform such other services as are in the interest of those represented." 11 U.S.C. § 1103(c)(5). Appellees also concede that the Committee's appointment pursuant to 11 U.S.C. § 1102(a) charged it only with representation of the general, unsecured creditors (not with representation of the I.R.S. or other priority creditors). Nevertheless, they contend, any agreement negotiated by the Committee should have been negotiated to benefit the estate as a whole and thus any contractual right to receive payment from Citizens rightfully belongs to the estate.

[9] We do not accept this contention, as it seems based on the erroneous assumption that the Official Unsecured Creditors' Committee is a fiduciary for the estate as a whole. While a creditors' committee and its members must act in accordance with the provisions of the Bankruptcy Code and with proper regard for the bankruptcy court, the committee is a fiduciary for those whom it represents, not for the debtor or the estate generally. *In re Microboard Processing, Inc.*, 95 B.R. 283, 285 (Bankr.D.Conn.1989); *In re Johns-Manville Corp.*, 60 B.R. 842, 853 (S.D.N.Y.), *rev'd on other grounds*, 801 F.2d 60 (2d Cir.1986). Thus the committee's fiduciary duty, as such, runs to the parties or class it represents. *Markey v. Orr*, No. G89-40886, 1990 WL 483808 at *4, 1990 U.S. Dist. LEXIS 3005 at *9-*10 (W.D.Mich.1990); *Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein P.C.*, 42 B.R. 960, 963 (E.D.Pa.1984); *Microboard*, 95 B.R. at 285; *Johns-Manville*, 60 B.R. at 853. It is charged with pursuing whatever lawful course best serves the interests of the class of creditors represented. *In re Seascope Cruises*, *1316 *Ltd.*, 131 B.R. 241, 243 (Bankr.S.D.Fla.1991).

In this case, the Committee reasonably determined that entering into the Agreement with Citizens was in the best

interests of the class it represented, *to wit*, the general, unsecured creditors. No general, unsecured creditor objected to the Committee's decision, *see In re Seascope Cruises*, 131 B.R. at 243-44, nor have appellees offered any evidence or reason for us to believe that the represented class would have been better off had the Committee not acted as it did. The contrary appears true. Although the Shaines and the Debtor may have preferred a less active committee, and one more sympathetic to them, an effective creditors' committee must sometimes be adversarial if it is to fulfill its role in a Chapter 11 case. *In re Seascope Cruises*, 131 B.R. at 243; *In re Daig Corp.*, 17 B.R. 41, 43 (Bankr.D.Minn.1981).

The creditors' committee is not merely a conduit through whom the debtor speaks to and negotiates with creditors generally. On the contrary, it is purposely intended to represent the necessarily different interests and concerns of the creditors it represents. It must necessarily be adversarial in a sense, though its relation with the debtor may be supportive and friendly. There is simply no other entity established by the Code to guard those interests. The committee as the sum of its members is not intended to be merely an arbiter but a partisan which will aid, assist, and monitor the debtor pursuant to its own self-interest.

In re Daig Corp., 17 B.R. at 43. We conclude, therefore, that the bankruptcy court erred as a matter of law insofar as it felt that the Committee was under a particular duty to negotiate the sharing provision of the Agreement for the benefit of the estate as a whole.

C. Balance of Power in Reorganization Proceedings

Appellees contend that the bankruptcy court's order equitably prevented Citizens and the Committee from forming an alliance which would destroy the "balance of power" allegedly created by the Code, especially sections 507 and 1129. The Agreement between Citizens and the Committee, appellees argue, frustrated SPM's attempts to reorganize and, if similar agreements are permitted in future cases,

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

could create “chaos” and “free for all” in reorganization proceedings.

[10] The first part of appellees' argument—that the Agreement actually prevented the Debtor in this case from successfully reorganizing—was not timely raised below and we do not, therefore, consider it. Issues not raised in the bankruptcy court are ordinarily not considered for the first time on appeal. *In re LaRoche*, 969 F.2d 1299, 1305 (1st Cir.1992); *In re Burgess*, 955 F.2d 134, 136 n. 2 (1st Cir.1992); *Liakas v. Creditors' Committee of Deja Vu, Inc.*, 780 F.2d 176, 179 (1st Cir.1986). This principle applies to cases where, as here, a party attempts to justify a bankruptcy court order with a theory not raised before or considered by the bankruptcy court. *In re Sun Runner Marine, Inc.*, 945 F.2d 1089, 1095 (9th Cir.1991). Though the Shaines knew of the Agreement's existence since December 1989, they never complained to the bankruptcy court about Citizens' and the Committee's joining of forces during the reorganization proceedings; they raised questions only about the distribution of Citizens' proceeds to nonpriority creditors. The bankruptcy court gave no indication in its findings and rulings that it was bothered by that aspect of the Agreement. Not until oral argument before the district court hearing on this appeal did the Shaines and the Trustee invoke the alleged negative effects on reorganization of the Citizens–Committee alliance.

It is true that, in the interest of justice, parties are sometimes permitted to offer unraised alternative rationales for affirming a judgment. *See, e.g., In re Killebrew*, 888 F.2d 1516, 1521 (5th Cir.1989). But appellees' contention here that the Agreement disrupted the Debtor's reorganization proceedings is essentially a factual issue requiring findings of fact not now contained in the record before us. The bankruptcy court, not the district court or court of appeals, is the only tribunal equipped to make evidentiary findings on relevant factual *1317 matters such as whether the parties acted in bad faith, whether the parties intended to frustrate attempts to reorganize the Debtor, and whether the parties' actions actually prevented the Debtor from successfully reorganizing. *See* Bankruptcy Rules 7052, 8013; *In re Sublett*, 895 F.2d at 1384. We are in no position to ascertain by ourselves whether the Agreement, in fact, interfered unjustifiably with the reorganization proceedings. *See In re Sun Runner Marine*, 945 F.2d at 1095 (“We do not know what legal standard the bankruptcy court would have applied, or whether the bankruptcy court would have found facts warranting [the parties' requested order], had that issue been presented to it.”)

We respond briefly to appellees' warning that if this agreement stands, creditors in the future will form alliances to defeat attempts to reorganize, extort higher payouts from debtors, and generally create chaos in Chapter 11. Our focus is necessarily on the particular agreement before us, to see whether it conflicts with the reorganization provisions of Chapter 11 and whether the record supports appellees' portrait of the dire effects of giving effect to such a contract. Insofar as we can see, the parties' promises made in the Agreement were well within their rights under the Bankruptcy Code: they agreed to move the bankruptcy court to replace the Debtor's current management, *see* 11 U.S.C. § 1104(a), (b), and to propose a plan of reorganization, *see* 11 U.S.C. § 1121(c). The record shows that, in addition to the joint motions contemplated by the Agreement, the parties moved for conversion of the case to Chapter 7. This action was allowed by 11 U.S.C. § 1112(b). We see no indication in the Agreement that Citizens and the Committee agreed to vote for or against any particular plans, a restriction which could raise charges of bad faith. *See* 11 U.S.C. § 1126(e); *Young v. Higbee Co.*, 324 U.S. 204, 210–11, 65 S.Ct. 594, 597–98, 89 L.Ed. 890 (1945). Appellees have not pointed to any other Code provision implicated by the parties' cooperative efforts. Looking at the ones mentioned, we cannot find support for appellees' assertion that this agreement conflicts with any policy in favor of reorganizations manifested by Chapter 11.

As for future cases, we note that the bankruptcy court always retains the power to monitor and control the tenor of reorganization proceedings. If the unsecured creditors' committee fails to be properly representative of the unsecured creditors, any party in interest can move to have the committee reconstituted. *See* 11 U.S.C. § 1102(a)(2); *In re Daig Corp.*, 17 B.R. at 42. If an entity's acceptance or rejection of a plan is not made in good faith, or was not solicited or procured in good faith, the court can disqualify that vote. *See* 11 U.S.C. § 1126(e). The good faith requirement bars creditors from casting their votes from ulterior motives, such as coercing a higher payment from the debtor's estate, pure malice, and advancing the interests of a competing business. *In re Federal Support Co.*, 859 F.2d 17, 19 (4th Cir.1988). The record contains no evidence that Citizens and the Committee harbored any such sinister designs.

Appellees assert that creditors should not do anything to alter the usual divergence of interests between secured and unsecured creditors. While secured creditors might generally prefer liquidation and unsecured creditors might generally support reorganization, the Code surely does not require

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

them to take such positions. No two creditors have identical interests, *see In re Microboard Processing, Inc.*, 95 B.R. at 285, and the Code implicitly recognizes that fact by providing a procedural framework for handling the various divergent interests of the parties to a bankruptcy. *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U.Chi.L.Rev. 775, 785–89 (1987); *see also* Elizabeth Warren & Jay Lawrence Westbrook, *The Law of Debtors and Creditors* 427–35 (2d ed. 1991). While unsecured creditors may sometimes share common objectives with the debtor and current management, they are not required to rubber stamp the proposals of the debtor nor to support the retention of current management. *See In re Federal Support Co.*, 859 F.2d at 19 (“It is well settled [] that good faith in casting a vote does not require of *1318 the creditor a selfless disinterest.”) The duty of the unsecured creditors' committee to pursue the best interests of the unsecured creditors requires different outcomes in different situations, and may entail entering contracts regarding reorganization plans, *see, e.g., In re Donlevy's Inc.*, 111 B.R. 1, 2 (Bankr.D.Mass.1990), recommending rejection of a debtor's plan of reorganization, or filing motions to convert a Chapter 11 case to Chapter 7, *see, e.g., In re Seascope Cruises, Ltd.*, 131 B.R. at 243. For the reasons discussed, we do not think that the bankruptcy court's order was justified as a means to enforce the rules or policies spelled out in Chapter 11.¹¹

D. Other Arguments

[11] We briefly dispose of the parties' other arguments. We reject appellees' argument that Citizens, by agreeing to share some of its bankruptcy proceeds with the Committee, “carved out” or “divested itself” of a portion of its lien and thus the court “simply used its equitable powers to determine who best was entitled to receive this carved out portion” of Citizens' claim. This argument is untenable because no appeal was taken from the bankruptcy court's express ruling that Citizens, pursuant to its \$5 million allowed secured claim, was entitled to receive the entire sale proceeds. Furthermore, under Massachusetts law a valid assignment of a debt does not divest the claim of its priority or alter the debtor's obligation to pay the debt; the assignee steps into the shoes of the assignor for the portion of the claim assigned.¹² *See* Mass.Gen.L. ch. 106, § 9–302(2); *Grise v. White*, 355 Mass. 698, 247 N.E.2d 385, 388 (1969).

Because the bankruptcy court's order compelling Citizens to pay the estate from the proceeds of its security interest was not authorized by [section 105\(a\)](#), we need not consider the

Committee's argument that section 510(a), 11 U.S.C. § 510(a), required the bankruptcy court to give effect to the Agreement as a subordination agreement.¹³ And because the Agreement did not conflict with federal bankruptcy policy, there is no need to resolve the parties' dispute as to when and to what extent courts may, under Massachusetts law, reform contracts which violate public policy.

III. CONCLUSION

For the reasons discussed above, we hold that the bankruptcy court erred as a matter of law in ordering Citizens to pay to the Trustee the amount due to the Committee under the Agreement. Accordingly, we reverse the judgment of the district court and vacate paragraph six of the bankruptcy court's Disbursement Order of January 8, 1991.

No question is raised in this appeal as to whether the Agreement is binding on Citizens and the Committee. Indeed, Citizens previously expressed, at hearings before the bankruptcy court and the district court, its complete willingness to abide by its obligation under the Agreement to pay the Committee the agreed share of the sale proceeds. At the hearing on January 3, 1991, counsel for Citizens requested the court to order the Chapter 7 Trustee to *1319 oversee the distribution of the proceeds to the general, unsecured creditors. Appellees Robert and Frances Shaine point out in their appellate brief that the mechanics of distributing these proceeds to the general, unsecured creditors were not made clear in the Agreement, nor did the bankruptcy court decide how the proceeds should be handled.

Consequently, having reversed the bankruptcy court's order, we remand to the bankruptcy court to determine whether to allow Citizens' motion to have the Trustee administer the distribution of the funds due to the general, unsecured creditors under the Agreement. Appellant has not pointed to any basis in the Code for authorizing, let alone requiring, the bankruptcy court or Trustee to administer a distribution of nonestate funds pursuant to a private agreement. However, because we lack a complete record and because the precise issue was not appealed, we leave it up to the bankruptcy court to decide, in the first instance, whether to order the Trustee (rather than Citizens) to administer the distribution, and to determine the allocation of any related administrative expenses. If the bankruptcy court determines that the Trustee should not oversee distribution, or if Citizens withdraws its motion for the Trustee to administer the funds, then

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

the bankruptcy court shall distribute the funds in escrow, including accrued interest, to Citizens subject to any proper administrative charges or other obligations.

ORDER OF COURT

The district court judgment is reversed, the bankruptcy court order is vacated in part, and the matter is remanded for further proceedings not inconsistent herewith. Costs to appellant.

The panel of judges that rendered the decision in this case having voted to deny the petition for rehearing and the suggestion for the holding of a rehearing en banc having been carefully considered by the judges of the Court in regular active service and a majority of said judges not having voted to order that the appeal be heard or reheard by the Court en banc,

ON PETITION FOR REHEARING

It is ordered that the petition for rehearing and the suggestion for rehearing en banc be denied.

Feb. 24, 1993.

Before BREYER, Chief Judge, [CAMPBELL](#), Senior Circuit Judge, [TORRUELLA](#), [SELYA](#), [CYR](#), [BOUDIN](#),** Circuit Judges, and BRODY,*** District Judge.

All Citations

984 F.2d 1305, 61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529, Bankr. L. Rep. P 75,090

Footnotes

- * Of the District of Maine, sitting by designation.
- 1 For simplicity, this opinion uses only the approximate value of the various claims against the Debtor. The exact amounts of these claims are not at issue in this appeal.
- 2 Other creditors not relevant to this appeal are various “insiders” and Heritage Bank for Savings, which held a valid first mortgage on real estate owned by SPM in Holyoke, Massachusetts.
- 3 When he first saw the Agreement, the bankruptcy judge indicated that he thought it might violate section 1129(d), which prohibits confirmation of a reorganization plan “if the principal purpose of the plan is the avoidance of taxes.” [11 U.S.C. § 1129\(d\)](#). Appellees long ago abandoned the tax-avoidance argument, probably because the Agreement is not a “plan” requiring confirmation within the meaning of [section 1129](#) and thus not subject to the requirements of [section 1129\(d\)](#).
- 4 Appellee Stern was not appointed as the Chapter 7 trustee until December 1990.
- 5 On its face, the motion by Citizens and the Committee does not request approval of the Agreement. However, during the motion hearing, counsel for Citizens requested the court to order the Chapter 7 trustee to oversee the distribution of proceeds to the general, unsecured creditors. The court treated this request as part of the motion and refused to grant it. We consider the mechanics of the proceeds distribution *infra* in Part III.
- 6 Citizens had previously agreed to the payment of counsel's fees and other administrative expenses from the sale proceeds; it had included paragraphs four and five in its proposed order attached to the joint motion.
- 7 The parties in their briefs assume that the amount owed to the Committee under the Agreement would be approximately \$700,000. However, the actual amount could be less due to payment of administrative fees and expenses prior to distribution of the proceeds. This is not a matter for us to resolve.
- 8 We do not decide exactly how to categorize the Agreement because that issue is not necessary to our decision. *See infra* note 13.
- 9 Bankruptcy Rule 3001(e)(2) sets out the procedures for transfers of claims other than for security after proof of the claim is filed:

If a claim other than one based on a publicly traded note, bond, or debenture has been transferred other than for security after the proof of claim has been filed, evidence of the transfer shall be filed by the transferee. The clerk shall immediately notify the alleged transferor by mail.... If the alleged transferor files a timely objection and the court finds, after notice and a hearing, that the claim has been transferred other than for security, it shall enter an order substituting the transferee for the transferor. If a timely objection is not filed by the alleged transferor, the transferee shall be substituted for the transferor.

In re SPM Mfg. Corp., 984 F.2d 1305 (1993)

61 USLW 2498, 28 Collier Bankr.Cas.2d 451, 23 Bankr.Ct.Dec. 1529...

Bankr.Rule 3001(e)(2).

Prior to 1991, some courts interpreted Rule 3001 as authorization for courts "to monitor the manner in which claims are transferred or assigned and thereby prevent, inter alia, the improper proliferation of claims, wrongdoing and inequitable conduct." *In re Ionosphere Clubs, Inc.*, 119 B.R. 440, 443 (Bankr.S.D.N.Y.1990). Rule 3001(e) was amended in 1991 to restrict the bankruptcy court's power to inspect the terms of such transfers. See *In re Odd Lot Trading, Inc.*, 115 B.R. 97, 100–01 (Bankr.N.D. Ohio 1990). Transfers are no longer required to be unconditional and assignees do not have to submit to the bankruptcy court the terms of the transfer for its approval. Consequently, under the amended rule, the bankruptcy court cannot disapprove the transfer because of its terms, e.g., inadequate consideration. The 1991 Advisory Committee Note explains that:

Subdivision (e) is amended to limit the court's role to the adjudication of disputes regarding the transfer of claims.... If a claim has been transferred other than for security after a proof of claim has been filed, the transferee is substituted for the transferor. In that event, the clerk should note the transfer without the need for court approval. If a timely objection is filed, the court's role is to determine whether a transfer has been made that is enforceable under nonbankruptcy law. This rule is not intended either to encourage or discourage postpetition transfers of claims....

Bankr.Rule 3001, Advisory Committee Notes, 1991 Amendment.

- 10 We do not decide whether the Agreement in this case constitutes a "transfer" of claim subject to the requirements of Rule 3001 because appellees did not raise this issue. Even if notice of the Agreement should have been but was not filed with the court, that failure would not authorize the bankruptcy court to void or alter the Agreement. Failure to file notice of a transfer under Rule 3001(e) only affects the standing of the transferee as a "creditor" and thus the duty of the trustee to make payment on the claim to the transferee. See Bankr.Rule 3001(e); *In re FRG, Inc.*, 124 B.R. 653, 656–57 (Bankr.E.D.Pa.1991); *In re Oxford Royal Mushroom Prods., Inc.*, 93 B.R. 390, 397 (Bankr.E.D.Pa.1988).
 - 11 Even, indeed, if an alliance of the type reflected in the Agreement were believed to contravene bankruptcy policies, the remedy—ordering Citizens to pay out to the estate funds it had agreed to pay to the Committee—would seem questionable. If the Agreement violated public policy, the more usual remedy would be to declare it invalid and unenforceable rather than to enforce it, out of Citizens' pocket, in favor of a nonparty to the Agreement.
 - 12 We assume, for the moment, that the Agreement could be characterized as a partial assignment of the parties' claims. As explained *infra* note 13, the issue of how to characterize the Agreement is not before us.
 - 13 How to categorize the Agreement is no simple question. It has attributes of both a partial assignment and a subordination agreement. See generally David Gray Carlson, *A Theory of Contractual Debt Subordination and Lien Priority*, 38 Vand.L.Rev. 975 (1985) (discussing the characteristics of and enforceability of various types of subordination and assignment agreements in bankruptcy). Even if it cannot be deemed a subordination agreement for purposes of enforcement pursuant to 11 U.S.C. § 510(a), the question on appeal is not whether the Agreement is valid and enforceable, but whether the bankruptcy court had authority under the Code to issue its order.
- ** Judge Norman Stahl has recused himself.
- *** Of the District of Maine, sitting by designation.

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

In re World Health Alternatives, Inc., 344 B.R. 291 (2006)

46 Bankr.Ct.Dec. 204



KeyCite Yellow Flag - Negative Treatment

Distinguished by In re OCA, Inc., Bankr.E.D.La., December 29, 2006

344 B.R. 291

United States Bankruptcy Court, D. Delaware.

In re WORLD HEALTH
ALTERNATIVES, INC., et al., Debtors.

No. 06–10166(PJW).

|
July 7, 2006.**Synopsis**

Background: Chapter 11 debtors moved for entry of order approving proposed settlement negotiated by debtors, unsecured creditors' committee and creditor.

Holdings: The Bankruptcy Court, Peter J. Walsh, J., held that:

[1] proposed settlement, whereby creditor, in exchange for release of estate's claims against it and for withdrawal of committee's objection to proposed sale, had agreed to cap its claim against estate and to provide \$1.625 million “carveout” for benefit of unsecured creditors or for investigation and pursuit of claims against parties other than creditor, did not implicate “absolute priority” rule, though settlement would permit distribution to unsecured creditors before priority tax claims had been paid in full; and

[2] settlement would be approved, as fair, reasonable, adequate and in interest of estate.

Motion granted.

West Headnotes (7)

[1] Bankruptcy **Compromises, Releases, and Stipulations**

Settlements are generally favored in bankruptcy, as serving to minimize litigation and to expedite administration of bankruptcy estate. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[1 Cases that cite this headnote](#)**[2] Bankruptcy** **Judicial authority or approval**

Decision whether to approve settlement is within the discretion of bankruptcy court. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[1 Cases that cite this headnote](#)**[3] Bankruptcy** **Judicial authority or approval**

In deciding whether to exercise its discretion to approve proposed settlement, bankruptcy court must assess and balance value of claim that is being compromised against value to estate of acceptance of compromise proposal. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[1 Cases that cite this headnote](#)**[4] Bankruptcy** **Judicial authority or approval**

Bankruptcy court must examine four factors in deciding whether to exercise its discretion to approve proposed settlement: (1) probability of success in litigation; (2) likely difficulties in collection; (3) complexity of litigation involved, and expense, inconvenience and delay necessarily attending it; and (4) paramount interest of creditors. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[6 Cases that cite this headnote](#)**[5] Bankruptcy** **Judicial authority or approval**

Bankruptcy court does not have to be convinced that proposed settlement is best possible compromise in order to approve it; rather, court need only conclude that settlement is within reasonable range of litigation possibilities. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[3 Cases that cite this headnote](#)

[6] **Bankruptcy**

🔑 **Preservation of priority**

Proposed settlement negotiated by debtors, unsecured creditors' committee, and creditor, whereby creditor, in return for release of estate's claims against it and for withdrawal of committee's objection to proposed sale, had agreed to cap its claim against estate and to provide \$1.625 million "carveout" for benefit of unsecured creditors or for investigation and pursuit of claims against parties other than creditor, did not implicate "absolute priority" rule, though settlement would permit distribution to unsecured creditors before priority tax claims had been paid in full; distribution would not be pursuant to terms of proposed plan of reorganization and would not involve money belonging to estate, but to creditor. [11 U.S.C.A. § 1129\(b\)\(2\)\(B\)](#).

[10 Cases that cite this headnote](#)

[7] **Bankruptcy**

🔑 **Judicial authority or approval**

Bankruptcy court would approve, as fair, reasonable, adequate and in interest of estate, proposed settlement negotiated by debtors, unsecured creditors' committee and creditor, whereby creditor, in exchange for release of estate's claims against it and for withdrawal of committee's objection to proposed sale, had agreed to cap its claim against estate and to provide \$1.625 million "carveout" for benefit of unsecured creditors or for investigation and pursuit of claims against parties other than creditor, where sufficient degree of uncertainty existed as to whether committee, or trustee, could prevail on any of potential causes of action against creditor, where expense, inconvenience and delay attendant to any litigation with creditor could be great, and where settlement provided source of funds, not only for unsecured creditors, but to pursue appropriate causes of action against others, which might produce recoveries distributable to all creditors. [Fed.Rules Bankr.Proc.Rule 9019, 11 U.S.C.A.](#)

[7 Cases that cite this headnote](#)

Attorneys and Law Firms

***292** [Stephen M. Miller](#), [Carl N. Kunz, III](#), [Rafael X. Zahralddin](#), Morris, James, Hitchens & Williams LLP, Wilmington, DE, [Sarah Robinson Borders](#), [Felton E. Parrish](#), [Seema N. Patel](#), King & Spalding LLP, Atlanta, GA, for Debtors.

Kelly Beaudin Stapleton, United States Trustee, [Joseph J. McMahon, Jr.](#), Trial Attorney, United States Department of Justice, Office of the U.S. Trustee, Wilmington, DE, [Pauline K. Morgan](#), [M. Blake Cleary](#), [Erin Edwards](#), Young Conaway Stargatt & Taylor, LLP, Wilmington, DE, Counsel to the Official Committee of Unsecured Creditors.

[Kenneth J. Ottaviano](#), Katten, Muchin, Rosenman LLP, Chicago, IL, Counsel for CapitalSource Finance, LLC.

MEMORANDUM OPINION

[PETER J. WALSH](#), Bankruptcy Judge.

This opinion is with respect to the Debtors' motion (Doc. # 310) for entry of an order approving a settlement agreement among the Official Committee of Unsecured Creditors (the "Committee"), the Debtors, and CapitalSource Finance, LLC. ("CapSource"). The United States Trustee ("UST") opposes the motion. For the ***293** reasons discussed below, the Court will grant the motion.

BACKGROUND

On February 20, 2006, the Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code, [11 U.S.C. §§ 101 et seq.](#) (the "Bankruptcy Code") (Doc. # 1). That day, the Debtors also filed a series of motions including (1) a motion to schedule an auction for the sale of substantially all of the Debtors' assets and approving of the bid procedures governing the proposed sale (Doc # 22), (2) a motion approving the sale of substantially all of the Debtors' assets (Doc. # 23) and (3) a motion granting the authority to incur post-petition secured and super-priority indebtedness (Doc. # 9). The proposed DIP financing lender

was CapSource, the pre-petition lender with a first lien on all of the Debtors' assets.

On March 6, 2006, the UST appointed the Committee pursuant to [Bankruptcy Code § 1102\(a\)\(1\)](#). On March 10, 2006, the Committee filed objections to the bid procedures and the DIP financing motion. Negotiations followed, and on March 17, 2006, the Court granted a final order authorizing the DIP financing motion and the proposed bid procedures.

The final DIP financing order (the “DIP Financing Order”) is rather conventional in its terms. With respect to the matter before me, two terms are of particular significance. First, the Debtors acknowledged and agreed “that the Pre-Petition Debt is (i) legal, valid, binding and enforceable against each Debtor; and (ii) not subject to any contest, objection, recoupment, defense, counterclaim, offset, claim of subordination, claim of re-characterization, claim of avoidance of any nature, attack or challenge under the Bankruptcy Code, other applicable non-bankruptcy law or otherwise.” (Doc. # 168, ¶ F). Paragraph 23(b) of the DIP Financing Order again recites that the Debtors have waived and shall be barred from any challenge to CapSource's claim (Doc. # 168, ¶ 23(b)). The Debtors' positions are binding on their successors and assigns, including any bankruptcy trustees. (Doc. # 168, ¶ 24). Second, Paragraph 23(b) contains the following proviso regarding the right of others to challenge CapSource's position:

Notwithstanding the foregoing, any party-in-interest (other than Debtors) with the requisite standing to do so, and the Committee shall be permitted to investigate ... and challenge, in accordance with the Bankruptcy Rules, the validity, enforceability, priority, perfection or amount of the Pre-Petition Debt or Pre-Petition Lender's liens on the Pre-Petition Lender Collateral in respect thereof, or otherwise asserting any claims or causes of action against Pre-Petition Lender or on behalf of Debtor's estates, which shall be filed no later than the earlier of (x) seventy-five (75) calendar days after the Petition Date, (y) two (2) calendar days prior to the

Auction or (z) two (2) business days prior to the Sale Hearing.

(Doc. # 168, ¶ 23(b)) (footnotes omitted). Pursuant to this provision, as of April 16, 2006 the time period for any challenges to CapSource's position expired as to all parties in interest other than the Committee and prior to that date, no such parties had filed any challenge. The Committee obtained from CapSource an extension of the time period to April 19, 2006 and, as described below, a further extension was agreed to.

Pursuant to the bid procedures order, an auction was scheduled for April 18, 2006. But no one other than the pre-petition stalking horse bidder submitted a bid—which bid was for a purchase price of \$43,000,000. A hearing on the Debtors' *294 motion to approve the sale to the stalking horse bidder was scheduled for April 20, 2006. The Committee reserved its right to object to the sale motion, and for several days prior to the April 20, 2006 hearing date, the Committee negotiated extensively with CapSource and the Debtors regarding the Committee's objection. As a result, on April 19, 2006, the Debtors, the Committee, and CapSource entered into a letter agreement (the “Letter Agreement”), which provided for a global settlement of disputes among the parties (Doc. # 310, ex. A).

At the sale hearing on April 20, 2006, counsel for the Committee advised the Court that, as a result of extensive negotiations, the parties had reached a settlement, whereby the Committee agreed to withdraw its objection to the sale motion. Counsel for the Committee represented to the Court that the withdrawal was made in consideration for certain concessions made by CapSource as set forth in the Letter Agreement. Committee counsel handed up to the Court a copy of the Letter Agreement, briefly outlined the terms of that agreement and advised that Court approval of the Letter Agreement would be sought at a later hearing. A Bankruptcy [Rule 9019](#) motion to approve the Letter Agreement was filed by the Debtors the next day and was served on all creditors. A hearing on the motion was scheduled for May 11, 2006. While that motion was pending, the Court, on April 25, 2006, entered an order approving the sale motion (Doc. # 315), and on April 28, 2006, the sale transaction closed. The hearing on the [Rule 9019](#) motion was held on May 11, 2006 and June 12, 2006.

The principal terms of the Letter Agreement are as follows (with some significant portions quoted verbatim):

(1) Committee objections: “The Committee has raised formal and informal objections with respect to (a) the Sale Motion, (b) the extent and validity of certain of the CapitalSource Liens, (c) the amount of certain of the CapitalSource Claims, and (d) has asserted possible Causes of Action against CapitalSource (collectively, the ‘Objections’).” (Doc. # 310, ex. A, p. 2).

(2) CapSource's claim cap: CapSource agreed to cap its secured claim at \$42,500,000 (an amount less than its asserted claim), and it waived any deficiency claim. (Doc. # 310, ex. A, ¶ 2).

(3) Committee right to challenge preserved: The challenge period in Paragraph 23 of the DIP Financing Order was stayed so that the Committee's right to challenge CapSource is preserved until the Court enters a final and nonappealable order approving the Letter Agreement, provided that if the Court denies approval of the Letter Agreement, then pursuant to Paragraph 23, the Committee has an additional five days to challenge CapSource's position. (Doc. # 310, ex. A, ¶ 3).

(4) Collateral Carve-Out (\$1,625,000):

Within two (2) business days after an order approving this Letter Agreement becomes final and non-appealable, CapitalSource shall grant and pay to and for the exclusive benefit of the Debtors' general unsecured creditors a collateral carveout from its lien in the amount of \$1,625,000.00 (the “Collateral Carve-Out”) to be (a) distributed to the holders of allowed general unsecured claims after payment of any unpaid professional fees and expenses of the Committee and/or (b) used to investigate and prosecute estate causes of action against parties other than CapitalSource. The Collateral Carve-Out shall be wired into an escrow account for counsel to the Committee. The Debtors and the Committee acknowledge and agree that the

Collateral Carve-Out will be available to be: (i) distributed to the holders of allowed *295 general unsecured claims after payment of any unpaid professional fees and expenses of the Committee and/or (ii) used to investigate and prosecute estate causes of action against parties other than CapitalSource.

(Doc. # 310, ex. A, ¶ 4).

(5) Objections withdrawn and release of claims: The Committee agreed not to pursue its Objections, agreed to support the sale motion, and agreed that “the Debtors and the Committee on behalf of themselves and the Debtors' estates ... shall be deemed to have released, acquitted and forever discharged CapitalSource ... from any and all claims and causes of action that the Debtors, the Committee, or the Debtors' estates may have or claim to have against” CapSource.¹ (Doc. # 310, ex. A, ¶ 5).

(6) Committee pursuit of causes of action: Upon final approval of the Letter Agreement, “the Committee is granted the right to pursue claims, causes of action and recoveries (a) under sections 502(d), 544, 547, 548, 549, 550, 551 or 553 of the Bankruptcy Code, or any other avoidance actions under 11 U.S.C. §§ 101–1330 et seq. (the ‘Avoidance Actions’); and (b) relating to (i) the D & O Claims, (ii) the Former Auditor Claims, and (iii) the Former Counsel Claims.” (Doc. # 310, ex. A, ¶ 6). The latter three defined terms refer to the Debtors' officers, directors and pre-petition professionals.² CapSource waived any right to pursue causes of action against these persons. (Doc. # 310, ex. A, ¶ 5).

The UST filed an objection to the settlement motion, arguing that a recent Third Circuit opinion, *In re Armstrong World Indus., Inc.*, 432 F.3d 507 (3d Cir.2005), prohibits this Court from approving a settlement that pays anything to the general unsecured creditors before priority tax creditors are paid. The Debtors' schedules list a number of tax creditors entitled to priority under Bankruptcy Code § 507. The amounts of these claims are listed as “unknown,” but there was testimony to the effect that the IRS asserts a tax claim in excess of \$4,000,000. None of these priority creditors, nor any other party in interest other than the UST, objects to the settlement.

After the Debtors filed their motion to approve the Letter Agreement, the UST filed a motion to appoint a chapter 11 trustee or, alternatively, to convert the cases to chapter 7. Subsequently, the Debtors filed a motion to convert the cases to chapter 7. At the June 12, 2006 hearing on the motion to approve the Letter Agreement, the Debtors, the Committee and the UST supported a conversion to chapter 7, with the Debtors and the Committee requesting a ruling on the Letter Agreement prior to a conversion. No party in interest opposes the conversion to chapter 7, and following this ruling on the Letter Agreement, a conversion order seems inevitable. Of course, upon conversion of the cases to chapter 7, the Committee will cease to exist. *Official Comm. of Unsecured Creditors v. Belgravia Paper Co. (In re Great Northern Paper, Inc.)*, 299 B.R. 1, 6–7 (D.Me.2003); see also *In re Parks Jagers Aerospace Co.*, 129 B.R. 265, 268 (M.D.Fla.1991); *In re Freedlander, Inc. The Mortgage People*, 103 B.R. 752, 758 (Bankr.E.D.Va.1989) (same).

DISCUSSION

[1] A bankruptcy court has the authority to “approve a compromise or settlement.” *296 FED. R. BANKR. P. 9019(a). Settlements are generally favored in bankruptcy. *Myers v. Martin (In re Martin)*, 91 F.3d 389, 393 (3d Cir.1996). They minimize litigation and expedite the administration of the estate. *Id.*

[2] [3] [4] Whether to approve a settlement, however, is within the discretion of the bankruptcy court. *In re Key3Media Group, Inc.*, 336 B.R. 87, 92 (Bankr.D.Del.2005). The court, when exercising this discretion, must “assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal.” *In re Martin*, 91 F.3d at 393. In striking this balance, the court must examine four factors:

- (1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors.

Id. (“taking [its] cue” from *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 88 S.Ct. 1157, 20 L.Ed.2d 1 (1968)).

[5] In the final analysis, “the court does not have to be convinced that the settlement is the best possible compromise.” *In re Coram Healthcare Corp.*, 315 B.R. 321, 330 (Bankr.D.Del.2004) (citing *Nellis v. Shugrue*, 165 B.R. 115, 123 (S.D.N.Y.1994)). Rather, the court must conclude that the settlement is “within the reasonable range of litigation possibilities.” *In re Penn Cent. Transp. Co.*, 596 F.2d 1102, 1114 (3d Cir.1979); see *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir.1983) (stating that the responsibility of the bankruptcy judge is “not to decide the numerous questions of law and fact raised” by the objections, “but rather to canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness.” (internal quotations and alteration omitted)).

[6] In this case, the settlement represents global peace among the Debtors, the Committee, and CapSource. As noted above, pursuant to the DIP Financing Order, the Committee and any other party in interest (but not the Debtors) could bring causes of action against CapSource during the specified period of time (Doc. # 168, ¶ 23). That period of time expired on April 16, 2006, two calendar days before the auction date (Doc. # 168, ¶ 23). Before the time period expired, the Committee sought and received an extension from CapSource (Doc. # 310, ex. A, p. 2). As a result, at the time the parties executed the Letter Agreement, only the Committee had preserved its right to bring any cause of action against CapSource.

As detailed above, the Letter Agreement effected the following: (1) the Committee, in conjunction with the Debtors, released the estate's causes of action against CapSource (Doc. # 310, ex. A, ¶ 5), and the Committee withdrew its Objections, (2) CapSource promised to limit its secured claim against the estate to \$42,500,000 and to waive its right to any deficiency claim (Doc. # 310, ex. A, ¶ 2), (3) CapSource agreed to pay a \$1,625,000 collateral carve out for the benefit of general unsecured creditors (Doc. # 310, ex. A, ¶ 4), (4) these funds can be either directly distributed to the general unsecured creditors and/or used to pursue causes of action against parties other than CapSource, including the Debtors' officers, directors, lawyers and accountants (Doc. # 310, ex. A, ¶ 4). To the extent the \$1,625,000 is used to pursue those causes of action and any of them are successful, the recoveries will be to the benefit of the estate since they are

estate causes of action *297 (Doc. # 310, ex. A, ¶ 4). On the other hand, to the extent the carve out funds are distributed to the general unsecured creditors, then the estate is not directly benefited.³

The UST objects to the settlement on two grounds. First, the UST argues that the settlement violates the law (Doc. # 340, p. 1 (citing *In re Armstrong World Indus., Inc.*, 432 F.3d 507)). Second, the UST argues that the settlement reflects a result that the Committee could not achieve had it successfully litigated the causes of action against CapSource (Doc. # 340, p. 2). This is really one objection, and the UST acknowledges as much in its papers: “[a]t bottom, the principle motivating the UST’s two objections is the same—the [Committee] is not authorized to borrow and/or compromise estate claims and causes of action at the expense of priority creditors in chapter 11.” (Doc. # 340, p. 2).

Although the general unsecured creditors will receive money before the priority creditors, that money does not belong to the estate—it belongs to CapSource. See *Official Comm. Of Unsecured Creditors v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305, 1313 (1st Cir.1993). In other words, the payout to the general unsecured creditors is a carve out of the secured creditor’s lien and not estate property. I believe the Bankruptcy Code does not prohibit this arrangement and reported cases so hold. *Id.* at 1313.

Despite this, the UST argues that the Third Circuit’s decision in *In re Armstrong World Indus., Inc.* prohibits such an agreement (Doc. 397, p. 2). I disagree. *Armstrong* distinguished, but did not disapprove of, a line of authority that approved this type of agreement. *Armstrong*, 432 F.3d at 514 (discussing *In re SPM*, 984 F.2d 1305, *In re MCorp Fin., Inc.*, 160 B.R. 941 (S.D.Tex.1993), and *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr.D.Del.2001)).

Armstrong also explained that the above line of authority did “not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive.” *Armstrong*, 432 F.3d at 514. Rather, “[c]reditors must also be guided by the statutory prohibitions of the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B).” *Id.* Section 1129(b)(2)(B) provides:

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

* * * * *

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115 subject to the requirements *298 of subsection (a)(14) of this section.

11 U.S.C. § 1129(b)(2)(B) (emphasis added). Section 1129(b)(2)(B) and the absolute priority rule, however, are not implicated here because the settlement does not arise in the context of a plan of reorganization. Indeed, the UST does not argue that *Armstrong* actually supplies the result to this case, but rather asserts that the ideas or general principles discussed in *Armstrong* suggest that such an agreement is improper (Doc. # 340, pp. 1, 6). The Court disagrees.

Armstrong dealt with a plan of reorganization, thus implicating the absolute priority rule of Bankruptcy Code § 1129(b)(2)(B). Under the plan at issue in *Armstrong*, “an unsecured creditor class would receive and automatically transfer warrants to the holder of equity interests in the event that its co-equal class rejects the reorganization plan.” *Armstrong*, 432 F.3d at 514. The Third Circuit concluded that the absolute priority rule applied and was violated by such a distribution scheme. *Id.*

In coming to that result, *Armstrong* expressly distinguished the *SPM*, *MCorp*, and *Genesis* cases. These cases allowed a senior creditor to agree to give up part of its collateral to another class, skipping other classes in between. *Id.* *Armstrong*’s grounds for distinguishing such cases are important. For example, *Armstrong* distinguished *SPM* on three grounds:

(1) *SPM* involved a distribution under Chapter 7, which did not trigger 11 U.S.C. § 1129(b)(2)(B)(ii); (2) the senior creditor had a perfected security interest, meaning that the property was

not subject to distribution under the Bankruptcy Code's priority scheme; and (3) the distribution was a "carve out," a situation where a party whose claim is secured by assets in the bankruptcy estate allows a portion of its lien proceeds to be paid to others.

Armstrong, 432 F.3d at 514. Each of these grounds is relevant to the matter here.

First, *SPM* involved a settlement agreement in a chapter 7 context, which did not trigger the absolute priority rule. *Id.* Like *SPM*, the instant dispute also arises in the context of a settlement agreement—not a plan. Further, this case is moving toward conversion and an order to that effect will be entered shortly. There are no prospects for a plan of reorganization here.

Second, *SPM* involved a secured creditor's perfected security interest. The Third Circuit recognized that this meant "that the property was not subject to distribution under the Bankruptcy Code's priority scheme." *Armstrong*, 432 F.3d at 514 (adopting the District Court's reasoning). This is the case here as well.

Third, *SPM*, unlike *Armstrong*, involved a "'carve out,' a situation where a party whose claim is secured by assets in the bankruptcy estate allows a portion of its lien proceeds to be paid to others." *Id.* This again is the exact situation here. Thus, the three grounds on which the Third Circuit distinguished *SPM* also distinguish the case here from *Armstrong*.⁴

Seemingly, even if the absolute priority rule applied, which it does not, an ordinary carve out such as here would not offend the rule. This follows from *Armstrong's* discussion of the *Genesis* and *MCorp* cases. Both cases involved plans of reorganization, *299 thereby implicating the absolute priority rule. *See id.* This also follows from the *Armstrong* District Court's reasoning, which the Third Circuit adopted.

The Third Circuit in *Armstrong* characterized the *Genesis* court as allowing a secured creditor to "(1) give up a portion of their proceeds under the reorganization plan to holders of unsecured and subordinated claims, without including holders of punitive damages claims in the arrangement, and (2) allocate part of their value under the plan to the debtor's officers and directors as an employment incentive package."

Id. *Armstrong* then distinguished this arrangement as an ordinary carve out of the senior creditors' liens for the junior claimants' benefit. *Id.* Such a carve out does not offend the absolute priority rule or the Bankruptcy Code's distribution scheme because the property belongs to the secured creditor—not the estate. *See id.* Likewise, the *Armstrong* District Court, whose reasoning the Third Circuit adopted, also acknowledged the propriety of an ordinary carve out and the correctness of *SPM*: "the secured lender in *SPM* had a substantive right to dispose of its property, including the right to share the proceeds subject to its lien with other classes." *In re Armstrong World Indus., Inc.*, 320 B.R. 523, 534 (D.Del.2005) aff'd 432 F.3d 507 (3d Cir.2005). Thus, *Armstrong* distinguished, but did not disapprove of, *SPM* and the *Genesis-MCorp* line of authority. That line of authority holds that agreements, like the one at issue here, are valid carve outs that allow the secured creditor to give up a portion of its lien for the benefit of junior creditors without violating the provisions of the Bankruptcy Code. *See In re SPM*, 984 F.2d at 1313; *In re MCorp*, 160 B.R. at 960; *In re Genesis*, 266 B.R. at 602.

The UST asserts that this Court should reach a different result than *SPM* and its progeny because *SPM* did not involve a party releasing claims on behalf of the estate (Doc. # 397, p. 15). The UST makes this argument on the basis of a copy of the settlement agreement in *SPM*, which she obtained from a party to the *SPM* case (Doc. # 397, p. 15). Pursuant to that settlement agreement, the secured bank lender and the creditors committee undertook joint efforts to maximize recovery, with the bank sharing a small portion of its recovery with the committee. I am not persuaded that this distinction is meaningful. Furthermore, the Court does not have before it the record made in the *SPM* case regarding that settlement, including any ancillary matters or events. That document alone presents an insufficient record upon which to weigh the UST's distinction.

The UST focuses on the Letter Agreement's release of causes of action against CapSource which, if pursued and succeeded in recoveries, those recoveries would be for the benefit of the estate and distributed first to priority creditors prior to any possible distribution to the general unsecured creditors. However, it is important to note that giving up estate causes of action against CapSource is not the only consideration that CapSource receives under the Letter Agreement. The Committee gave up *its* right to pursue its objection to the sale motion. This right belonged exclusively to the Committee. When this case was filed, it clearly was a liquidating case, and

indeed, the Debtors had already signed up a stalking horse bidder for the purchase of the going concern business. With respect to the concept of a quick sale, the facts surrounding the marketing effort and timing of the sale, the Committee vigorously opposed the Debtors and CapSource from the outset of its appointment. The only substantive objections to the auction *300 procedures motion and the sale motion were those raised by the Committee. The Letter Agreement allowed the sale motion to go forward, and of course, the sale closed at the end of April 2006. Obviously, if the Debtors lost the sale motion or if there were a serious delay to the approval of that motion, the value of CapSource's collateral could have been seriously jeopardized. Thus, the \$1,625,000 carve out payment is not only in exchange for the release of estate causes of action against CapSource, but for the removal of the only serious challenge (by the Committee) to the Debtors' and CapSource's joint goal at the outset of the case to effect a quick sale that would likely provide little, if any, benefit to any party other than CapSource.

As stated in its supplemental memorandum (Doc. # 402, p. 10), the Committee's challenges included the following:

The Committee challenged, among other things,⁷ the integrity of the sale process, the length and adequacy of the Debtors' marketing efforts, the actions and statements by insiders who stood to benefit from an ownership interest in the purchaser if the stalking horse bid was approved, the influence exerted by, and fees paid to, CapSource in the months leading up to the Petition Date, the calculation of CapSource's claim, and the propriety of permitting the sale proceeds to be paid to CapSource at closing.

In a footnote to that statement, the Committee comments as follows:

One arrow that the Committee did *not* have in its quiver was a credible threat to challenge the validity and perfection of CapSource's liens, since it could

discern no infirmity in those liens. *See* Tr. at 22:18–20. Thus, as in *SPM*, the lender had a first priority secured claim in the proceeds of its collateral.

I find the first of these two statements to reflect the record fairly in this case, and neither statement is seriously challenged by the UST. Thus, I conclude that the Committee's withdrawal of its objection to the sale motion constitutes substantial consideration given by the Committee, not on behalf of the estate or the Debtors, in exchange for the Collateral Carve-Out.⁵ Given the fact that this consideration running from the Committee to CapSource has already occurred and cannot be undone, to deny approval of the Letter Agreement at this time would give only CapSource the benefit of this part of the settlement. And, of course, non-approval would enable CapSource to keep the \$1,625,000.

Denial of approval of the Letter Agreement could have an additional negative impact on the estate. The estate has \$1,347,000 remaining from the sale proceeds, after administrative expenses have been paid or otherwise provided for (Doc. # 474). If the Letter Agreement is not approved, then CapSource could seek to recover the full amount of its secured claim against the sale proceeds. This, in turn, could reduce the \$1,347,000 remaining in the estate that may be used by the chapter 7 trustee to pursue estate causes of action against Debtors' officers, directors, *301 and professionals. On the record before me, it is not possible to quantify the difference between CapSource's capped claim (\$42,500,000) and a potential allowed claim. CapSource believes that it could assert an additional claim of \$1,850,196 with respect to the remaining sale proceeds (Doc. # 474). The Debtors contend that CapSource's claim against the Debtors has been fully satisfied by the amounts previously paid by the Debtors to CapSource (Doc. # 474). At this time, I can only conclude that, absent approval of the Letter Agreement, some or all of the \$1,347,000 remaining in the estate may be subject to CapSource's secured claim and thus not available to benefit unsecured creditors. I note that the April 25, 2006 sale order recites that at the closing the payment of the sale proceeds to CapSource would not exceed \$42,500,000, "with \$325,000 of any balance of the cash proceeds to be held in escrow pending Court approval of the Letter Agreement." (Doc. # 315, ¶ 12). This \$325,000 of escrowed funds is included in the \$1,347,000 of estate funds remaining from the proceeds of the sale (Doc. # 475). If the Letter Agreement is not approved,

I believe that, at a minimum, CapSource would arguably be entitled to that \$325,000.

As noted above, the thrust of the UST's objection is that the Committee is unfairly compromising estate causes of action at the expense of priority creditors. That position raises the question as to the value of those causes of action. During the course of its settlement negotiations with CapSource, the Committee drafted a complaint against CapSource that sets forth multiple counts. The UST makes much of this draft document in support of her assertion that recoveries on these claims should inure to the benefit of the entire estate, including priority creditors. However, the testimony put on the record at the May 11, 2006 hearing regarding the potential for success on those claims was not encouraging.

The only testimony on this issue came from Mr. Gavin, the Committee's financial advisor, and Mr. Jones, the Debtors' financial advisor (Doc. # 384, p. 9 ll.14–15, p. 26 ll.7–8). Both testified that the settlement was in the best interests of their clients. Their testimony is uncontradicted.

Mr. Gavin testified that the litigation would be very expensive, time consuming, and uncertain (Doc. # 384, p. 11 ll.1–8). With respect to at least some of the claims, Mr. Gavin appeared to question whether there were even any recoverable damages (Doc. # 384, p. 19 ll.9–14). As such, Mr. Gavin testified that “the Committee's guaranteed recovery and ability to pursue other actions on behalf of the estate in exchange for the Committee's cooperation and supporting the sale and the Committee's agreement not to sue CapitalSource was a fair compromise.” (Doc. # 384, p. 11 ll.9–14). In other words, “the letter agreement represent[ed] a fair, adequate, and reasonable settlement for the general unsecured creditors and the estate as a whole.” (Doc. # 384, p. 10 ll.8–11).

Mr. Jones agreed, explaining that “the debtor had undertaken its own review of possible causes of action against CapitalSource, and it determined that the likelihood of success on the merits of any such claims was very low.” (Doc. # 384, p. 26 ll.19–22). In addition, “any litigation against CapitalSource by the Committee would be time consuming, expensive.” (Doc. # 384, p. 27 ll.6–8). Further, “[i]t would not likely resolve in any significant recovery for the benefit of the estate.” (Doc. # 384, p. 27 ll.8–9). Thus, Mr. Jones concluded that “the interests of the estate are clearly best served by compromising the asserted claims on the basis set forth *302 in the letter agreement.” (Doc. # 384, p. 27 ll.21–23).

[7] The Court agrees with Mr. Gavin and Mr. Jones, this agreement represents the best result and is fair, reasonable, adequate, and in the interest of the estate. The four *Martin* factors so demonstrate.

Factor one favors settlement because there is a low probability of litigation success. A sufficient degree of uncertainty exists as to whether the Committee, or a chapter 7 trustee, could prevail on any of the potential causes of action against CapSource. Moreover, the Court finds that the probability of successfully challenging CapSource's liens is low. As the Committee states, “[o]ne arrow that the Committee did *not* have in its quiver was a credible threat to challenge the validity, and perfection of CapSource's liens, since it could discern no infirmity in those liens.” (Doc. # 402, p. 10 n. 7). The UST does not challenge this representation. Further, from the Court's experience, successful challenges to a pre-petition first lien creditor's position are unusual, if not rare. I attach little significance to the fact that the Committee counsel produced a draft multiple count complaint against CapSource. This may be viewed as litigation saber rattling.

Factor two is seemingly not relevant, and no party has addressed this point.

Factor three, however, weighs in favor of approving the proposed settlement. The expense, inconvenience, and delay attendant to any litigation with CapSource could be great. Substantial expenditure of money may not be warranted in light of the low probability of success and the estate's limited resources.

Furthermore, the record in this case indicates a number of serious irregularities in the Debtors' pre-petition conduct of its financial affairs. Counsel for the Committee observed that “this company has been the subject of pre-petition fraud and we do believe there are good causes of action against perhaps Debtor's directors and officers, prior auditors, [and] prior attorneys for the company” (Doc. # 349, pp. 13–14 ll.24–2). The Letter Agreement potentially provides funds to finance the pursuit of such causes of action (Doc. # 310, ex. A, ¶ 6). Equally important, the estate will have \$1,347,000 available to finance such causes of action by the chapter 7 trustee. Thus, the Court finds it is reasonable, when faced with limited funds, to forego expensive litigation against the pre-petition secured lender in favor of what appears to be more fruitful litigation against the Debtors' officers and directors and the professionals engaged by the Debtors.

Finally, factor four favors settlement. The estate is better off because the settlement guarantees a substantial fund (\$1,347,000) to pursue appropriate causes of action against others, which may produce recoveries distributable to all creditors.

At the June 12, 2006 hearing, I raised the question of whether the Committee had fiduciary obligations to the priority creditors. The parties submitted supplemental filings on this question.

The Committee states in its brief that “as priority creditors are not intended to be constituent members of a creditors’ committee because their pecuniary interests are fundamentally inimical to those of the general unsecured creditors, they are not a constituent group to whom the Committee owes a fiduciary duty.” (Doc. # 402, p. 5). The UST was more hesitant. She acknowledged that “[t]he case law uniformly indicates that the [Committee’s] fiduciary duties run to the constituency it represents, and a number of courts have defined that constituency as being general unsecured creditors.” (Doc. # 397, p. 9). *303 Still, the UST concluded that the scope of the Committee’s fiduciary duties was a collateral issue and should not affect the outcome in this dispute (Doc. # 397, p. 9).

As such, both parties acknowledge that a number of cases support the proposition that the official committee of unsecured creditors owes its fiduciary duty only to the general unsecured creditors (Doc. # 402, p. 8 (citing *In re SPM*, 984 F.2d at 1316; *Official Dalkon Shield Claimants’ Comm. v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 769, 771 (4th Cir.1989); *In re Int’l Swimming Pool Corp.*, 186 F.Supp. 63, 64 (S.D.N.Y.1960); *Creditors’ Comm. Of Trantex Corp. v. Baybank Valley Trust Co.* (*In re Trantex Corp.*), 10 B.R. 235, 238 (Bankr.D.Mass.1981))). Presumably, the cases that find that the creditors committee owes a fiduciary duty to the general unsecured creditors only are recognizing the implicit conflict of interest between general unsecured creditors and priority creditors.

The UST has posed several interesting questions that the Court need not presently decide:

If the [Committee] is holding part of the 1.625 million (the “Settlement Funds”) on the date of conversion, who will distribute the remaining monies?

Is a chapter 7 trustee authorized to distribute the Settlement Funds given that they are not property of the Debtors’ estates? Irrespective of the direction of the Debtors’ cases, there are a number of troubling questions presented by the Settlement. Presumably, to the extent that there are Settlement Funds remaining for distribution, the [Committee] intends to distribute such funds *pro rata* on account of allowed unsecured claims. To the extent that there is a dispute regarding use of the Settlement Funds, does this Court have jurisdiction to resolve the dispute? Does an unsecured creditor’s acceptance of Settlement Funds satisfy (in whole or in part) the liability of the Debtors’ estates to the creditor? What authority, if any, does the [Committee] have to establish rules governing use and distribution of the funds?

(Doc. # 340, p. 7 n. 3). Some of these questions are misdirected because the Letter Agreement does not say that the Committee determines the distribution or use of the \$1,625,000. Nor does Committee counsel have an active role—counsel will only be an escrow agent. The Letter Agreement does not say who will determine any cash distributions or use of the funds for litigation purposes. It only provides that the funds will be distributed to holders of allowed general unsecured claims and/or used to pursue causes of action against the Debtors’ officers, directors, and professionals. The Letter Agreement recognizes these as “estate causes of action” (Doc. # 310, ex. A, ¶ 4), so that any recoveries will be for the benefit of the estate. In any event, these questions lead to yet more questions. For example, what effect will conversion of this case to chapter 7 have on the Letter Agreement implementation going forward? Upon conversion, the Committee will no longer exist. The chapter 7 trustee will then have the right to pursue causes of action on behalf of the estate against the Debtors’ officers, directors, and professionals. As to one of the UST’s questions, I note that the parties to the Letter Agreement intend for this Court to have exclusive jurisdiction for its implementation (Doc. # 310, ex. A, ¶ 12).

CONCLUSION

For the reasons discussed above, the settlement is approved. I believe that the record as a whole in this matter suggests that, at the end of the day, only CapSource would be a winner if the Letter Agreement *304 is not approved. The Court acknowledges the UST raises valid logistical questions. Nevertheless, the Court finds that the settlement is in the best interest of the estate.

ORDER

For the reasons set forth in the Court's memorandum opinion of this date, the Debtors' motion (Doc. # 310) for entry of an order approving a settlement agreement among the Official Committee of Unsecured Creditors, the Debtors, and CapitalSource Finance, LLC is **GRANTED**.

All Citations

344 B.R. 291, 46 Bankr.Ct.Dec. 204

Footnotes

- 1 The Debtors' release is somewhat puzzling in light of the fact that pursuant to the DIP Financing Order the Debtors had already granted a release to CapSource.
- 2 In this regard, the Committee states that there is a \$5,000,000 D & O insurance policy. (Doc. # 402, p. 18)
- 3 Over the course of the last five years or so, I have seen a number of liquidating chapter 11 cases in this Court where the official committee of unsecured creditors entered into this type of carve out settlement with the first lien lender for the benefit of general unsecured creditors. Similar to the instant situation, those cases involved asset sales with little or no prospects for any recovery therefrom for general unsecured creditors.
- 4 Interestingly, the *SPM* case also involved an IRS priority tax claim issue, except that the objection to the settlement was filed by former officers of the debtor who were exposed to personal liability for whatever portion of the tax claim was not paid by the estate.
- 5 In its opposition brief, the UST points out that at the May 11, 2006 hearing I stated that I did not think that the Committee's objection to the sale motion would have been successful. That comment was made on the basis of my experience with liquidating chapter 11 cases, and the Committee had not, and has not, set forth before the Court the bases for its opposition or the evidence intended to be offered in support of the opposition absent the settlement. Nor am I aware of CapSource's assessment of the Committee's bases for opposition which prompted CapSource to settle the matter for a substantial carve out to the general unsecured creditors.

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434



KeyCite Yellow Flag - Negative Treatment

Declined to Follow by In re Lindsey, 6th Cir.(Tenn.), August 13, 2013

432 F.3d 507

United States Court of Appeals,
Third Circuit.

In re ARMSTRONG WORLD
INDUSTRIES, INC., Appellant.

No. 05-1881.

|
Argued Oct. 24, 2005.

|
Dec. 29, 2005.

Synopsis

Background: Objections were filed to confirmation of Chapter 11 debtor's proposed reorganization plan. The United States District Court for the District of Delaware, [Eduardo C. Robreno](#), United States District Judge for the Eastern District of Pennsylvania, sitting by designation, [320 B.R. 523](#), denied confirmation, and debtor appealed.

[Holding:] The Court of Appeals, [Anne E. Thompson](#), District Judge, sitting by designation, held that plan violated absolute priority rule.

Affirmed.

West Headnotes (10)

[1] Bankruptcy

🔑 Finality

In bankruptcy cases, finality, for purpose of taking appeal, is construed more broadly than for other types of civil cases. [28 U.S.C.A. § 1291](#).

[8 Cases that cite this headnote](#)

[2] Bankruptcy

🔑 Finality

Factors appellate court considers in determining whether district court's decision in a bankruptcy

case is final are as follows: (1) impact on assets of bankruptcy estate; (2) need for further fact-finding on remand; (3) preclusive effect of decision on merits; and (4) interests of judicial economy. [28 U.S.C.A. § 1291](#).

[12 Cases that cite this headnote](#)

[3] Bankruptcy

🔑 Finality

Order denying confirmation of proposed Chapter 11 plan, on ground it violated absolute priority rule, was sufficiently final to warrant appellate review; order would likely affect distribution of assets between different creditor classes, and issue on appeal raised discrete question of law that would have preclusive effect on certain provisions of plan. [11 U.S.C.A. § 1129\(b\)\(2\)](#); [28 U.S.C.A. § 1291](#).

[9 Cases that cite this headnote](#)

[4] Bankruptcy

🔑 Conclusions of law; de novo review

Whether proposed Chapter 11 reorganization plan violates absolute priority rule is question of law, reviewed de novo. [11 U.S.C.A. § 1129\(b\)\(2\)](#).

[9 Cases that cite this headnote](#)

[5] Statutes

🔑 Plain language; plain, ordinary, common, or literal meaning

Statutes

🔑 Relation to plain, literal, or clear meaning; ambiguity

If meaning of statute is plain, construing court will make no further inquiry unless literal application of the statute will end in result that conflicts with Congressional intentions, which are controlling.

[11 Cases that cite this headnote](#)

[6] Bankruptcy

🔑 Preservation of priority

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

Proposed Chapter 11 plan provision, issuing new stock warrants to unsecured senior class of creditors for automatic transfer to junior class of equity holders if co-equally senior impaired class rejected plan, violated absolute priority rule; rule could not be evaded through fiction that creditor was free to transfer its distribution, and value of warrants far exceeded value of any intercompany claims given up by equity holders. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

19 Cases that cite this headnote

[7] **Bankruptcy**

🔑 Equitable powers and principles

Bankruptcy

🔑 Preservation of priority

Equitable considerations did not warrant approval of proposed Chapter 11 plan that violated absolute priority rule by issuing new stock warrants to equity holders over objection of senior impaired class of creditors, even though numerical majority of senior class's members had accepted plan and warrant issuance would not negatively affect distribution to senior class. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

17 Cases that cite this headnote

[8] **Bankruptcy**

🔑 Preservation of priority

Estoppel

🔑 Claim inconsistent with previous claim or position in general

Senior class of unsecured creditors was not judicially estopped from raising absolute priority rule objection to proposed Chapter 11 plan, even though it had participated in plan negotiations, initially endorsed plan, and subsequently withdrawn its support of plan for unrelated reason. 11 U.S.C.A. § 1129(b)(2)(B)(ii).

9 Cases that cite this headnote

[9] **Estoppel**

🔑 Claim inconsistent with previous claim or position in general

“Judicial estoppel” can be applied when party asserts certain position in legal proceeding and prevails, only to assert contrary position later on because of changed interests; its purpose is to protect judicial process by preventing parties from deliberately changing positions according to exigencies of moment.

12 Cases that cite this headnote

[10] **Estoppel**

🔑 Claim inconsistent with previous claim or position in general

In deciding whether to apply judicial estoppel, court considers such factors as whether party's position is clearly inconsistent with its earlier position and whether party changing position would gain unfair advantage over opposing party.

11 Cases that cite this headnote

Attorneys and Law Firms

*508 Gregory S. Coleman (Argued), Weil, Gotshal & Manges LLP, Austin, TX, Stephen Karotkin, Debra A. Dandeneau, Weil, Gotshal & Manges LLP, New York, NY, Mark D. Collins, Rebecca L. Booth, Richards, Layton & Finger, P.A., Wilmington, DE, for Appellant Armstrong World Industries, Inc.

Mark E. Felger, Jeffrey R. Waxman, Cozen & O'Connor, Wilmington, DE, Stephen J. Shimshak (Argued), Andrew N. Rosenberg, Curtis J. Weidler, Paul, Weiss, Rifkind, Wharton & Garrison LLP, New York, NY, for Appellee Official Committee of Unsecured Creditors of Armstrong World Industries, Inc.

Marla R. Eskin, Campbell & Levine, LLC, Wilmington, DE, Elihu Inselbuch, Caplin & Drysdale, Chartered, New York, NY, Peter Van N. Lockwood, Nathan D. Finch, Caplin & Drysdale, Chartered, Washington, D.C., for Appellee Official Committee of Asbestos Claimants of Armstrong World Industries, Inc.

James L. Patton, Jr., Sharon M. Zieg, Edwin J. Harron, Young, Conaway, Stargatt & Taylor, LLP, Wilmington, DE, Michael J. Crames, Andrew A. Kress, Kaye Scholer, LLP, New York,

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

NY, for Appellee Dean M. Trafelet, Legal Representative for Future Asbestos Personal Injury Claimants of Armstrong World Industries, Inc.

Before [SLOVITER](#) and [FISHER](#), Circuit Judges, and THOMPSON, * District Judge.

OPINION OF THE COURT

ANNE E. THOMPSON, * District Judge.

This matter is before the Court on Armstrong Worldwide Industries, Inc.'s *509 ("AWI") appeal of the District Court's decision to deny confirmation of AWI's bankruptcy reorganization plan. In its decision, the District Court concluded that the plan could not be confirmed because the distribution of warrants to AWI's equity interest holders over the objection of the class of unsecured creditors violated the absolute priority rule, as codified in [11 U.S.C. § 1129\(b\)\(2\)\(B\)](#). AWI filed a timely appeal, contending that (1) the issuance of warrants does not violate the absolute priority rule, and (2) an equitable exception to the absolute priority rule applies. For the following reasons, we affirm the judgment of the District Court.

I.

FACTS AND PROCEDURAL HISTORY

AWI designs, manufactures, and sells flooring products, kitchen and bathroom cabinets, and ceiling systems. Due to asbestos litigation liabilities, AWI and two of its subsidiaries filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the District of Delaware on December 6, 2000. The United States Trustee for the District of Delaware appointed two committees to represent AWI's unsecured creditors: (1) the Official Committee of Asbestos Personal Injury Claimants ("APIC"), and (2) the Official Committee of Unsecured Creditors ("UCC"). The Bankruptcy Court appointed Dean M. Trafelet as the Future Claimants' Representative ("FCR").

After holding negotiations with APIC, UCC, and FCR, AWI filed its Fourth Amended Plan of Reorganization (the "Plan") and Amended Disclosure Statement with the Bankruptcy Court in May 2003. Under the Plan, AWI's creditors were divided into eleven classes, and AWI's equity interest holders

were placed into a twelfth class. Relevant to this appeal are Class 6, a class of unsecured creditors; Class 7, a class of present and future asbestos-related personal injury claimants; and Class 12, the class of equity interest holders who own AWI's common stock. (App. at 1146–47, 1151.) The only member of Class 12 is Armstrong Worldwide, Inc. ("AWWD"), the parent company of AWI, which is in turn wholly owned by Armstrong Holdings, Inc. ("Holdings"). Classes 6 and 7 hold equal priority, and have interests senior to those of Class 12. (App. at 0019.) All three are impaired classes because their claims or interests would be altered by the Plan. [11 U.S.C. § 1124](#).

The Plan provided that AWI would place approximately \$1.8 billion of its assets into a trust for Class 7 pursuant to [11 U.S.C. § 524\(g\)](#). (App. at 1147–49.) Class 7's members would be entitled to an initial payment percentage from the trust of 20% of their allowed claims. (App. at 1177.) Meanwhile, Class 6 would recover about 59.5% of its \$1.651 billion in claims. (App. at 1146–47.) The Plan would also issue new warrants to purchase AWI's new common stock, estimated to be worth \$35 to \$40 million, to AWWD or Holdings (Class 12). If Class 6 rejected the Plan, then the Plan provided that Class 7 would receive the warrants. (App. at 1149.) However, the Plan also provided that Class 7 would automatically waive receipt of the warrants, which would then be issued to AWWD or Holdings (Class 12).

The Bankruptcy Court set September 22, 2003 as the deadline for voting on the Plan and for the parties to object to the Plan's confirmation. Because the Plan would distribute property to AWI's equity interest holders without fully paying off the unsecured creditors' claims, all impaired unsecured creditor classes were required to approve the Plan under [11 U.S.C. § 1129\(a\)\(8\)](#). If any impaired class objected to the Plan, then the Plan could only be "crammed down" if it was "fair and *510 equitable" to the objecting class. *See* [11 U.S.C. § 1129\(b\)\(1\)](#).

UCC represented all of the classes of unsecured creditors, including Class 6, during the negotiations that led to the Plan. Although UCC initially approved of the Plan in May 2003, it later filed a conditional objection to the Plan's confirmation on September 22, 2003 based on (1) the greater potential distribution to creditors that would result if federal asbestos legislation was passed (namely, the FAIR Act), and (2) the possible applicability of the absolute priority rule, as codified in [11 U.S.C. § 1129\(b\)](#), if the Plan was not accepted by all classes.

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

As indicated in its conditional objection, UCC's reservations about the Plan were prompted in part by the proposal of the FAIR Act, which was reported out of the Senate Judiciary Committee in July 2003.¹ If passed, the FAIR Act would remove asbestos-related personal injury claims from the courts and absolve asbestos defendants of liability in return for mandatory contributions to a federally supervised trust. (App. at 0017–18.) AWI's contribution to the FAIR Act trust was estimated to range from \$520 to \$805 million, far less than the \$1.8 billion it would put in trust for the Class 7 asbestos claimants under the Plan. Thus, if the FAIR Act passed, approximately \$1 billion could be freed up for distribution among AWI's other creditors, including the class of unsecured creditors.

In response to UCC's concerns about the FAIR Act, the Bankruptcy Court extended the final deadline for voting to October 31, 2003. (App. at 0018.) To accept the Plan, class members holding at least fifty percent of the number of claims and two-thirds of the amount of the claims would need to vote for the Plan. *See* 11 U.S.C. § 1126(c). Although 88.03% of Class 6 claim holders voted for the Plan, only 23.21% of the amount of the claims voted to accept the Plan. (App. at 1456.) As a result, Class 6 rejected the Plan. Classes 7 and 12 accepted the Plan, but Class 12's acceptance was rescinded under the Plan due to Class 6's rejection. (App. at 0020.)

Following a hearing on November 17 and 18, 2003, the Bankruptcy Court recommended confirmation of the Plan to the District Court in its December 19, 2003 Proposed Findings and Conclusions. (App. at 1430.) The Bankruptcy Court found that the absolute priority rule, as codified in [section 1129\(b\)\(2\) of the Bankruptcy Code](#), was satisfied because the warrants were distributed to the holder of equity interests because of the waiver by Class 7, citing *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bkrcty. D.Del.2001), and *In re SPM Mfg. Corp.*, 984 F.2d 1305 (1st Cir.1993). In addition, the Bankruptcy Court found that UCC had waived its right to object to the Plan when it “entered into a consensual plan encompassing” the Plan provisions. (App. at 1502–03.) Because the Plan included a channeling injunction under [section 524\(g\) of the Bankruptcy Code](#), the District Court was required to affirm the Bankruptcy Court's Proposed Findings and Conclusions before the Plan could go into effect. (App. at 1468.)

UCC filed objections to the Bankruptcy Court's Proposed Findings and Conclusions with the United States District Court for the District of Delaware. The District Court held a

hearing on the objections on December 15, 2004 and issued a memorandum and order on February 23, 2005 denying *511 confirmation of the Plan. The District Court found that (1) the issuance of warrants to the equity interest holders violated the absolute priority rule, and (2) no equitable exception to the absolute priority rule applied. *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D.Del.2005).

AWI now appeals the District Court's decision, and is joined by Appellees APIC and FCR, who jointly submitted a brief adopting and supporting AWI's arguments.

II.

DISCUSSION

A. Jurisdiction

[1] [2] This Court has jurisdiction to hear appeals of “all *final* decisions of the district courts.” 28 U.S.C. § 1291 (emphasis added); *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992). In bankruptcy cases, finality is construed more broadly than for other types of civil cases. *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 470 (3d Cir.1998). Because bankruptcy proceedings are often protracted, and time and resources can be wasted if an appeal is delayed until after a final disposition, our policy has been to quickly resolve issues central to the progress of a bankruptcy. *See In re Owens Corning*, 419 F.3d 195, 203 (3d Cir.2005). We consider four factors to determine whether a district court's decision in a bankruptcy case is final: (1) the impact on the assets of the bankruptcy estate; (2) the need for further fact-finding on remand; (3) the preclusive effect of a decision on the merits; and (4) the interests of judicial economy. *See id.* (citing *Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. P'ship IV*, 229 F.3d 245, 250 (3d Cir.2000)).

[3] Although Appellee UCC contends that we cannot hear this appeal because it involves an interlocutory order rather than a final order, we find jurisdiction after considering the above four factors. First, the District Court's denial of confirmation will likely affect the distribution of assets between the different creditor classes. *See Buncher Co.*, 229 F.3d at 250. Second, the issue presented here requires no additional fact-finding. Third, this appeal would require us to address a discrete question of law that would have a preclusive effect on certain provisions of the Plan. Lastly, practical considerations in the interests of judicial economy

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

require that we hear this appeal now. Because we find jurisdiction under 28 U.S.C. § 1291, we will not address whether we also have jurisdiction under 28 U.S.C. § 158(d).

B. Standard of Review

[4] We review the District Court's decision using a de novo standard for conclusions of law, and a clearly erroneous standard for findings of fact. *In re PWS Holding Corp.*, 228 F.3d 224, 235 (3d Cir.2000). Whether a reorganization plan violates the absolute priority rule is a question of law. See *In re Johnston*, 21 F.3d 323, 328–29 (9th Cir.1994).

C. Confirmation of a Reorganization Plan

Confirmation of a proposed Chapter 11 reorganization plan is governed by 11 U.S.C. § 1129. A court will confirm a plan if it meets all of the requirements set out in section 1129(a). Only one of these requirements concerns us in this appeal, and that is the requirement that the plan be consensual, with unanimous acceptance by all of the impaired classes.² 11 U.S.C. § 1129(a)(8). If the plan is not consensual, *512 a court may still confirm as long as the plan meets the other requirements of section 1129(a), and “does not discriminate unfairly, and is fair and equitable” as to any dissenting impaired class. 11 U.S.C. § 1129(b)(1); see *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) [hereinafter *LaSalle*]. The latter type of confirmation is also called a “cram down,” as the court can cram a plan down over the objection of an impaired class. See generally Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr.L.J. 133 (1979).

1. The Absolute Priority Rule

The issues in this case require us to examine the “fair and equitable” requirement for a cram down, which invokes the absolute priority rule. The absolute priority rule is a judicial invention that predated the Bankruptcy Code. It arose from the concern that because a debtor proposed its own reorganization plan, the plan could be “too good a deal” for that debtor's owners. *LaSalle*, 526 U.S. at 444, 119 S.Ct. 1411. In its initial form, the absolute priority rule required that “creditors ... be paid before the stockholders could retain [equity interests] for any purpose whatever.” *Id.* (quoting *N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 508, 33 S.Ct. 554, 57 L.Ed. 931 (1913)) (emphasis added).

The absolute priority rule was later codified as part of the “fair and equitable” requirement of 11 U.S.C. § 1129(b). Under the statute, a plan is fair and equitable with respect to an impaired, dissenting class of unsecured claims if (1) it pays the class's claims in full, or if (2) it does not allow holders of any junior claims or interests to receive or retain any property under the plan “on account of” such claims or interests. 11 U.S.C. § 1129(b)(2)(B)(i)-(ii); *LaSalle*, 526 U.S. at 441–42, 119 S.Ct. 1411.

At the heart of this appeal is the Plan provision that distributes warrants to AWI's equity interest holders (Class 12) through Class 7 in the event that Class 6 rejects the Plan. Appellant AWI argues that this provision does not violate the absolute priority rule because (1) legislative history and historical context indicate that the rule does not prohibit the transfer of warrants to the equity interest holders under the current circumstances; (2) case law establishes that Class 7 can transfer part of its distribution under the Plan to another claimant; and (3) the Plan did not give the warrants to Class 12 “on account of” its equity interests. We address each of these contentions in turn.

a. Interpreting the Absolute Priority Rule

[5] First, AWI suggests that this Court should apply a flexible interpretation of the absolute priority rule based on its legislative history and historical context. Because the absolute priority rule is now codified as part of the Bankruptcy Code, we will interpret it using standard principles of statutory construction. We begin by looking at the plain language of the statute. See *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). If the meaning is plain, we will make no further inquiry unless the literal application of the statute will end in a result that conflicts with Congress's intentions. *Id.* at 242–43, 109 S.Ct. 1026. In such a case, the intentions of Congress will control. *Id.*

[6] AWI contends that application of the absolute priority rule would be contrary to Congress's intentions because the rule was designed to prevent the “ ‘squeezing out’ [of] intermediate unsecured creditors.” See *In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1314 (7th Cir.1995) (citing *N. Pac. Ry. Co.*, 228 U.S. 482, 33 S.Ct. 554, 57 L.Ed. 931) (emphasis added). AWI supports its claim with floor statements by Representative Don Edwards and Senator Dennis DeConcini, key legislators of the Bankruptcy Code. See *Begier v. I.R.S.*, 496 U.S. 53, 64 n. 5, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990) (considering these remarks

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

as “persuasive evidence of congressional intent”). These statements indicate that “a senior class will not be able to give up value to a junior class over the dissent of an *intervening class* unless the *intervening class* receives the full amount, as opposed to value, of its claims or interests.” 124 Cong. Rec. 32,408 & 34,007 (1978) (remarks of Rep. Edwards on Sept. 28, 1978 and remarks of Sen. DeConcini on Oct. 5, 1978, respectively) (emphasis added). AWI argues that this language demonstrates that the absolute priority rule was not meant to apply to the situation before us because Class 6 is not an intervening (or intermediate) class, and is not being squeezed out by Class 7’s transfer of warrants to Class 12 under the Plan.

The absolute priority rule, as codified, ensures that “the holder of any claim or interest that is junior to the claims of [an impaired dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property.” 11 U.S.C. § 1129(b)(2)(B)(ii). The plain language of the statute makes it clear that a plan cannot give property to junior claimants over the objection of a more senior class that is impaired, but does not indicate that the objecting class must be an intervening class.

We find that the plain meaning of the statute does not conflict with Congress’s intent. The legislative history shows that section 1129(b) was at least designed to address “give-up” situations where a senior class gave property to a class junior to the dissenting class. Other statements in the legislative history of section 1129(b), however, appear to apply the statute more broadly. For example, the House Report for H.R. 8200, the bill that was eventually enacted, states that section 1129(b) “codifies the absolute priority rule from the dissenting class on down.” H.R.Rep. No. 95–595, at 413 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6369. Despite amendments to the original version of H.R. 8200, the House Report has been considered an authoritative source of legislative history for section 1129(b). See 124 Cong. Rec. 32,408 & 34,007 (1978) (remarks of Rep. Edwards on Sept. 28, 1978 and remarks of Sen. DeConcini on Oct. 5, 1978, respectively) (“[T]he House report remains an accurate description of confirmation of section 1129(b).”). In addition, the floor statements of Representative Edwards and Senator DeConcini do not rule out the possibility that an impaired class may object to a co-equal class’s distribution of property to a junior class. See *id.* (“As long as senior creditors have not been paid more than in full, and classes of equal claims are being treated so that the dissenting class of impaired unsecured claims is not being discriminated against unfairly,

the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) as long as no class junior to the dissenting class receives anything at all.”). As a result, we will apply the plain meaning of the statute. Under this reading, the statute would be violated because the Plan would give property to Class 12, which has claims junior to those of Class 6. This finding does not end our consideration of this appeal, as AWI makes further arguments regarding exceptions to the absolute priority rule.

b. Transfers of Bankruptcy Distributions Between Creditors and Equity Interest Holders

Second, AWI contends that Class 7 may distribute the property it will receive under *514 the Plan to Class 12 without violating the absolute priority rule. AWI derives this result from application of the so-called “*MCorp–Genesis*” rule, which is based on a line of cases where creditors were allowed to distribute their proceeds from the bankruptcy estate to other claimants without offending section 1129(b). See *SPM*, 984 F.2d 1305 (permitting senior secured creditors to share bankruptcy proceeds with junior unsecured creditors while skipping over priority tax creditors in a Chapter 7 liquidation); *Genesis Health*, 266 B.R. at 602, 617–18 (allowing senior secured lenders to (1) give up a portion of their proceeds under the reorganization plan to holders of unsecured and subordinated claims, without including holders of punitive damages claims in the arrangement, and (2) allocate part of their value under the plan to the debtor’s officers and directors as an employment incentive package); *In re MCorp Fin., Inc.*, 160 B.R. 941, 948 (S.D.Tex.1993) (permitting senior unsecured bondholders to allocate part of their claim to fund a settlement with the FDIC over the objection of the junior subordinated bondholders).

The District Court rejected this argument, and found that the *MCorp–Genesis* line of cases was distinguishable. It began its analysis with *SPM*, a First Circuit opinion cited by both the *MCorp* and *Genesis Health* courts to support the legality of the distribution schemes presented to them. *SPM*, 984 F.2d 1305. The District Court differentiated *SPM* from the current case in three ways: (1) *SPM* involved a distribution under Chapter 7, which did not trigger 11 U.S.C. § 1129(b)(2)(B)(ii); (2) the senior creditor had a perfected security interest, meaning that the property was not subject to distribution under the Bankruptcy Code’s priority scheme; and (3) the distribution was a “carve out,” a situation where a party whose claim is secured by assets in the bankruptcy estate allows a portion of its lien proceeds to be paid to others. *Armstrong*, 320 B.R. at 539; see generally Richard B. Levin, *Almost*

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

All You Ever Wanted to Know About Carve Out, 76 Am. Bankr.L.J. 445 (2002). Similarly, *Genesis Health* involved property subject to the senior creditors' liens that was "carved out" for the junior claimants. *Armstrong*, 320 B.R. at 539. In addition, the District Court found *MCorp* distinguishable on its facts because the senior unsecured creditor transferred funds to the FDIC to settle pre-petition litigation. *Id.*

We adopt the District Court's reading of these cases, and agree that they do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the absolute priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B). Under the plan at issue here, an unsecured creditor class would receive and automatically transfer warrants to the holder of equity interests in the event that its co-equal class rejects the reorganization plan. We conclude that the absolute priority rule applies and is violated by this distribution scheme.

In addition, the structure of the Plan makes plain that the transfer between Class 7 and Class 12 was devised to ensure that Class 12 received the warrants, with or without Class 6's consent. The distribution of the warrants was only made to Class 7 if Class 6 rejected the Plan. In turn, Class 7 automatically waived the warrants in favor of Class 12, without any means for dissenting members of Class 7 to protest. Allowing this particular type of transfer would encourage parties to impermissibly sidestep the carefully crafted strictures of the Bankruptcy Code, and would undermine Congress's intention to give unsecured creditors bargaining power *515 in this context. See H.R.Rep. No. 95-595, at 416, reprinted in 1978 U.S.C.C.A.N. 5963, 6372 ("[Section 1129(b)(2)(B)(ii)] gives intermediate creditors a great deal of leverage in negotiating with senior or secured creditors who wish to have a plan that gives value to equity.").

c. On Account of

Third, AWI argues that the warrants would not be distributed to Class 12 on account of their equity interests, but rather would be given as consideration for settlement of their intercompany claims. UCC disputes the existence of any such settlement, alleging that such an arrangement should have been brought to the attention of the Bankruptcy Court. In response, AWI indicates that the settlement was detailed in the Plan's Disclosure Statement, which the Bankruptcy Court approved on June 2, 2003. (Appellee's Br. 4.) The relevant portion of the Disclosure Statement reads as follows:

In the ordinary course of business, such intercompany claims have been recorded on the books and records of Holdings, AWWD and AWI, and, assuming that all such intercompany claims are valid, the *net intercompany claim so recorded is in favor of Holdings in the approximate amount of \$12 million*. In consideration of, among other things, AWI's agreement under the Plan to fund the reasonable fees and expenses associated with the Holdings Plan of Liquidation, the treatment of Holdings, AWWD, and their respective officers and directors as PI Protected Parties under the Asbestos PI Permanent Channeling Injunction, the simultaneous release by AWI of any claims (known and unknown) AWI has against Holdings and AWWD, and the *issuance of the New Warrants to AWWD*, and to avoid potentially protracted and complicated proceedings to determine the exact amounts, nature and status under the Plan of all such claims and to facilitate the expeditious consummation of the Plan and the completion of Holdings' winding up, Holdings and AWWD will, effective upon and subject to the occurrence of the Effective Date, release all such intercompany claims (known and unknown) against AWI or any of AWI's subsidiaries[.]

(App. at 1138) (emphasis added).

As stated earlier, section 1129(b)(2)(B)(ii) provides that holders of junior claims or interests "will not receive or retain [any property] under the plan *on account of* such junior claim or interest." 11 U.S.C. § 1129(b)(2)(B)(ii) (emphasis added). In *LaSalle*, the Supreme Court interpreted "on account of" to mean "because of," or a "causal relationship between holding the prior claim or interest and receiving and retaining property." 526 U.S. at 450-51, 119 S.Ct. 1411. Although the Supreme Court did not decide what degree of causation would

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

be necessary, its discussion on that topic revealed that the absolute priority rule, as codified, was not in fact absolute. First, it indicated that the “on account of” language would be redundant if [section 1129\(b\)](#) was read as a categorical prohibition against transfers to prior equity. *Id.* at 452–53, 119 S.Ct. 1411. Second, it noted that a “less absolute prohibition” stemming from the “on account of language” would “reconcile the two recognized policies underlying Chapter 11, of preserving going concerns and maximizing property available to satisfy creditors.” *Id.* at 453–54, 119 S.Ct. 1411.

In keeping with these observations, we noted in *PWS* that the “on account of” language “confirms that there are some cases in which property can transfer to junior interests not ‘on account of’ those interests but for other reasons.” 228 F.3d at 238 (discussing *LaSalle*, 526 U.S. at 451–52, 119 S.Ct. 1411). In *PWS*, the *516 debtors released their legal claims against various parties to facilitate their reorganization, including an avoidance claim that would have allowed them to avoid certain aspects of a previous recapitalization. *Id.* at 232–35. The appellants in *PWS* argued that releasing the avoidance claim resulted in a prohibited transfer of value to equity interest holders who had participated in the recapitalization. We held that “without direct evidence of causation, releasing potential claims against junior equity does not violate the absolute priority rule in the particular circumstance [where] the claims are of only marginal viability and could be costly for the reorganized entity to pursue.” *Id.* at 242.

AWI would analogize AWWD and Holdings's release of intercompany claims in exchange for warrants to the release of claims in *PWS*.³ We disagree. According to the Disclosure Statement, the warrants have an estimated value of \$35 to \$40 million. (App. at 1157.) In contrast, the intercompany claims were valued at approximately \$12 million. This settlement would amount to a substantial benefit for Class 12, especially as the warrants were only part of the consideration for which the intercompany claims were released. Among other things, the intercompany claims were also ostensibly released in exchange for the simultaneous release of any claims by AWI against AWWD or Holdings and facilitation of the reorganization process. (App. at 1138.) AWI gives no adequate explanation for this difference in value, leading us to conclude that AWWD or Holdings (Class 12) would receive the warrants on account of their status as equity interest holders. See *LaSalle*, 526 U.S. at 456, 119 S.Ct. 1411.

D. Equity

1. Applicability of *Penn Central*

[7] Appellant AWI further contends that this Court should apply equitable considerations to allow an exception to the absolute priority rule. It finds such an exception in the case of *In re Penn Central Transportation Co.*, 596 F.2d 1127, 1142 (3d Cir.1979), and points to language in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988), that indicates that exceptions to the absolute priority rule may indeed exist. See *id.* at 206, 108 S.Ct. 963 (stating that the enactment of [section 1129\(b\)](#) “bar[s] any expansion of any exception to the absolute priority rule beyond that recognized” in pre-1978 Bankruptcy Code cases).

Penn Central involved a “monumental [reorganization] plan designed to resolve what [at the time was] the most complex set of interrelated and conflicting claims ever addressed under ... the Bankruptcy Act.” 596 F.2d at 1129. *Penn Central* Transportation Company, which was formed in 1968 by the merger of the Pennsylvania Railroad Company and the New York Central Railroad Company, filed a petition for reorganization under the Bankruptcy Code in 1970. *Id.* at 1133. Thereafter, to prevent a rail transportation crisis and to address the particular difficulties of that reorganization, Congress passed the Regional Rail Reorganization Act of 1973, which directed that major portions of *Penn Central*'s rail assets be conveyed to Conrail, a new company formed under the Act to continue operation of some of the routes served by *Penn Central*. *Id.* at 1134. In light of these exceptional circumstances, we found that “[o]ur construction and application of precedents *517 such as the absolute priority rule must necessarily take account of the unique facts of this Plan and proceed in an environment pervaded more by relativity than by absolutes.” *Id.* at 1142.

AWI argues that the facts of the case before us are similarly unique, and also warrant a more equitable and flexible application of the absolute priority rule. (Appellant's Br. 36.) Among the facts that AWI finds unique are: (1) the involvement of UCC in the negotiation and drafting of the Plan; (2) UCC's endorsement of the Plan, as indicated by its signature on the cover letter accompanying the disclosure statement; (3) the lack of a negative effect on Class 6's distribution from the granting of warrants to Class 7; (4) the relatively small value of the warrants compared to the entire bankruptcy estate; (5) the acceptance of the Plan by the majority in number of UCC's constituents; and (6) the

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

delay caused by UCC's objection, which was primarily lodged in anticipation of the passage of the FAIR Act. We do not find these facts to be as compelling as those that led us to apply a more flexible absolute priority rule in the past. AWI's bankruptcy due to asbestos liabilities simply does not involve the kind of exigent circumstances present in *Penn Central*, where Congress intervened in the reorganization process to avoid a rail transportation crisis of national import.

In addition, our application of equitable considerations in *Penn Central* did not mean that the absolute priority rule was abandoned. Rather, we held firm to the idea that the rule still "required ... that provision be made for satisfaction of senior claims prior to satisfaction of junior claims." *Id.* at 1153.

2. Judicial Estoppel

[8] AWI also argues that UCC waived its right to object to the Plan because of its conduct during the reorganization process, specifically referring to UCC's role in shaping the Plan, its initial endorsement of the Plan, and then its subsequent objections to the Plan based on the possible passage of the FAIR Act. The Bankruptcy Court agreed with this argument and found that UCC waived its right to object to the Plan because its behavior was "too sharp even for a bankruptcy case." (App. at 1503–04.) The District Court took a different view, noting that

[e]ven if the Unsecured Creditors changed their minds based on political calculus that the FAIR Act would be passed, this was their prerogative. In the absence of bad faith, which was not alleged here, and particularly in light of the changed circumstances, until a party consents and the consent is final, that party may walk away from the table for a good or bad reason or no reason at all.

Armstrong, 320 B.R. at 534 n. 24 (citing *In re Huckabee Auto. Co.*, 33 B.R. 141, 149 (Bankr.M.D.Ga.1981)).

[9] [10] We agree with the District Court, but recast the issue of waiver as an issue of judicial estoppel. Judicial estoppel can be applied when a party asserts a certain position in a legal proceeding and prevails, only to assert a contrary

position later on because of changed interests. See *New Hampshire v. Maine*, 532 U.S. 742, 749–51, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001). Its purpose is to protect the judicial process by preventing parties from "deliberately changing positions according to the exigencies of the moment." *Id.* at 750, 121 S.Ct. 1808 (quoting *United States v. McCaskey*, 9 F.3d 368, 378 (5th Cir.1993)). In deciding whether to apply judicial estoppel, a court considers various factors, including whether the party's position is clearly inconsistent with its earlier position and whether the party changing position would gain an unfair advantage over *518 the opposing party. *Id.* at 750–51, 121 S.Ct. 1808.

UCC clearly changed its position when it lodged a conditional objection to the Plan after it had endorsed the disclosure statement and recommended acceptance of the Plan to its constituents. The confirmation process, however, entitled UCC to lodge an objection against the Plan before the objection deadline. See 11 U.S.C. § 1129(a)(8). We recognize that an objection based on speculation that legislation will be passed can be cause for concern. See *EEOC v. Bethlehem Steel Corp.*, 727 F.Supp. 952, 955 & n. 1 (E.D.Pa.1990) (commenting on the problems that stem from delaying judgment because of pending legislation). UCC's objection, however, was not based solely on the impact of the pending FAIR Act, but was also based on a violation of section 1129(b).

Furthermore, UCC's change in position could not be entirely prejudicial to AWI because the Plan and its disclosure statement were conditioned on the approval of all impaired classes. In fact, Class 6, one of UCC's constituents, did not accept the Plan. While the voting outcome of Class 6 raises the troubling possibility that a small number of hold-outs owning a large percentage of claims were causing costly delay in the reorganization process, this is contemplated by the Bankruptcy Code, which requires at least a majority vote for the number of claims and a supermajority vote for the amount of claims for a class to accept a plan. See 11 U.S.C. § 1126(c). In consideration of these factors, we will not apply judicial estoppel to silence UCC's objection merely because it was an active participant in the reorganization process.

III.

CONCLUSION

In re Armstrong World Industries, Inc., 432 F.3d 507 (2005)

55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

We recognize that the longer that the reorganization process takes, the less likely that the purposes of Chapter 11 (preserving the business as a going concern and maximizing the amount that can be paid to creditors) will be fulfilled. Nevertheless, we conclude that the absolute priority rule applies in this case. We will accordingly affirm the District Court's decision to deny confirmation of AWI's Plan.

All Citations

432 F.3d 507, 55 Collier Bankr.Cas.2d 789, 45 Bankr.Ct.Dec. 222, Bankr. L. Rep. P 80,434

Footnotes

- * Honorable [Anne E. Thompson](#), United States District Judge for the District of New Jersey, sitting by designation.
- 1 See generally Patrick M. Hanlon, *Asbestos Legislation: The FAIR Act Two Years On*, 1 Pratt's J. Bankr.L. 207 (2005). As it happened, the FAIR Act did not pass, but similar bills have been reintroduced in subsequent sessions of Congress. (Appellant's Br. 15; App. at 1243.)
- 2 A class is impaired if its legal, equitable, or contractual rights are altered under the reorganization plan. [11 U.S.C. § 1124](#).
- 3 Because AWI does not assert any argument regarding a new value exception to the absolute priority rule, we do not address that issue.

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933



KeyCite Yellow Flag - Negative Treatment

Declined to Extend by In re MCO Wash, Inc., Bankr.E.D.N.Y., August 2, 2016

634 F.3d 79

United States Court of Appeals,
Second Circuit.In re DBSD NORTH AMERICA,
Incorporated, Debtor.DISH Network Corporation, Creditor–Appellant,
v.

DBSD North America,

Incorporated, Debtor–Appellee,

Ad Hoc Committee of Senior Noteholders,

Official Committee of Unsecured

Creditors, Creditors–Appellees.

Sprint Nextel Corporation, Appellant,

v.

DBSD North America, Inc., Ad Hoc

Committee of Senior Noteholders, Official

Committee of Unsecured Creditors, Appellees.

Docket Nos. 10–1175, 10–1201, 10–1352.

Argued: Aug. 5, 2010.

Decided: Dec. 6, 2010.

Opinion filed: Feb. 7, 2011.

Synopsis

Background: Debtors in jointly administered Chapter 11 cases sought confirmation of proposed reorganization plan. Debtors' competitor, which had purchased first-lien debt postpetition, and unsecured creditor objected. The United States Bankruptcy Court for the Southern District of New York, [Robert E. Gerber, J.](#), 419 B.R. 179, designated the vote of competitor as “not in good faith,” rejected the objections, and entered order confirming plan. Unsecured creditor and competitor appealed. The District Court, [Lewis A. Kaplan, J.](#), 2010 WL 1223109, affirmed, and appeal was taken.

Holdings: The Court of Appeals, [Gerard E. Lynch](#), Circuit Judge, held that:

[1] unsecured creditor had standing to appeal;

[2] the plan violated the absolute priority rule;

[3] addressing an issue of apparent first impression for the court, the bankruptcy court did not err in designating the vote of competitor;

[4] after designating the vote, the bankruptcy court properly disregarded competitor's class for voting purposes; and

[5] the bankruptcy court did not clearly err in finding the reorganization feasible.

Affirmed in part, reversed in part, and remanded.

[Pooler](#), Circuit Judge, filed opinion concurring in part and dissenting in part.

See also 627 F.3d 496.

West Headnotes (39)

[1] **Bankruptcy**

Preservation of priority

“Absolute priority rule” provides that a reorganization plan may not give “property” to the holders of any junior claims or interests “on account of” those claims or interests, unless all classes of senior claims either receive the full value of their claims or give their consent. 11 U.S.C.A. § 1129(b)(2)(B).

10 Cases that cite this headnote

[2] **Bankruptcy**

Parties

Bankruptcy Code prescribes no limits on standing beyond those implicit in Article III of the United States Constitution. U.S.C.A. Const. Art. 3, § 1 et seq.

4 Cases that cite this headnote

[3] **Bankruptcy**

☞ Right of review and persons entitled; parties; waiver or estoppel

In order to have standing to appeal from a bankruptcy court ruling, an appellant generally must be a “person aggrieved,” that is, a person directly and adversely affected pecuniarily by the challenged order of the bankruptcy court. U.S.C.A. Const. Art. 3, § 1 et seq.

28 Cases that cite this headnote

[4] Bankruptcy

☞ Right of review and persons entitled; parties; waiver or estoppel

To appeal from a bankruptcy court ruling, an appellant must show not only “injury in fact” under Article III, but also that the injury is direct and financial. U.S.C.A. Const. Art. 3, § 1 et seq.

17 Cases that cite this headnote

[5] Bankruptcy

☞ Right of review and persons entitled; parties; waiver or estoppel

Court of Appeals generally grants standing to creditors appealing orders of the bankruptcy court disposing of property of the estate because such orders directly affect the creditors' ability to receive payment of their claims.

5 Cases that cite this headnote

[6] Bankruptcy

☞ Impairment of Claims or Interests

Bankruptcy Code treats a claim as impaired unless the Chapter 11 plan leaves in place all rights to which the claim entitles its holder, except for certain rights to accelerate payments after default. 11 U.S.C.A. § 1124.

2 Cases that cite this headnote

[7] Bankruptcy

☞ Right of review and persons entitled; parties; waiver or estoppel

Unsecured creditor had standing to appeal confirmation of Chapter 11 plan; confirmation

of plan affected unsecured creditor “directly” and “financially,” in that before confirmation, unsecured creditor had a claim that the bankruptcy court valued at \$2 million for voting purposes, while after confirmation, unsecured creditor stood to receive property worth less than half of that amount, specifically, between four percent and 46 percent of that amount, unsecured creditor also suffered “direct” and “financial” injury by plan's provision of “gift” to debtors' existing shareholder before paying unsecured creditor the full value of its claim, in alleged violation of the absolute priority rule, fact that bankruptcy court's valuation of debtors put unsecured creditor's claim “under water” or “out of the money” was not sufficient reason to withhold standing, and merits or ultimate worth of unsecured creditor's claim had no impact on its standing to appeal. 11 U.S.C.A. § 1129(b)(2)(B); Fed.Rules Bankr.Proc.Rule 3018(a), 11 U.S.C.A.

4 Cases that cite this headnote

[8] Bankruptcy

☞ Right of review and persons entitled; parties; waiver or estoppel

Standing to appeal in no way depends on the merits of the issue appealed, and certainly cannot depend on the merits of an issue that is not before the appellate court at all.

Cases that cite this headnote

[9] Bankruptcy

☞ Preservation of priority

Chapter 11 plan violated the absolute priority rule by giving shares and warrants to a junior class, namely, debtors' existing shareholder, “in exchange for” or “because of” its prior, junior interest, even though a more senior class, namely, unsecured creditor's class, neither approved the plan nor received the full value of its claims; notwithstanding the various economic reasons that may have contributed to the decision to award property to old equity, including the desire to ensure existing shareholder's continued cooperation and assistance in the reorganization, it was clear that existing shareholder could not

have gained its new position but for its prior equity position, and, under the plain text of the Bankruptcy Code, secured creditors were not entitled to “gift” the shares and warrants to existing shareholder as they saw fit. 11 U.S.C.A. § 1129(b)(2)(B).

1 Cases that cite this headnote

[10] **Bankruptcy**

🔑 Scope of review in general

Bankruptcy

🔑 Conclusions of law; de novo review

In reviewing orders of the bankruptcy court, the Court of Appeals looks through the district court to the bankruptcy court's decision, and reviews its analysis of law de novo.

9 Cases that cite this headnote

[11] **Bankruptcy**

🔑 Preservation of priority

Pursuant to the Bankruptcy Code's absolute priority rule, absent the consent of all impaired classes of unsecured claimants, a confirmable plan must ensure either (1) that the dissenting class receives the full value of its claim, or (2) that no classes junior to that class receive any property under the plan on account of their junior claims or interests. 11 U.S.C.A. § 1129(b)(2)(B).

10 Cases that cite this headnote

[12] **Bankruptcy**

🔑 Preservation of priority

Term “property,” as used in the section of the Bankruptcy Code setting forth the absolute priority rule, is meant to be interpreted broadly. 11 U.S.C.A. § 1129(b)(2)(B).

Cases that cite this headnote

[13] **Bankruptcy**

🔑 Preservation of priority

Not all distributions of property to a junior class are necessarily “on account of” the junior claims or interests, for purposes of the Bankruptcy

Code's absolute priority rule; for example, old equity might take under a Chapter 11 plan if it invests new value in the reorganized entity, provided its contribution is adequate. 11 U.S.C.A. § 1129(b)(2)(B).

9 Cases that cite this headnote

[14] **Bankruptcy**

🔑 Preservation of priority

For purposes of the Bankruptcy Code's absolute priority rule, a transfer partly on account of factors other than the prior junior interest is still partly “on account of” that interest. 11 U.S.C.A. § 1129(b)(2)(B).

Cases that cite this headnote

[15] **Bankruptcy**

🔑 Distribution

Distribution scheme of Chapter 7 of the Bankruptcy Code does not come into play until all valid liens on the property are satisfied. 11 U.S.C.A. § 726(a).

Cases that cite this headnote

[16] **Bankruptcy**

🔑 Eligibility to vote; impairment

To confirm a plan of reorganization, Chapter 11 generally requires a vote of all holders of claims or interests impaired by that plan. 11 U.S.C.A. §§ 1126, 1129(a)(8).

2 Cases that cite this headnote

[17] **Bankruptcy**

🔑 Acceptance

One exception to the voting requirement of all holders of claims or interests impaired by a Chapter 11 plan allows a bankruptcy court to “designate,” that is, in effect, to disregard, the votes of any entity whose acceptance or rejection of such plan was not in good faith. 11 U.S.C.A. § 1126(e).

2 Cases that cite this headnote

[18] Bankruptcy Acceptance

Bankruptcy Code provides no guidance about what constitutes a bad faith vote to accept or reject a proposed Chapter 11 plan; rather, the Code's "good faith" test effectively delegates to the courts the task of deciding when a party steps over the boundary, for purposes of designating that party's vote. 11 U.S.C.A. § 1126(e).

[3 Cases that cite this headnote](#)

[19] Bankruptcy Acceptance

Under the section of the Bankruptcy Code authorizing the court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, bankruptcy courts should employ "designation" sparingly, as the exception, not the rule. 11 U.S.C.A. § 1126(e).

[2 Cases that cite this headnote](#)

[20] Bankruptcy Determination

Party seeking to "designate" another's vote bears the burden of proving that it was not cast in good faith. 11 U.S.C.A. § 1126(e).

[5 Cases that cite this headnote](#)

[21] Bankruptcy Acceptance

Merely purchasing claims in bankruptcy for the purpose of securing the approval or rejection of a plan does not, of itself, amount to "bad faith," within the meaning of the section of the Bankruptcy Code authorizing court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed. 11 U.S.C.A. § 1126(e).

[3 Cases that cite this headnote](#)

[22] Bankruptcy Acceptance**Bankruptcy** Determination

Selfishness alone will not defeat a creditor's good faith, for purposes of the section of the Bankruptcy Code authorizing court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed; the Code assumes that parties will act in their own self interest and allows them to do so. 11 U.S.C.A. § 1126(e).

[Cases that cite this headnote](#)

[23] Bankruptcy Acceptance

Section of the Bankruptcy Code authorizing court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, comes into play when voters venture beyond mere self-interested promotion of their claims. 11 U.S.C.A. § 1126(e).

[Cases that cite this headnote](#)

[24] Bankruptcy Acceptance

Section of the Bankruptcy Code authorizing court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, was intended to apply to those who were not attempting to protect their own proper interests, but who were, instead, attempting to obtain some benefit to which they were not entitled. 11 U.S.C.A. § 1126(e).

[2 Cases that cite this headnote](#)

[25] Bankruptcy Acceptance

Under the section of the Bankruptcy Code authorizing court to "designate" particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, a bankruptcy court may designate the vote of a party who votes in the hope

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets, or one who votes with an “ulterior motive,” that is, with an interest other than an interest as a creditor. 11 U.S.C.A. § 1126(e).

5 Cases that cite this headnote

[26] **Bankruptcy**

🔑 Conclusions of law; de novo review

Question of what sort of “ulterior motives” may trigger a bankruptcy court’s designation of a vote on a Chapter 11 plan was a question of law that the Court of Appeals would review de novo. 11 U.S.C.A. § 1126(e).

1 Cases that cite this headnote

[27] **Bankruptcy**

🔑 Particular cases and issues

Whether particular entity voted with an impermissible motive, for purposes of the section of the Bankruptcy Code authorizing court to “designate” particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, was a question of fact that the Court of Appeals would review for clear error. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[28] **Bankruptcy**

🔑 Acceptance

Not just any ulterior motive constitutes the sort of improper motive that will support a finding of bad faith under the section of the Bankruptcy Code authorizing court to “designate” particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed. 11 U.S.C.A. § 1126(e).

2 Cases that cite this headnote

[29] **Bankruptcy**

🔑 Acceptance

Bankruptcy court did not err in designating the vote of entity which, as Chapter 11 debtors’

indirect competitor and part-owner of a direct competitor, bought a blocking position in, and in fact the entirety of, a class of claims, after a plan had been proposed, with the intention not to maximize its return on the debt, but to enter a strategic transaction with debtor-telecommunications companies in order to acquire debtors’ spectrum rights. 11 U.S.C.A. § 1126(e).

1 Cases that cite this headnote

[30] **Bankruptcy**

🔑 Acceptance

Although buying claims at or above par cannot provide the sole basis for designating a creditor’s vote under the section of the Bankruptcy Code authorizing court to “designate” particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, a willingness to pay high prices may tend to show that the purchaser is interested in more than the claim for its own sake. 11 U.S.C.A. § 1126(e).

Cases that cite this headnote

[31] **Bankruptcy**

🔑 Acceptance

Bankruptcy

🔑 Determination

Bankruptcy court’s finding that entity acted in bad faith, for purposes of the section of the Bankruptcy Code authorizing court to “designate” particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, was supported by entity’s admission that it bought the first lien debt not just to acquire a “market piece of paper” but also to “be in a position to take advantage of [its claim] if things didn’t go well in a restructuring,” as well as by evidence that entity was a competitor of debtors, that entity was willing to overpay for the claims it bought, that entity attempted to propose its own plan, and that entity’s internal communications showed a desire “to obtain a blocking position” and “control the

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

bankruptcy process for this potentially strategic asset.” 11 U.S.C.A. § 1126(e).

3 Cases that cite this headnote

[32] **Bankruptcy**

🔑 Acceptance

Bankruptcy

🔑 Particular cases and issues

Whether a vote has been properly designated is a fact-intensive question that must be based on the totality of the circumstances, according considerable deference to the expertise of bankruptcy judges. 11 U.S.C.A. § 1126(e).

2 Cases that cite this headnote

[33] **Bankruptcy**

🔑 Fairness and Equity; “Cram Down.”

Each impaired class must vote in favor of a Chapter 11 plan for the bankruptcy court to confirm it without resorting to the Bankruptcy Code's more arduous cram-down standards. 11 U.S.C.A. § 1129(a)(8), (b).

Cases that cite this headnote

[34] **Bankruptcy**

🔑 Acceptance

After designating entity's vote, under the section of the Bankruptcy Code authorizing court to “designate” particular entity as not having voted on proposed Chapter 11 plan in good faith, such that its vote will be disallowed, the bankruptcy court properly disregarded entity's class for voting purposes where, because of the designation, the court was faced with a class that effectively contained zero claims. 11 U.S.C.A. §§ 1126(c, e), 1129(a)(8).

Cases that cite this headnote

[35] **Bankruptcy**

🔑 Feasibility in general

To confirm a plan under Chapter 11, a bankruptcy court must find that the plan is feasible. 11 U.S.C.A. § 1129(a)(11).

9 Cases that cite this headnote

[36] **Bankruptcy**

🔑 Particular cases and issues

Court of Appeals reviews a bankruptcy court's finding of plan feasibility only for clear error. 11 U.S.C.A. § 1129(a)(11).

5 Cases that cite this headnote

[37] **Bankruptcy**

🔑 Feasibility in general

Bankruptcy

🔑 Confirmation; Objections

Bankruptcy court did not clearly err in finding the reorganization of Chapter 11 debtor-telecommunications companies feasible; plan dramatically deleveraged debtors, it was likely that debtors would be able to obtain needed capital, as they already had received commitments for a credit facility to provide working capital for the first two years and there was a very reasonable possibility that after that time debtors would be able to secure either more financing or a strategic investor, there was little risk of default on debtors' secured obligations and still less risk that any such default would lead to liquidation or financial reorganization, and general credit markets had improved. 11 U.S.C.A. § 1129(a)(11).

Cases that cite this headnote

[38] **Bankruptcy**

🔑 Feasibility in general

For a Chapter 11 plan to be “feasible,” it must offer a reasonable assurance of success, but it need not guarantee success; some possibility of liquidation or further reorganization is acceptable and often unavoidable. 11 U.S.C.A. § 1129(a)(11).

3 Cases that cite this headnote

[39] **Bankruptcy**

🔑 Feasibility in general

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

Small or even moderate chance of failure does not mean that a Chapter 11 plan is “likely” to be followed by the liquidation, or the need for further financial reorganization, of the debtor, for feasibility purposes. 11 U.S.C.A. § 1129(a)(11).

1 Cases that cite this headnote

Attorneys and Law Firms

*84 Lawrence Byrne (Martin N. Flics, Paul S. Hessler, on the brief), Linklaters LLP, New York, NY, for Creditor–Appellant DISH Network Corporation.

John H. Culver III (Felton E. Parrish, on the brief), K & L Gates LLP, Charlotte, North Carolina, Eric T. Moser, on the brief, K & L Gates LLP, New York, NY, for Creditor–Appellant Sprint Nextel Corporation.

Yosef J. Riemer (James H.M. Sprayregen, Lee Ann Stevenson, on the brief), Kirkland & Ellis LLP, New York, NY, Marc J. Carmel, Lauren M. Hawkins, on the brief, Kirkland & Ellis LLP, Chicago, IL, for Debtor–Appellee DBSD North America, Incorporated.

Theresa A. Foudy (Steven J. Reisman, Maryann Gallagher, on the brief), Curtis, Mallet–Prevost, Colt & Mosle LLP, for Creditor–Appellee, Official Committee of Unsecured Creditors.

Dennis F. Dunne (Risa M. Rosenberg, on the brief), Milbank, Tweed, Hadley & *85 McCloy LLP, New York, NY, Andrew M. LeBlanc, on the brief, Milbank, Tweed, Hadley & McCloy LLP, Washington, DC, for Creditor–Appellee Ad Hoc Committee of Senior Noteholders.

Evan M. Jones, O'Melveny & Myers LLP, Los Angeles, CA, Jennifer M. Taylor, on the brief, O'Melveny & Myers LLP, San Francisco, CA, Elliot Ganz, on the brief, Loan Syndications and Trading Association, New York, NY, for Amicus Curiae Loan Syndications and Trading Association.

Before: POOLER, RAGGI, and LYNCH, Circuit Judges.

Opinion

Judge POOLER concurs in part and dissents in part in a separate opinion.

GERARDE E. LYNCH, Circuit Judge:

These consolidated appeals arise out of the bankruptcy of DBSD North America, Incorporated and its various subsidiaries (together, “DBSD”). The bankruptcy court confirmed a plan of reorganization for DBSD over the objections of the two appellants here, Sprint Nextel Corporation (“Sprint”) and DISH Network Corporation (“DISH”).

Before us, Sprint argues that the plan improperly gave shares and warrants to DBSD's owner—whose interest lies below Sprint's in priority—in violation of the absolute priority rule of 11 U.S.C. § 1129(b)(2)(B). DISH, meanwhile, argues that the bankruptcy court erred when it found DISH did not vote “in good faith” under 11 U.S.C. § 1126(e) and when, because of the § 1126(e) ruling, it disregarded DISH's class for the purposes of counting votes under 11 U.S.C. § 1129(a)(8). DISH also argues that the bankruptcy court should not have confirmed the plan because the plan was not feasible. See 11 U.S.C. § 1129(a)(11).

On Sprint's appeal, we conclude (1) that Sprint has standing to appeal and (2) that the plan violated the absolute priority rule. On DISH's appeal we find no error, and conclude (1) that the bankruptcy court did not err in designating DISH's vote, (2) that, after designating DISH's vote, the bankruptcy court properly disregarded DISH's class for voting purposes, and (3) that the bankruptcy court did not err in finding the reorganization feasible. We therefore affirm in part, reverse in part, and remand for further proceedings.

BACKGROUND

The reader may find the full facts of this case in the decisions of both the bankruptcy court, *In re DBSD North America, Inc.* (“*DBSD I*”), 419 B.R. 179 (Bankr.S.D.N.Y.2009); *In re DBSD North America, Inc.* (“*DBSD II*”) 421 B.R. 133 (Bankr.S.D.N.Y.2009), and the district court, *In re DBSD North America, Inc.* (“*DBSD III*”), Nos. 09–cv–10156 (LAK), 09–cv–10372 (LAK), 09–cv–10373 (LAK), 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010); see also *In re DBSD North America, Inc.* (“*DBSD IV*”), 427 B.R. 245 (S.D.N.Y.2010) (affirming bankruptcy court's treatment of Sprint's claim). We therefore focus only on the facts most pertinent to these appeals.

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

ICO Global Communications founded DBSD in 2004 to develop a mobile communications network that would use both satellites and land-based transmission towers. In its first five years, DBSD made progress toward this goal, successfully launching a satellite and obtaining certain spectrum licenses from the FCC, but it also accumulated a large amount of debt. Because its network remained in the developmental stage and had not become operational, DBSD had little if any revenue to offset its mounting obligations.

***86** On May 15, 2009, DBSD (but not its parent ICO Global), filed a voluntary petition in the United States Bankruptcy Court for the Southern District of New York, listing liabilities of \$813 million against assets with a book value of \$627 million. Of the various claims against DBSD, three have particular relevance here:

1. *The First Lien Debt*: a \$40 million revolving credit facility that DBSD obtained in early 2008 to support its operations, with a first-priority security interest in substantially all of DBSD's assets. It bore an initial interest rate of 12.5%.
2. *The Second Lien Debt*: \$650 million in 7.5% convertible senior secured notes that DISH issued in August 2005, due August 2009. These notes hold a second-priority security interest in substantially all of DBSD's assets. At the time of filing, the Second Lien Debt had grown to approximately \$740 million. It constitutes the bulk of DBSD's indebtedness.
3. *Sprint's Claim*: an unliquidated, unsecured claim based on a lawsuit against a DBSD subsidiary. Sprint had sued seeking reimbursement for DBSD's share of certain spectrum relocation expenses under an FCC order. At the time of DBSD's filing, that litigation was pending in the United States District Court for the Eastern District of Virginia and before the FCC. In the bankruptcy case, Sprint filed a claim against each of the DBSD entities jointly and severally, seeking \$211 million. The bankruptcy court temporarily allowed Sprint's claim in the amount of \$2 million for voting purposes.¹

After negotiations with various parties, DBSD proposed a plan of reorganization which, as amended, provided for “substantial de-leveraging,” a renewed focus on “core operations,” and a “continued path as a development-stage enterprise.” The plan provided that the holders of the First Lien Debt would receive new obligations with a four-year maturity date and the same 12.5% interest rate, but with

interest to be paid in kind (“PIK”), meaning that for the first four years the owners of the new obligations would receive as interest more debt from DBSD rather than cash. The holders of the Second Lien Debt would receive the bulk of the shares of the reorganized entity, which the bankruptcy court estimated would be worth between 51% and 73% of their original claims. The holders of unsecured claims, such as Sprint, would receive shares estimated as worth between 4% and 46% of their original claims. Finally, the existing shareholder (effectively just ICO Global, which owned 99.8% of DBSD) would receive shares and warrants in the reorganized entity.

Sprint objected to the plan, arguing among other things that the plan violates the absolute priority rule of [11 U.S.C. § 1129\(b\)\(2\)\(B\)](#). That rule requires that, if a class of senior claim-holders will not receive the full value of their claims under the plan and the class does not accept the plan, no junior claim- or interest-holder may receive “any property” “under the plan on account of such junior claim or interest.” *Id.* In making its objection, ***87** Sprint noted that the plan provided for the existing shareholder, whose interest is junior to Sprint's class of general unsecured claims, to receive substantial quantities of shares and warrants under the plan—in fact, much more than all the unsecured creditors received together. Sprint argued that “[b]ecause the Plan fails to satisfy” the absolute priority rule, “it cannot be confirmed.”

The bankruptcy court disagreed. It characterized the existing shareholder's receipt of shares and warrants as a “gift” from the holders of the Second Lien Debt, who are senior to Sprint in priority yet who were themselves not receiving the full value of their claims, and who may therefore “voluntarily offer a portion of their recovered property to junior stakeholders” without violating the absolute priority rule. [DBSD I](#), 419 B.R. at 210. It held that it would permit such gifting “at least where, as here, the gift comes from secured creditors, there is no doubt as to their secured creditor status, where there are understandable reasons for the gift, where there are no ulterior, improper ends ... and where the complaining creditor would get no more if the gift had not been made.” *Id.* at 212 (footnotes and quotation marks omitted).

Meanwhile, DISH, although not a creditor of DBSD before its filing, had purchased the claims of various creditors with an eye toward DBSD's spectrum rights. As a provider of satellite television, DISH has launched a number of its own satellites, and it also has a significant investment in TerreStar

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

Corporation, a direct competitor of DBSD's in the developing field of hybrid satellite/terrestrial mobile communications. DISH desired to "reach some sort of transaction with [DBSD] in the future if [DBSD's] spectrum could be useful in our business."

Shortly after DBSD filed its plan disclosure, DISH purchased all of the First Lien Debt at its full face value of \$40 million, with an agreement that the sellers would make objections to the plan that DISH could adopt after the sale. As DISH admitted, it bought the First Lien Debt not just to acquire a "market piece of paper" but also to "be in a position to take advantage of [its claim] if things didn't go well in a restructuring." Internal DISH communications also promoted an "opportunity to obtain a blocking position in the [Second Lien Debt] and control the bankruptcy process for this potentially strategic asset." In the end, DISH (through a subsidiary) purchased only \$111 million of the Second Lien Debt—not nearly enough to control that class—with the small size of its stake due in part to DISH's unwillingness to buy any claims whose prior owners had already entered into an agreement to support the plan.

In addition to voting its claims against confirmation, DISH reasserted the objections that the sellers of those claims had made pursuant to the transfer agreement, arguing, among other things, that the plan was not feasible under 11 U.S.C. § 1129(a)(11) and that the plan did not give DISH the "indubitable equivalent" of its First Lien Debt as required to cram down a dissenting class of secured creditors under 11 U.S.C. § 1129(b)(2)(A). Separately, DISH proposed to enter into a strategic transaction with DBSD, and requested permission to propose its own competing plan (a request it later withdrew).

DBSD responded by moving for the court to designate that DISH's "rejection of [the] plan was not in good faith." 11 U.S.C. § 1126(e). The bankruptcy court agreed, finding that DISH, a competitor to DBSD, was voting against the plan "not as a traditional creditor seeking to maximize *88 its return on the debt it holds, but ... 'to establish control over this strategic asset.' " *DBSD II*, 421 B.R. at 137 (quoting DISH's own internal presentation slides). The bankruptcy court therefore designated DISH's vote and disregarded DISH's wholly-owned class of First Lien Debt for the purposes of determining plan acceptance under 11 U.S.C. § 1129(a)(8). *Id.* at 143; *DBSD I*, 419 B.R. at 206.² The court also rejected DISH's objections to the plan, finding that the plan was feasible and that, even assuming that DISH's vote counted, the

plan gave DISH the "indubitable equivalent" of its First Lien Debt claim and could thus be crammed down over DISH's dissent. *DBSD I*, 419 B.R. at 203, 208–09.

After designating DISH's vote and rejecting all objections, the bankruptcy court confirmed the plan. *See id.* at 221. The district court affirmed, *see DBSD III*, 2010 WL 1223109, and DISH and Sprint appealed to this Court. After oral argument, DBSD received approval from the FCC to transfer its spectrum rights to the reorganized entity—the last hurdle before consummation of the reorganization. We subsequently stayed consummation of the plan and then, on December 6, 2010, issued an order disposing of the case and vacating our stay so that the proceedings could continue below without further delay, indicating that an opinion would follow. *See In re DBSD North America, Inc.*, 627 F.3d 496 (2d Cir.2010). This is that opinion.

DISCUSSION

I. Sprint's Appeal

[1] Sprint raises only one issue on appeal: it asserts that the plan improperly gives property to DBSD's shareholder without fully satisfying Sprint's senior claim, in violation of the absolute priority rule. *See* 11 U.S.C. § 1129(b)(2)(B). That rule provides that a reorganization plan may not give "property" to the holders of any junior claims or interests "on account of" those claims or interests, unless all classes of senior claims either receive the full value of their claims or give their consent. *Id.*; *see In re Coltex Loop Cent. Three Partners, L.P.*, 138 F.3d 39, 42 (2d Cir.1998); *see also In re Armstrong World Indus., Inc.*, 432 F.3d 507, 512 (3d Cir.2005). Because the existing shareholder received shares and warrants on account of its junior interest, Sprint argues, Sprint's class of general unsecured creditors had a right to receive "full satisfaction of their claims" or at least "an amount sufficient to obtain approval from the class." But the plan provided neither, and so Sprint asks us to vacate the order confirming it or to provide other relief that would satisfy Sprint's claim.

A. Sprint's Standing to Appeal

[2] [3] [4] Before we can address the merits of Sprint's appeal, we must decide whether Sprint has standing to bring it. The current Bankruptcy Code prescribes no limits on standing beyond those implicit in Article III of the United States Constitution. *See In re Gucci*, 126 F.3d 380,

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

388 (2d Cir.1997). Congress has given us jurisdiction over “all final decisions, judgments, orders, and decrees” of the district courts in bankruptcy cases, 28 U.S.C. § 158(d)(1), which courts in turn have jurisdiction to review all “final judgments, orders, and decrees” of the bankruptcy courts, *id.* § 158(a)(1). Nevertheless, for practical reasons this Court and others *89 have “adopted the general rule, loosely modeled on the former Bankruptcy Act, that in order to have standing to appeal from a bankruptcy court ruling, an appellant must be ‘a person aggrieved’—a person ‘directly and adversely affected pecuniarily’ by the challenged order of the bankruptcy court.”³ *Int’l Trade Admin. v. Rensselaer Polytechnic Inst.*, 936 F.2d 744, 747 (2d Cir.1991) (citation omitted). An appellant like Sprint, therefore, must show not only “injury in fact” under Article III but also that the injury is “direct[]” and “financial.” *Kane v. Johns–Manville Corp.*, 843 F.2d 636, 642 & n. 2 (2d Cir.1988).

[5] [6] “As a general rule,” we grant standing to “creditors ... appeal[ing] orders of the bankruptcy court disposing of property of the estate because such orders directly affect the creditors’ ability to receive payment of their claims.” *Id.* at 642; see *In re Gucci*, 126 F.3d at 388. In *Kane*, for instance, we did not hesitate to grant standing to an asbestos-injury claimant who appealed the confirmation of a plan of reorganization. The plan in that case was even more generous to the appellant than the plan in this case, since it promised him “the full amount of whatever compensatory damages he is awarded.” *Kane*, 843 F.2d at 640. The Court, however, held that Kane was an aggrieved party entitled to appeal: as “a creditor, [he had] economic interests ... directly impaired by the Plan” because the plan limited his recourse to the courts, eliminated the possibility of punitive damages, and made his recovery “subject to the Trust’s being fully funded.” *Id.* at 642. Other courts have generally found standing for impaired creditors⁴ when their “interests are directly and pecuniarily affected by the order of the Bankruptcy Court.” In *re Combustion Eng’g, Inc.*, 391 F.3d 190, 223–24 (3d Cir.2004); see also *In re P.R.T.C., Inc.*, 177 F.3d 774, 778 (9th Cir.1999) (noting that creditors “have a direct pecuniary interest in a bankruptcy court’s order transferring the assets of the estate”).

[7] We likewise hold that Sprint has standing to appeal the confirmation of the plan in this case. Before confirmation, Sprint had a claim that the bankruptcy court valued at \$2 million for voting purposes.⁵ After confirmation, however, Sprint stood to receive property worth less than half (between

4% and 46%) of that amount. Therefore, confirmation of the plan affected Sprint “directly” and “financially.”

The appellees challenge the above analysis from two different perspectives, looking both at the confirmation of the plan as a whole and at the gifting provision that *90 Sprint protests. First, and more broadly, they argue that confirmation could not have harmed Sprint’s interests because those interests were already worthless: with insufficient value in DBSD to pay off the secured creditors, Sprint’s unsecured claim entitled it to nothing. Second, and more narrowly, they argue that the gift to the existing shareholder did not harm Sprint’s interests because the absolute priority rule requires *either* that the objecting class receive the full value of its claim (which would more than double Sprint’s recovery) *or* that junior classes receive nothing (which could lead to a reduced recovery for Sprint), so even a strict interpretation of that rule would not guarantee any benefit for Sprint. None of our cases directly address the level of generality at which we should consider standing; because we reject the appellees’ analysis at both levels, however, we need not decide whether either perspective is generally preferable.

Taking the broader perspective first, we decline to withhold standing merely because the bankruptcy court’s valuation of DBSD put Sprint’s claim under water. By the bankruptcy court’s estimate—which we accept for purposes of this appeal—DBSD is not worth enough to cover even the Second Lien Debt, much less the claims of unsecured creditors like Sprint who stand several rungs lower on the ladder of priority. But none of our prior appellate standing decisions—at least none involving creditors—have turned on estimations of valuation, or on whether a creditor was in the money or out of the money. We have never demanded more to accord a creditor standing than that it has a valid and impaired claim.

Cosmopolitan Aviation, the primary decision on which the appellees rely for their broader argument, is easily distinguishable. See *In re Cosmopolitan Aviation Corp.*, 763 F.2d 507, 513 (2d Cir.1985), *abrogated on other grounds by Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P’ship*, 507 U.S. 380, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993). In that case, a state court had held that a debtor’s lease had expired before it filed for bankruptcy. *Id.* at 511. The bankruptcy court found that the debtor was hopelessly insolvent, with or without the lease, and ordered the debtor’s liquidation. *Id.* The debtor did not then appeal. It appealed only a later order to turn over the land—apparently solely for purposes of delay. *Id.* at 512–13. We held that, because the debtor could no longer contest the

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

first two rulings, it no longer had any interest in the land or even any right to “continued existence,” and therefore would suffer no injury from the turn-over. *Id.* at 513. *Cosmopolitan Aviation* is thus a far cry from this case, where the bankruptcy court provisionally allowed Sprint's claim against the debtor, where the plan already gives Sprint some recovery, and where Sprint has appealed the adverse order directly.

The only case the appellees cite that comes close to denying a creditor standing is *In re Ashford Hotels, Ltd.*, 235 B.R. 734 (S.D.N.Y.1999). But in that case the district court never accepted the appellants' attempts to characterize themselves as creditors. *Id.* at 738. The so-called creditors had sued the debtor in state court, not to win any damages but to rescind a contract under which *they* were liable to the debtor. *Id.* at 736. In the bankruptcy proceeding, they sought to stop funding the defense against their lawsuit and, after losing that attempt, they appealed. *Id.* at 737–38. The district court found that the appellants had no interest in the debtor besides their desire to stop the defense of the rescission lawsuit and thereby thwart the debtor from collecting against them. *Id.* at 738. Noting that other courts had found no standing where “a party's interest *91 in a Bankruptcy Court appeal is (only) that of a potential defendant to another lawsuit,” the district court likewise denied standing to the appellants in that case, because they were not “ ‘directly and adversely affected pecuniarily’ by the Bankruptcy Court's order except as adversaries to the Debtor's estate in other litigations.” *Id.* at 739. That case is therefore nothing like this one, where Sprint is clearly a creditor (albeit one with an unliquidated claim) and where Sprint appeals seeking to enlarge its recovery, not to head off the collection of debts against it.

The three additional district court decisions cited by the dissent are equally distinguishable. The first two do not involve creditors. In one, *In re Taylor*, the appellant was a chapter 7 debtor, see No. 00 Civ. 5021(VM), 2000 WL 1634371, at *1–2 (S.D.N.Y. Oct.30, 2000), a member of a class that often lacks standing in the bankruptcy court as well as on appeal, see *In re 60 E. 80th St. Equities, Inc.*, 218 F.3d 109, 115–16 (2d Cir.2000). In the other, *Freeman v. Journal Register Co.*, it was a shareholder of the debtor who appealed. See No. 09 Civ. 7296(JGK), 2010 WL 768942, at *3 (S.D.N.Y. Mar.8, 2010). Although this case does not require us to address shareholder standing in bankruptcy cases, we note that some courts have been more cautious in granting standing to shareholders than to creditors. See *In re Troutman Enters., Inc.*, 286 F.3d 359, 364–65 (6th Cir.2002). Finally, in the third case, *Bartel v. Bar Harbor Airways, Inc.*,

the appellant was a creditor, but a creditor whose claim the bankruptcy court disallowed because the debtor had already settled it. See 196 B.R. 268, 271–72 (S.D.N.Y.1996). There is all the difference in the world between a claim that has already been disallowed by the bankruptcy court, as in *Bartel*, and one like Sprint's that remains allowed and pending, whatever appellate judges might guess about its chances of success. None of these decisions have any bearing on the case before us.

We think it plain that we should not forbid all appeals by out-of-the-money creditors. Such a rule would bar a large percentage of creditors in bankruptcy court, perhaps a majority of them, from ever reaching the district court or this Court, however erroneous the orders of the bankruptcy court might be. In this case, for instance, members of only two classes could appeal under the appellees' proposed rule—the holders of the First Lien Debt and Second Lien Debt—even though the plan involved twenty-six classes of claims and interests in ten different levels. The other twenty-four classes would have to be satisfied with whatever the plan awarded them. This would remain true, under the appellees' theory, even if the bankruptcy court had committed a fundamental error such as not allowing the out-of-the-money creditors to vote or not following another of the numerous requirements of § 1129. Such a result might benefit this Court's docket, but would disserve the protection of the parties' rights and the development of the law. We should not raise the standing bar so high, especially when it is a bar of our own creation and not one required by the language of the Code, which “does not contain any express restrictions on appellate standing.” *Kane*, 843 F.2d at 642.

The appellees try to soften the negative consequences of their proposed rule by positing that a creditor in Sprint's position may appeal if it at least argues—as Sprint did in the district court but does not in this Court—that the bankruptcy court undervalued the estate and that, under a true valuation, there was enough to cover its claim. But that rule would not separate appropriate from inappropriate appeals by creditors; it would only increase the number *92 of appeals involving frivolous valuation arguments. It would turn an extremely harsh rule into an easily-evaded one. We decline either variation of the proposed rule.

Even taking the narrower perspective, focusing not on the plan's confirmation overall but only on the “gift” to the existing shareholder that Sprint challenges under the absolute priority rule, we still find standing. Sprint argues that the

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

absolute priority rule entitled it to the full value of its claim before the plan could give any equity to the existing shareholder. A plan like this one that gives property to a junior interest-holder (the existing shareholder) must provide the senior claim-holder (Sprint) with “property of a value ... equal to the amount of [its] claim.” 11 U.S.C. § 1129(b)(2) (B). When the law requires full payment, getting less than full payment surely constitutes “direct” and “financial” injury.

The appellees respond that Sprint is entitled to nothing under the priority rules and only receives anything because it itself is the beneficiary of a gift under the plan. Rejecting this plan would not give anything to Sprint, they argue: although an alternative plan might give Sprint the full value of its claim in order to maintain the gift to the existing shareholder, an alternative plan might well cut out both Sprint and the shareholder entirely. But we rejected just such an argument in *Kane*. In that case, we accepted the possibility that the appellant, Kane, actually benefitted from the plan he was challenging and could have fared worse under alternative plans. 843 F.2d at 642. We refused, however, to allow this possibility to defeat Kane's appellate standing:

Kane might receive more under this Plan than he would receive in liquidation. However, he might do better still under alternative plans. Since the ... Plan gives Kane less than what he might have received, he is directly and adversely affected pecuniarily by it, and he therefore has standing to challenge it on appeal.

Id. at 642. We did not investigate any particular alternative plan or estimate the likelihood that a plan more advantageous to Kane would actually be adopted if the existing plan were rejected; rather, we found it sufficient for appellate standing that Kane “might” receive more under a different plan.

Here, too, Sprint “might do better still under alternative plans.” *Id.* As the bankruptcy court found, “there were good business reasons for the ... gifts” to the existing shareholder, *DBSD I*, 419 B.R. at 212 n. 140, and those reasons might well lead the secured creditors to support the gift even at the price of sufficiently favorable treatment for Sprint to secure its support. Put another way, if the absolute priority rule applies, Sprint may use its unsecured claim as leverage to increase its

share in the reorganized entity if the “good business reasons” for the gift to the existing shareholder are still worth the cost. By rejecting the absolute priority rule, however, the bankruptcy court eliminated Sprint's leverage and reduced its potential financial recovery. To be sure, enforcing the absolute priority rule in this case would make the gift to the existing shareholder more costly to the plan proponents, who would have to pay more to Sprint in order to maintain that gift. Sprint therefore risks receiving nothing by enforcing the absolute priority rule because, if its demands outweigh the gift's perceived benefits to the senior creditors, the latter may cut out the junior classes entirely and leave nothing for Sprint. Whether such a risk is in Sprint's best interests, however, is not the issue here. See *93 *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (“[I]t is up to the creditors—and not the courts—to accept or reject a reorganization plan which fails ... to honor the absolute priority rule.”) For Sprint to have standing, we need only determine that, whatever the exact odds may be, Sprint at very least stands a reasonable chance of improving its position below. From whatever angle we look at the issue, therefore, we reject the appellees' challenge to Sprint's standing.

[8] Like the appellees, our dissenting colleague does not argue that all out-of-the-money creditors lack standing to challenge a plan for violating the absolute priority rule. See Dissent. Op. at 111. Rather, adopting an approach not argued by appellees, Judge Pooler finds that Sprint lacks standing because it is not only out of the money but has an unliquidated claim that might turn out to be valueless on its own merits. We do not find the ultimate merits of Sprint's claim against DBSD relevant. Standing to appeal “in no way depends on the merits” of the issue appealed, *Warth v. Seldin*, 422 U.S. 490, 500, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975), and certainly cannot depend on the merits of an issue that is not before us at all. Here, the bankruptcy court allowed Sprint's claim against a DBSD entity for voting purposes, see *Fed. R. Bankr.P.* 3018(a), which are the only purposes that matter at this stage. The plan's supporters did not object to this ruling, did not appeal it, and do not argue that any uncertainty about the merits of Sprint's underlying claim against the debtor should deny Sprint standing. They have good reason for their silence before us, as the dissent cites no decision where standing turned on the unliquidated status of a creditor's claim, or on an appellate court's assessment of the likely merits of such a claim.

Even if it were appropriate for us to consider the merits or ultimate worth of Sprint's claim, we would have no

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

way to make that determination, lacking any briefing from the parties or much information in the record on appeal regarding the merits of that claim, which will turn not only on the potential offset of its obligations to the government (as the dissent recognizes) but also on the date that the relevant DBSD subsidiary occupied a specific band of the transmission spectrum. See *DBSD IV*, 427 B.R. at 249 n. 4. Because the parties do not brief the issue and did not raise it below, moreover, our evaluation of Sprint's claim would require piecing together the evidence without a guide.

A rule that would turn a claimant's standing to appeal a bankruptcy court's ruling on the as-yet-undetermined merits of the claimant's underlying claim would unduly complicate the standing determination, and require district and circuit courts prematurely to address the merits of issues the bankruptcy court has not yet addressed. We see no need for such an inquiry. The bankruptcy court's temporary allowance of Sprint's claim for voting purposes was enough to allow it to object below, where no one argues that Sprint lacked standing. The ultimate merits of that claim should not determine standing here, where we have less ability than the bankruptcy court to decide those merits.

Accordingly, we conclude that Sprint has standing to appeal the denial of its objection to the confirmation of the reorganization plan. We therefore turn to the merits of that objection.

B. Gifting and the Absolute Priority Rule

[9] [10] Sprint argues that the plan violated the absolute priority rule by giving shares and warrants to a junior class (the existing shareholder) although a more senior *94 class (Sprint's class) neither approved the plan nor received the full value of its claims. See 11 U.S.C. § 1129(b)(2)(B). The appellees respond, and the courts below held, that the holders of the Second Lien Debt, who are senior to Sprint and whom the bankruptcy court found to be undersecured, were entitled to the full residual value of the debtor and were therefore free to “gift” some of that value to the existing shareholder if they chose to. *DBSD I*, 419 B.R. at 210; *DBSD III*, 2010 WL 1223109, at *4. We recently avoided deciding the viability of this “gifting doctrine” in a similar context, see *In re Iridium Operating LLC*, 478 F.3d 452, 460–61 (2d Cir.2007), but we now face the question squarely. We look through the district court to the bankruptcy court's decision, and review its analysis of law *de novo*. See *In re Baker*, 604 F.3d 727, 729 (2d Cir.2010).

Long before anyone had imagined such a thing as Chapter 11 bankruptcy, it was already “well settled that stockholders are not entitled to any share of the capital stock nor to any dividend of the profits until all the debts of the corporation are paid.” *Chi., Rock Island & Pac. R.R. v. Howard*, 74 U.S. (7 Wall) 392, 409–10, 19 L.Ed. 117 (1868). In the days of the railroad barons, however, parties observed this rule in the breach. Senior creditors and original shareholders often cooperated to control the reorganization of a failed company, sometimes to make the process go smoothly—to encourage the old shareholders to provide new capital for the reorganization or to keep them from engaging in costly and delaying litigation—or sometimes simply because the senior creditors and the old shareholders were the same parties. For their cooperation, the old owners would often receive or retain some stake in whatever entity arose from the reorganization. Junior creditors, however, often received little or nothing even though they technically stood above the old shareholders in priority. See John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L.Rev. 963, 970–71 (1989).

In response to this practice, the Supreme Court developed a “fixed principle” for reorganizations: that all “creditors were entitled to be paid before the stockholders could retain [shares] for any purpose whatever.” *N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 507–08, 33 S.Ct. 554, 57 L.Ed. 931 (1913). “[A] plan of reorganization,” the Court later stated, “would not be fair and equitable which ... admitted the stockholders to participation, unless” at very least “the stockholders made a fresh contribution in money or in money's worth in return for ‘a participation reasonably equivalent to their contribution.’” *Marine Harbor Props., Inc. v. Mfrs. Trust Co.*, 317 U.S. 78, 85, 63 S.Ct. 93, 87 L.Ed. 64 (1942), quoting *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106, 121, 60 S.Ct. 1, 84 L.Ed. 110 (1939). Courts came to call this the “absolute priority rule.” *Ecker v. W. Pac. R.R. Corp.*, 318 U.S. 448, 484, 63 S.Ct. 692, 87 L.Ed. 892 (1943).

[11] The Bankruptcy Code incorporates a form of the absolute priority rule in its provisions for confirming a Chapter 11 plan of reorganization. For a district court to confirm a plan over the vote of a dissenting class of claims, the Code demands that the plan be “fair and equitable, with respect to each class of claims ... that is impaired under, and has not accepted, the plan.” 11 U.S.C. § 1129(b)(1). The Code does not define the full extent of “fair and equitable,” but it includes a form of the absolute priority rule as a prerequisite. According to the Code, a plan is not “fair and equitable” unless:

With respect to a class of unsecured claims—

***95 (i)** the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property....

Id. § 1129(b)(2)(B). Absent the consent of all impaired classes of unsecured claimants, therefore, a confirmable plan must ensure either (i) that the dissenting class receives the full value of its claim, or (ii) that no classes junior to that class receive any property under the plan on account of their junior claims or interests.

Under the plan in this case, Sprint does not receive “property of a value ... equal to the allowed amount” of its claim. Rather, Sprint gets less than half the value of its claim. The plan may be confirmed, therefore, only if the existing shareholder, whose interest is junior to Sprint’s, does “not receive or retain” “any property” “under the plan on account of such junior ... interest.” We hold that the existing shareholder did receive property under the plan on account of its interest, and that the bankruptcy court therefore should not have confirmed the plan.

[12] First, under the challenged plan, the existing shareholder receives “property” in the form of shares and warrants in the reorganized entity. The term “property” in § 1129(b)(2)(B) is meant to be interpreted broadly. *See Ahlers*, 485 U.S. at 208, 108 S.Ct. 963. But even if it were not, there is no doubt that “any property” includes shares and warrants like these.

Second, the existing shareholder receives that property “under the plan.” The disclosure statement for the second amended plan, under the heading “ARTICLE IV: THE JOINT PLAN,” states:

Class 9—Existing Stockholder Interests

.... In full and final satisfaction, settlement, release, and discharge of each Existing Stockholder Interest, and on account of all valuable consideration provided by the Existing Stockholder, including, without limitation, certain consideration provided in the Support Agreement, ... *the*

Holder of such Class 9 Existing Stockholder Interest shall receive the Existing Stockholder Shares and the Warrants.

(emphasis added). We need not decide whether the Code would allow the existing shareholder and Senior Noteholders to agree to transfer shares outside of the plan, for, on the present record, the existing shareholder clearly receives these shares and warrants “under the plan.”

Finally, the existing shareholder receives its shares and warrants “on account of” its junior interest. The Supreme Court has noted that “on account of” could take one of several interpretations. *See Bank of Am. Nat’l Trust & Sav. Ass’n v. 203 N. LaSalle St. P’ship*, 526 U.S. 434, 449, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). The interpretation most friendly to old equity—which the Supreme Court rejected as “beset with troubles ... exceedingly odd ... [and] unlikely”—reads “on account of” as “in exchange for.” *Id.* at 449–50, 119 S.Ct. 1411. Even under this generous test, the existing shareholder here receives property “on account of” its prior junior interest because it receives new shares and warrants at least partially “in exchange for” its old ones. The passage from the plan quoted above states as much: the existing shareholder receives shares and warrants “[i]n full and final satisfaction, settlement, release, and discharge ***96** of each Existing Stockholder Interest.”

[13] The gift here even more easily satisfies the two less restrictive tests the Supreme Court examined (and viewed more favorably) in *203 North LaSalle*, both of which read “on account of” to mean some form of “because of.” *Id.* at 450, 119 S.Ct. 1411. The existing shareholder received its property “because of,” and thus “on account of,” its prior interest, for the same reasons set forth above.⁶

[14] This conclusion is not undermined by the fact that the disclosure statement recites, and the district court found, additional reasons why the existing shareholder merited receiving the shares and warrants. First, a transfer *partly* on account of factors other than the prior interest is still partly “on account of” that interest. “If Congress had intended to modify [‘on account of’] with the addition of the words ‘only,’ ‘solely,’ or even ‘primarily,’ it would have done so.” *In re Coltex Loop*, 138 F.3d at 43. Upholding this principle in *203 North LaSalle*, the Supreme Court refused to characterize a benefit given to existing shareholders “merely as a detail of the broader transaction” in which those shareholders also contributed new capital. 526 U.S. at 456, 119 S.Ct. 1411. Instead, receipt of property partly on account of the existing

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

interest was enough for the absolute priority rule to bar confirmation of the plan. See *id.* at 456–58, 119 S.Ct. 1411.

Second, the other reasons that the appellees assert drove the award of warrants and shares to old equity here are themselves “on account of” the existing shareholder’s prior interest. The existing shareholder did not contribute additional capital to the reorganized entity, see, e.g., *id.* at 443, 119 S.Ct. 1411 (suggesting uncertainty about whether even new capital may suffice); rather, as the bankruptcy court explained, the gift aimed to ensure the existing shareholder’s “continued cooperation and assistance” in the reorganization, *DBSD I*, 419 B.R. at 212 n. 140. The “continued cooperation” of the existing shareholder was useful only because of the shareholder’s position as equity holder and “the rights emanating from that position,” *In re Coltex Loop*, 138 F.3d at 43; an unrelated third party’s cooperation would not have been useful. And “assistance” sounds like the sort of “future labor, management, or expertise” that the Supreme Court has held insufficient to avoid falling under the prohibition of the absolute priority rule. *Ahlers*, 485 U.S. at 204, 108 S.Ct. 963. Thus, notwithstanding the various economic reasons that may have contributed to the decision to award property to old equity here, it is clear that the existing shareholder “could not have gained [its] new position but for [its] prior equity position.” *In re Coltex Loop*, 138 F.3d at 44.

In sum, we conclude that the existing shareholder received “property,” that it *97 did so “under the plan,” and that it did so “on account of” its prior, junior interest.

The Supreme Court’s interpretations of § 1129(b)(2)(B) give us confidence in ours. Although that Court has not addressed the exact scenario presented here under the codified absolute priority rule, its two post-Code cases on the rule are instructive. In both cases, the prior owners tried to avoid the absolute priority rule by arguing that they received distributions not on account of their prior interests but rather on account of the new value that they would contribute to the entity. See *203 N. LaSalle*, 526 U.S. at 437, 119 S.Ct. 1411; *Ahlers*, 485 U.S. at 199, 108 S.Ct. 963. In both cases, the Supreme Court rejected those arguments. Although dictum in an earlier case had suggested that contributing new value could allow prior shareholders to participate in the reorganized entity, see *Case*, 308 U.S. at 121, 60 S.Ct. 1, the Court refused to decide whether § 1129(b)(2)(B) permitted such new-value exchanges. Instead, the Court held that neither “future labor, experience and expertise,” *Ahlers*, 485 U.S. at 199, 108 S.Ct. 963 (quotation marks omitted), nor

capital contributions “without benefit of market valuation,” *203 N. LaSalle*, 526 U.S. at 458, 119 S.Ct. 1411, could suffice to escape the absolute priority rule, even assuming the ongoing validity of the *Case* dictum.

203 North LaSalle and *Ahlers* indicate a preference for reading the rule strictly. Given that the Supreme Court has hesitated to allow old owners to receive new ownership interests even when contributing new value, it is doubtful the Court would allow old owners to receive new ownership without contributing any new value, as in this case. As the Court explained in *Ahlers*, “the statutory language and the legislative history of § 1129(b) clearly bar any expansion of any exception to the absolute priority rule beyond that recognized in our cases at the time Congress enacted the 1978 Bankruptcy Code.” *Ahlers*, 485 U.S. at 206, 108 S.Ct. 963. The Supreme Court has never suggested any exception that would cover a case like this one.

The appellees, unsurprisingly, see the case in a different light. They contend that, under the “gifting doctrine,” the shares and warrants rightfully belonged to the secured creditors, who were entitled to share them with the existing shareholder as they saw fit. Citing *In re SPM Manufacturing Corp.*, 984 F.2d 1305 (1st Cir.1993), the appellees argue that, until the debts of the secured creditors “are paid in full, the Bankruptcy Code’s distributional priority scheme, as embodied in the absolute priority rule, is not implicated.” *DBSD* was not worth enough, according to the bankruptcy court’s valuation, to cover even the secured lenders’ claims, much less those of unsecured creditors like Sprint. Therefore, as the bankruptcy court stated in ruling for the appellees, “the ‘Gifting’ Doctrine—under which senior secured creditors voluntarily offer a portion of their recovered property to junior stakeholders (as the Senior Noteholders did here)—defeats Sprint’s Absolute Priority Rule objection.” *DBSD I*, 419 B.R. at 210. We disagree.

Most fatally, this interpretation does not square with the text of the Bankruptcy Code. The Code extends the absolute priority rule to “any property,” 11 U.S.C. § 1129(b)(2)(B)(ii), not “any property not covered by a senior creditor’s lien.” The Code focuses entirely on who “receive[s]” or “retain[s]” the property “under the plan,” *id.*, not on who *would* receive it under a liquidation plan. And it applies the rule to any distribution “under the plan on account of” a junior interest, *id.*, regardless of whether the distribution could have been made outside the plan, *98 and regardless of whether other reasons might support the distribution in addition to the junior interest.

We distinguish this case from *In re SPM* on several grounds. In that case, a secured creditor and the general unsecured creditors agreed to seek liquidation of the debtor and to share the proceeds from the liquidation. 984 F.2d at 1307–08. The bankruptcy court granted relief from the automatic stay and converted the case from Chapter 11 to a Chapter 7 liquidation. *Id.* at 1309. The bankruptcy court refused, however, to allow the unsecured creditors to receive their share under the agreement with the secured creditor, ordering instead that the unsecured creditors' share go to a priority creditor in between those two classes. *Id.* at 1310. The district court affirmed, but the First Circuit reversed, holding that nothing in the Code barred the secured creditors from sharing their proceeds in a Chapter 7 liquidation with unsecured creditors, even at the expense of a creditor who would otherwise take priority over those unsecured creditors. *Id.* at 1312–19.

[15] The first and most important distinction is that *In re SPM* involved Chapter 7, not Chapter 11, and thus involved a liquidation of the debtor, not a reorganization. *Id.* at 1309. Chapter 7 does not include the rigid absolute priority rule of § 1129(b)(2)(B). See *In re Armstrong*, 432 F.3d at 514. As the First Circuit noted, “the distribution scheme” of Chapter 7 “does not come into play until all valid liens on the property are satisfied.” *In re SPM*, 984 F.2d at 1312; see 11 U.S.C. § 726(a); *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 5, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). *In re SPM* repeatedly emphasized the “lack[]” of “statutory support” for the argument against gifting in the Chapter 7 context. 984 F.2d at 1313; see *id.* at 1313–14 (finding “no support in the Code for” rejecting gifting). Under Chapter 11, in contrast, § 1129(b)(2)(B) provides clear “statutory support” to reject gifting in this case, and the distribution scheme of Chapter 11 ordinarily distributes *all* property in the estate (as it does here), including property subject to security interests, see 11 U.S.C. § 1129(b)(2)(A).

Furthermore, the bankruptcy court in *In re SPM* had granted the secured creditor relief from the automatic stay, 984 F.2d at 1309, and treated the property in question as no longer part of the estate, *id.* at 1313. In a very real sense, the property belonged to the secured creditor alone, and the secured creditor could do what it pleased with it. Here, however, the relevant property has remained in the estate throughout, and has never belonged to the secured creditors outright. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203–04, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983). For these reasons, therefore, assuming without deciding that the First Circuit's

approach was correct in the context of Chapter 7—a question not before us—we do not find it relevant to this case. See *In re Armstrong*, 432 F.3d at 514 (similarly distinguishing *In re SPM*).

Even if the text of § 1129(b)(2)(B) left any room for the appellees' view of the case, we would hesitate to accept it in light of the Supreme Court's long history of rejecting such views. That history begins at least as early as 1868, in *Howard*, 74 U.S. (7 Wall) 392. In that case, the stockholders and mortgagees of a failing railroad agreed to foreclose on the railroad and convey its property to a new corporation, with the old stockholders receiving some of the new shares. *Id.* at 408–09. The agreement gave nothing, however, to certain intermediate creditors, who sought a share of the distribution in the courts. *Id.* at 408.

*99 The stockholders defended their agreement with nearly the exact logic the appellees employ here:

The road was mortgaged for near three times its value.... If, then, these stockholders have got anything, it must be because the bondholders have *surrendered* a part of *their* fund to them. If the fund belonged to the bondholders, they had a right so to surrender a part or a whole of it. And if the bondholders did so surrender their own property to the stockholders, it became the private property of these last; a gift, or, if you please, a transfer for consideration from the bondholders.... What right have these complainants to *such* property in the hands of the stockholders?

Id. at 400. Even in 1868, however, the Supreme Court found that “[e]xtended discussion of that proposition is not necessary.” *Id.* at 414. “Holders of bonds secured by mortgages as in this case,” the Court noted, “may exact the whole amount of the bonds, principal and interest, or they may, if they see fit, accept a percentage as a compromise in full discharge of their respective claims, but whenever their lien is legally discharged, the property embraced in the mortgage, or whatever remains of it, belongs to the corporation” for distribution to other creditors. *Id.* Similarly,

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

in this case, the secured creditors could have demanded a plan in which they received all of the reorganized corporation, but, having chosen not to, they may not “surrender” part of the value of the estate for distribution “to the stockholder[],” as “a gift.” *Id.* at 400. Whatever the secured creditors here did not take remains in the estate for the benefit of other claim-holders.

As the Court built upon *Howard* to develop the absolute priority rule, it continued to reject arguments similar to the ones the appellees make before us. For example, in *Louisville Trust Co. v. Louisville, New Albany & Chicago Railway Co.*, the Court noted that “if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders, he may do so; but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof.” 174 U.S. 674, 683–84, 19 S.Ct. 827, 43 L.Ed. 1130 (1899). The Court rejected another similar argument in 1913 in *Boyd*, where it finally set down the “fixed principle” that we now call the absolute priority rule. 228 U.S. at 507, 33 S.Ct. 554.

Those cases dealt with facts much like the facts of this one: an over-leveraged corporation whose undersecured senior lenders agree to give shares to prior shareholders while intermediate lenders receive less than the value of their claim. See Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. Chi. L.Rev. 738, 739–44 (1988). And it was on the basis of those facts that the Supreme Court developed the absolute priority rule, with the aim of stopping the very sort of transaction that the appellees propose here. See *In re Iridium*, 478 F.3d at 463 n. 17. These old cases do not bind us directly, given that Congress has now codified the absolute priority rule. But if courts will not infer statutory abrogation of the common law without evidence that Congress intended such abrogation, see *United States v. Texas*, 507 U.S. 529, 534, 113 S.Ct. 1631, 123 L.Ed.2d 245 (1993), it would be even less appropriate to conclude that Congress abrogated the more-than-a-century-old core of the absolute priority rule by passing a statute whose language explicitly adopts it.

*100 We recognize the policy arguments against the absolute priority rule. Gifting may be a “powerful tool in accelerating an efficient and non-adversarial ... chapter 11 proceeding,” Leah M. Eisenberg, *Gifting and Asset Reallocation in Chapter 11 Proceedings: A Synthesized*

Approach, 29 Am. Bankr.Inst. J. 50, 50 (2010), and no doubt the parties intended the gift to have such an effect here. See *DBSD I*, 419 B.R. at 214. As one witness testified below, “where ... the equity sponsor is out of the money, ... a tip is common to [e]nsure a consensual bankruptcy rather than a contested one.” Enforcing the absolute priority rule, by contrast, “may encourage hold-out behavior by objecting creditors ... even though the transfer has no direct effect on the value to be received by the objecting creditors.” Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit’s Armstrong Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 Am. U.L.Rev. 1345, 1349 (2006).

It deserves noting, however, that there are substantial policy arguments in favor of the rule. Shareholders retain substantial control over the Chapter 11 process, and with that control comes significant opportunity for self-enrichment at the expense of creditors. See, e.g., 11 U.S.C. § 1121(b) (giving debtor, which is usually controlled by old shareholders, exclusive 120-day period in which to propose plan). This case provides a nice example. Although no one alleges any untoward conduct here, it is noticeable how much larger a distribution the existing shareholder will receive under this plan (4.99% of all equity in the reorganized entity) than the general unsecured creditors put together (0.15% of all equity), despite the latter’s technical seniority. Indeed, based on the debtor’s estimate that the reorganized entity would be worth approximately \$572 million, the existing shareholder will receive approximately \$28.5 million worth of equity under the plan while the unsecured creditors must share only \$850,000. And if the parties here were less scrupulous or the bankruptcy court less vigilant, a weakened absolute priority rule could allow for serious mischief between senior creditors and existing shareholders.

Whatever the policy merits of the absolute priority rule, however, Congress was well aware of both its benefits and disadvantages when it codified the rule in the Bankruptcy Code. The policy objections to the rule are not new ones; the rule has attracted controversy from its early days. Four Justices dissented from the Supreme Court’s 1913 holding in *Boyd*, see 228 U.S. at 511, 33 S.Ct. 554, and that decision “was received by the reorganization bar and bankers with something akin to horror,” James N. Rosenberg, *Reorganization—The Next Step*, 22 Colum. L.Rev. 14, 14 (1922). The Commission charged with reviewing the bankruptcy laws in the lead-up to the enactment of the

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

Bankruptcy Code suggested loosening the absolute priority rule to allow greater participation by equity owners. See Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L.Rev. 70, 87–89 & n. 117 (1991). Yet, although Congress did soften the absolute priority rule in some ways,⁷ it did not create any exception for “gifts” like the one at issue here. See also H.R. Rep. 95–595, 1978 U.S.C.C.A.N. 5963, 6372 (1977) (noting that absolute priority rule was “designed *101 to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired”).⁸ We therefore hold that the bankruptcy court erred in confirming the plan of reorganization.

II. DISH's Appeal

DISH raises different objections to the bankruptcy court's order.⁹ First, DISH contends that the bankruptcy court should not have designated its vote as “not in good faith,” 11 U.S.C. § 1126(e), and that, even after the designation, the bankruptcy court should not have disregarded the entire class that DISH's claim comprised. Second, DISH argues that the plan should have been rejected in its entirety as not feasible. We address these arguments in turn.

A. The Treatment of DISH's Vote

1. Designating DISH's Vote as “Not in Good Faith”

[16] [17] To confirm a plan of reorganization, Chapter 11 generally requires a vote of all holders of claims or interests impaired by that plan. See 11 U.S.C. §§ 1126, 1129(a)(8). This voting requirement has exceptions, however, including one that allows a bankruptcy court to designate (in effect, to disregard) the votes of “any entity whose acceptance or rejection of such plan was not in good faith.” *Id.* § 1126(e).

[18] The Code provides no guidance about what constitutes a bad faith vote to accept or reject a plan. Rather, § 1126(e)'s “good faith” test effectively delegates to the courts the task of deciding when a party steps over the boundary. See *In re Figter Ltd.*, 118 F.3d 635, 638 (9th Cir.1997); see also Revision of the Bankruptcy Act: Hearing on H.R. 6439 Before the House Comm. on the Judiciary, 75th Cong. 181 (1937) [“1937 Hearing”] (statement of Jacob Weinstein) (describing “good faith” test of predecessor to § 1126(e) as delegation to the courts). Case by case, courts have taken up this responsibility. No circuit court has ever dealt with a case like this one, however, and neither we nor the Supreme Court

have many precedents on the “good faith” voting requirement in any context; the most recent cases from both courts are now more than 65 years old and address § 1126(e)'s predecessor, § 203 of the Bankruptcy Act. See *Young v. Higbee Co.*, 324 U.S. 204, 65 S.Ct. 594, 89 L.Ed. 890 (1945); *In re P–R Holding Corp.*, 147 F.2d 895 (2d Cir.1945). Nevertheless, these cases, cases from other jurisdictions, legislative history, and the purposes of the good-faith requirement give us confidence in affirming the bankruptcy court's decision to designate DISH's vote in this case.

[19] [20] [21] [22] We start with general principles that neither side disputes. Bankruptcy courts should employ § 1126(e) designation sparingly, as “the exception, not the rule.” *102 *In re Adelphia Commc'ns Corp.*, 359 B.R. 54, 61 (Bankr.S.D.N.Y.2006). For this reason, a party seeking to designate another's vote bears the burden of proving that it was not cast in good faith. See *id.* Merely purchasing claims in bankruptcy “for the purpose of securing the approval or rejection of a plan does not of itself amount to ‘bad faith.’” *In re P–R Holding*, 147 F.2d at 897; see *In re 255 Park Plaza Assocs. Ltd. P'ship*, 100 F.3d 1214, 1219 (6th Cir.1996). Nor will selfishness alone defeat a creditor's good faith; the Code assumes that parties will act in their own self interest and allows them to do so. See *In re Figter*, 118 F.3d at 639.

[23] [24] [25] Section 1126(e) comes into play when voters venture beyond mere self-interested promotion of their claims. “[T]he section was intended to apply to those who were not attempting to protect their own proper interests, but who were, instead, attempting to obtain some benefit to which they were not entitled.” *In re Figter*, 118 F.3d at 638. A bankruptcy court may, therefore, designate the vote of a party who votes “in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets,” *Young*, 324 U.S. at 211, 65 S.Ct. 594, or one who votes with an “ulterior motive,” 1937 Hearing, *supra*, at 180 (statement of SEC Commissioner William O. Douglas), that is, with “an interest other than an interest as a creditor,” *In re P–R Holding*, 147 F.2d at 897.

[26] [27] Here, the debate centers on what sort of “ulterior motives” may trigger designation under § 1126(e), and whether DISH voted with such an impermissible motive. The first question is a question of law that we review *de novo*, and the second a question of fact that we review for clear error, see *In re Baker*, 604 F.3d at 729, recognizing that “a decision that someone did or did not act in good faith” hinges on “an essentially factual inquiry and is driven by the data of practical

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

human experience,” *In re Figter*, 118 F.3d at 638 (quotation marks omitted).

[28] Clearly, not just any ulterior motive constitutes the sort of improper motive that will support a finding of bad faith. After all, most creditors have interests beyond their claim against a particular debtor, and those other interests will inevitably affect how they vote the claim. For instance, trade creditors who do regular business with a debtor may vote in the way most likely to allow them to continue to do business with the debtor after reorganization. See *John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs.*, 987 F.2d 154, 161–62 (3d Cir.1993). And, as interest rates change, a fully secured creditor may seek liquidation to allow money once invested at unfavorable rates to be invested more favorably elsewhere. See *In re Landing Assocs., Ltd.*, 157 B.R. 791, 807 (Bankr.W.D.Tex.1993). We do not purport to decide here the propriety of either of these motives, but they at least demonstrate that allowing the disqualification of votes on account of *any* ulterior motive could have far-reaching consequences and might leave few votes upheld.

The sort of ulterior motive that § 1126(e) targets is illustrated by the case that motivated the creation of the “good faith” rule in the first place, *Texas Hotel Securities Corp. v. Waco Development Co.*, 87 F.2d 395 (5th Cir.1936). In that case, Conrad Hilton purchased claims of a debtor to block a plan of reorganization that would have given a lease on the debtor's property—once held by Hilton's company, later cancelled—to a third party. *Id.* at 397–99. Hilton and his partners sought, by buying and voting the claims, to “force [a plan] that would give them again the operation of the hotel or otherwise reestablish an interest that they felt they justly had in the property.” *Id.* at 398. The *103 district court refused to count Hilton's vote, but the court of appeals reversed, seeing no authority in the Bankruptcy Act for looking into the motives of creditors voting against a plan. *Id.* at 400.

That case spurred Congress to require good faith in voting claims. As the Supreme Court has noted, the legislative history of the predecessor to § 1126(e) “make[s] clear the purpose of the [House] Committee [on the Judiciary] to pass legislation which would bar creditors from a vote who were prompted by such a purpose” as Hilton's. *Young*, 324 U.S. at 211 n. 10, 65 S.Ct. 594. As then-SEC Commissioner Douglas explained to the House Committee:

We envisage that “good faith” clause to enable the courts to affirm a plan over the opposition of a minority attempting to block the adoption of a plan merely for selfish purposes. The *Waco* case ... was such a situation. If my memory does not serve me wrong it was a case where a minority group of security holders refused to vote in favor of the plan unless that group were given some particular preferential treatment, such as the management of the company. That is, there were ulterior reasons for their actions.

1937 Hearing, *supra*, at 181–82.¹⁰ One year after Commissioner Douglas's testimony, and two years after the *Waco* case, Congress enacted the proposed good faith clause as part of the Chandler Act of 1938. Pub.L. 75–575, § 203, 52 Stat. 840, 894. The Bankruptcy Code of 1978 preserved this good faith requirement, with some rewording, as 11 U.S.C. § 1126(e).¹¹

Modern cases have found “ulterior motives” in a variety of situations. In perhaps the most famous case, and one on which the bankruptcy court in our case relied heavily, a court found bad faith because a party bought a blocking position in several classes after the debtor proposed a plan of reorganization, and then sought to defeat that plan and to promote its own plan that would have given it control over the debtor. See *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 289–90 (Bankr.W.D.Pa.1990). In another case, the court designated the votes of parties affiliated with a competitor who bought their claims in an attempt to obstruct the debtor's reorganization and thereby to further the interests of their own business. See *In re MacLeod Co.*, 63 B.R. 654, 655–56 (Bankr.S.D.Ohio 1986). In a third case, the court found bad faith where an affiliate of the debtor purchased claims not for the purpose of collecting on those claims but to prevent confirmation *104 of a competing plan. See *In re Applegate Prop., Ltd.*, 133 B.R. 827, 833–35 (Bankr.W.D.Tex.1991).

[29] Although we express no view on the correctness of the specific findings of bad faith of the parties in those specific

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

cases, we think that this case fits in the general constellation they form. As the bankruptcy court found, DISH, as an indirect competitor of DBSD and part-owner of a direct competitor, bought a blocking position in (and in fact the entirety of) a class of claims, after a plan had been proposed, with the intention not to maximize its return on the debt but to enter a strategic transaction with DBSD and “to use status as a creditor to provide advantages over proposing a plan as an outsider, or making a traditional bid for the company or its assets.” *DBSD II*, 421 B.R. at 139–40. In effect, DISH purchased the claims as votes it could use as levers to bend the bankruptcy process toward its own strategic objective of acquiring DBSD's spectrum rights, not toward protecting its claim.

We conclude that the bankruptcy court permissibly designated DISH's vote based on the facts above. This case echoes the *Waco* case that motivated Congress to impose the good faith requirement in the first place. In that case, a competitor bought claims with the intent of voting against any plan that did not give it a lease in or management of the debtor's property. 87 F.2d at 397–99. In this case, a competitor bought claims with the intent of voting against any plan that did not give it a strategic interest in the reorganized company. The purchasing party in both cases was less interested in maximizing the return on its claim than in diverting the progress of the proceedings to achieve an outside benefit. In 1936, no authority allowed disregarding votes in such a situation, but Congress created that authority two years later with cases like *Waco* in mind. We therefore hold that a court may designate a creditor's vote in these circumstances.

[30] [31] We also find that, just as the law supports the bankruptcy court's legal conclusion, so the evidence supports its relevant factual findings. DISH's motive—the most controversial finding—is evinced by DISH's own admissions in court, by its position as a competitor to DBSD,¹² by its willingness to overpay for the claims it bought,¹³ by its attempt to propose its own plan, and especially by its internal communications, which, although addressing the Second Lien Debt rather than the First Lien Debt at issue here, nevertheless showed a desire to “to obtain a blocking position” and “control the bankruptcy process for this potentially strategic asset.”

The Loan Syndications and Trading Association (LSTA), as *amicus curiae*, argues that courts should encourage acquisitions and other strategic transactions because such transactions can benefit all parties in bankruptcy. We agree.

But our holding does not “shut[] the door to strategic transactions,” as the LSTA suggests. Rather, it simply limits the methods by which parties may pursue them. DISH had every right to propose for consideration whatever strategic transaction it wanted—a right it took advantage of here—and DISH still retained this right even after it purchased its claims. All that the bankruptcy court stopped DISH from doing here was using the votes it had bought to secure an advantage in pursuing that strategic transaction.

[32] DISH argues that, if we uphold the decision below, “future creditors looking for potential strategic transactions with chapter 11 debtors will be deterred from exploring such deals for fear of forfeiting their rights as creditors.” But our ruling today should deter only attempts to “obtain a blocking position” and thereby “control the bankruptcy process for [a] potentially strategic asset” (as DISH's own internal documents stated). We leave for another day the situation in which a *preexisting* creditor votes with strategic intentions. Cf. *In re Pine Hill Collieries Co.*, 46 F.Supp. 669, 672 (E.D.Pa.1942). We emphasize, moreover, that our opinion imposes no categorical prohibition on purchasing claims with acquisitive or other strategic intentions. On other facts, such purchases may be appropriate. Whether a vote has been properly designated is a fact-intensive question that must be based on the totality of the circumstances, according considerable deference to the expertise of bankruptcy judges. Having reviewed the careful and fact-specific decision of the bankruptcy court here, we find no error in its decision to designate DISH's vote as not having been cast in good faith.

2. Disregarding DISH's Class for Voting Purposes

[33] [34] DISH next argues that the bankruptcy court erred when, after designating DISH's vote, it disregarded the entire class of the First Lien Debt for the purpose of determining plan acceptance under 11 U.S.C. § 1129(a)(8). Section 1129(a)(8) provides that each impaired class must vote in favor of a plan for the bankruptcy court to confirm it without resorting to the (more arduous) cram-down standards of § 1129(b). Faced with a class that effectively contained zero claims—because DISH's claim had been designated—the bankruptcy court concluded that “[t]he most appropriate way to deal with that [situation] is by disregarding [DISH's class] for the purposes of section 1129(a)(8).” *DBSD I*, 419 B.R. at 206. We agree with the bankruptcy court. Common sense demands this result, which is consistent with (if not explicitly demanded by) the text of the Bankruptcy Code.

In re DBSD North America, Inc., 634 F.3d 79 (2011)
65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

The Code measures the acceptance of a plan not creditor-by-creditor or claim-by-claim, but class-by-class. The relevant provision explains how to tally acceptances within a class of claims to arrive at the vote of the overall class:

A class of claims has accepted a plan if such plan has been accepted by creditors, *other than any entity designated under subsection (e) of this section*, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by *106 creditors, *other than any entity designated under subsection (e) of this section*, that have accepted or rejected such plan.

11 U.S.C. § 1126(c) (emphasis added). For each class, then, the bankruptcy court must calculate two fractions based on the non-designated, allowed claims in the class. To arrive at the first fraction, the court divides the value of such claims that vote to accept the plan by the value of all claims that vote either way. For the second fraction, the court uses the number of claims rather than their value. If the first fraction equals two-thirds or more, and the second fraction more than one-half, then the class as a whole votes to accept the plan.

The arithmetic breaks down in cases like this one. Because the only claim in DISH's class belongs to DISH, whose vote the court designated, each fraction ends up as zero divided by zero. In this case, the plain meaning of the statute and common sense lead clearly to one answer: just as a bankruptcy court properly ignores designated *claims* when calculating the vote of a class, *see* 11 U.S.C. § 1126(e), so it should ignore a wholly designated *class* when deciding to confirm a plan under § 1129(a)(8).¹⁴ We agree with the bankruptcy court that any other rule “would make [the] designation ruling meaningless” in this context. *DBSD I*, 419 B.R. at 206.¹⁵ We therefore affirm the bankruptcy court's treatment of DISH's class.

3. Indubitable Equivalence

Finally, because we affirm the bankruptcy court's treatment of both DISH's vote and its class's vote, we do not reach that court's alternative theory that it could cram the plan down over DISH's objection because DISH realized “the indubitable

equivalent” of its First Lien Debt under the plan. 11 U.S.C. § 1129(b)(2)(A)(iii).

B. The Feasibility of the Plan

[35] [36] [37] To confirm a plan under Chapter 11, a bankruptcy court must find that the plan is feasible, or, more precisely, that “[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor ... unless such liquidation or reorganization is proposed in the plan.” 11 U.S.C. § 1129(a)(11). DISH argues that the feasibility of this plan is “purely speculative” and that the bankruptcy court therefore should not have confirmed it. We review a finding of feasibility only for clear error, *see In re Webb*, 932 F.2d 155, 158 (2d Cir.1991), and we find none here.

[38] For a plan to be feasible, it must “offer[] a reasonable assurance of success,” but it need not “guarantee[]” success. *Kane*, 843 F.2d at 649. Some possibility of liquidation or further reorganization *107 is acceptable and often unavoidable. The bankruptcy court applied this standard and found this plan feasible based primarily on four factors. *DBSD I*, 419 B.R. at 201–03.

First, the plan “dramatically deleverage[s]” DBSD. *Id.* at 202; *see In re Piece Goods Shops Co.*, 188 B.R. 778, 798 (Bankr.M.D.N.C.1995). Before bankruptcy, DBSD owed over \$800 million; the projected debt of the reformed DBSD would be as low as \$260 million as late as 2013. Given the bankruptcy court's valuation of a reorganized DBSD as worth between \$492 million and \$692 million, this debt reduction makes a big difference.

Second, the court found it likely that DBSD would be able to obtain the capital it needs. DBSD has already received commitments for a credit facility to provide working capital for the first two years. *DBSD I*, 419 B.R. at 203. After two years, DBSD would need further capital, but the court found “very reasonable” the possibility that DBSD will be able to secure either more financing or a strategic investor. *Id.* As evidence of this possibility, the court pointed to expert testimony, actual offers that had been made (including DISH's own offer), and the ability of similar companies to access the capital markets. The court also noted the likely attractiveness to future investors of DBSD's control over 20MHz of prime bandwidth, a “finite” and “very valuable” resource. *Id.* at 194.

Third, the court found little risk of default on DBSD's secured obligations to DISH, and still less risk that any such default

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

would lead to the liquidation or financial reorganization that § 1129(a)(11) seeks to avert. *Id.* at 203. The plan makes the interest on DISH's First Lien Debt, which had been payable in cash, payable only in kind, with no cash due for four years. This feature buys DBSD breathing room to shore up its position before it becomes necessary to secure significant additional capital, as described above.

Fourth, and finally, the bankruptcy court noted that general credit markets at the time of its decision in October 2009 had improved from their low a year before. *Id.* Although no one can predict market conditions two or four years down the road, the improvement the bankruptcy court noted was real, and increased the likelihood that DBSD will be able to repay its creditors.

Based on all of these factors, the bankruptcy court found the plan of reorganization feasible. *Id.* We find the bankruptcy court's analysis thorough and persuasive. DISH's arguments to the contrary do not successfully identify any clear error in it.

First, DISH argues that the bankruptcy court employed the wrong legal standard. DISH claims that a bankruptcy court cannot confirm a plan unless the proponents prove “specifics ... as to how the Debtors would be able to meet their repayment obligations at the end of the Plan period.” That is true at some level of generality, but exactly how specific those “specifics” must be depends on the circumstances. In most situations, the time immediately following bankruptcy will call for fairly specific proof of the company's ability to meet its obligations—as here, where it was “undisputed that the Debtors have commitments for working capital financing for the next two years.” *DBSD I*, 419 B.R. at 203. As one moves further away from the time of confirmation, however, the proof will necessarily become less and less specific. Had DBSD's plan called for the issuance of 20-year notes, for instance, no one would expect specifics about the sort of financing it might get in year 19. When a court is dealing with an intermediate time frame like the four years after which *108 the balloon payment comes due in this case, the level of proof required will be somewhere in the middle. In this context, the bankruptcy court based its feasibility finding on sufficiently specific proof to conclude that DBSD would be likely to avoid reorganization or liquidation even after four years. Overall, the bankruptcy court both stated and applied the correct standard in this case, dooming DISH's legal challenge.

[39] Second, DISH argues that the district court clearly erred in its fact-finding. At most, DISH's arguments on this front demonstrate that there is some chance that DBSD might eventually face liquidation or further reorganization. But that small chance does not change the feasibility analysis, which requires only a “reasonable assurance of success,” not an absolute “guarantee[].” *Kane*, 843 F.2d at 649. A small or even moderate chance of failure does not mean that the plan is “likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor.” 11 U.S.C. § 1129(a)(11) (emphasis added). We therefore uphold the bankruptcy court's feasibility determination.

CONCLUSION

For the reasons set forth above, we REVERSE the order of confirmation on absolute-priority grounds, AFFIRM on all other grounds, and REMAND for further proceedings consistent with this opinion.

POOLER, Circuit Judge, concurring in part, dissenting in part.

I join Judge Lynch's thoughtful opinion affirming the Bankruptcy Court's and District Court's orders concerning the appeal of DISH Network Corporation (“DISH”). I, however, respectfully dissent from the portion of the opinion granting appellate standing to Sprint Nextel Corporation (“Sprint”).

The question before us is whether Sprint, an out-of-the-money unsecured creditor with an unliquidated claim, has standing to challenge a Chapter 11 confirmation plan (the “Plan”) approved by all the creditors save the two who are before us, and affirmed by the bankruptcy and district courts below. See *DBSD II*, 421 B.R. 133 (Bankr.S.D.N.Y.2009); *DBSD III*, No. 09–civ–10156 (LAK), 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010). On appeal, Sprint raises only one argument: that a provision of the Plan allowing for a “gift” from the senior noteholders to the existing stockholder violates the absolute priority rule.

BACKGROUND

Sprint brings before this Court a claim initially brought against debtor New Satellite Services (“New Satellite”). New Satellite is one of the debtors that joined together to form a

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

business still in the developmental stage, for the purpose of providing mobile satellite services. DBSD, North America, Inc. (“DBSD”), the lead debtor, is a holding company and the direct or indirect corporate parent of the other debtors, including New Satellite. *See DBSD IV*, 427 B.R. 245, 249 (S.D.N.Y.2010). Sprint's complaint against New Satellite initially sought to recoup the costs of Sprint's relocation to a 2-gigahertz spectrum band (“2 GHz band”). Sprint alleged New Satellite owed Sprint its pro rata share of band clearing costs. Significantly, Sprint did not name the other debtors as defendants in its complaint, nor did it seek to hold the debtors jointly and severally liable for the reimbursement obligation. *See DBSD IV*, 427 B.R. at 249. This changed after the debtors, including New Satellite, filed for bankruptcy. Shortly thereafter, Sprint filed nine identical proofs of claim in the Chapter 11 cases *109 against each of the nine debtors, claiming that they were jointly and severally liable to Sprint for the full claim amount of at least \$1.9 billion. *See id.* The \$1.9 billion represented a nineteen-fold increase over the \$100 million Sprint had initially sought in its complaint against New Satellite. *See id.* The bankruptcy court rejected Sprint's claim of joint and several liability, and the district court affirmed this order on appeal. *See id.* at 254–55.

Before rejecting Sprint's claim of joint and several liability, the bankruptcy court temporarily allowed Sprint's claim for voting purposes only in the amount of \$2 million. *In re DBSD North America, Inc.*, Case No. 09–13061(REG) (Sept. 11, 2009); *see also DBSD I*, 419 B.R. 179, 203–04 (S.D.N.Y.2009). The bankruptcy court tentatively reached this decision, given that Sprint had not—and still has not—provided any documentation of the expenditures it claims it is owed. The bankruptcy court also noted that the 2 GHz band that Sprint acquired is so valuable that Sprint must make an anti-windfall payment to the United States Treasury in the amount of \$2.8 billion. *In re DBSD North America, Inc.*, Case No. 09–13061(REG) (Sept. 30, 2009). Moreover, the relocation agreement provided that Sprint could deduct any unrecouped band-clearing costs from the \$2.8 billion anti-windfall payment; it appeared to the court that Sprint had not taken its ability to offset into account when calculating its damages. *Id.* Thus, there is a very real possibility that Sprint's as-of-yet-undetermined relocation costs may be paid for in full without necessitating any recourse to DBSD. The bankruptcy court emphasized that Sprint's \$2 million claim was temporarily allowed “for voting purposes (*and those alone*).” *Id.* (emphasis added).

Twenty-four classes of claims ultimately voted in favor of the confirmation plan. Sprint and DISH were the only two creditors to object. Because DISH's votes were designated, Sprint—holding a contingent, disputed, and unliquidated claim—singlehandedly prevented the confirmation of a Plan that would have resulted in a reorganized entity worth between an undisputed \$ 492 million to \$692 million. *DBSD I*, 419 B.R. at 200.

DISCUSSION

The preliminary issue raised on appeal is whether Sprint has standing before this Court. If so, then the merits of its sole claim on appeal must be addressed—whether a gift from the senior noteholders to the existing stockholder and unsecured creditors, including Sprint, violates the absolute priority rule. Because I do not believe that Sprint has standing, I do not reach the merits of Sprint's challenge.

Standing is raised for the first time before this Court, as Sprint had standing below based on its challenge to the bankruptcy court's valuation of the estate. Sprint abandoned its position contesting the bankruptcy court's valuation on appeal, thus raising the question of whether an out-of-the-money, unsecured creditor with an unliquidated claim has standing.¹

The claims initially allowed in a bankruptcy proceeding are broad under the language of 11 U.S.C. § 101(4), and it is well-settled within our Circuit that the definition of such a claim “is to have wide scope.” *In re Chateaugay Corp.*, 944 F.2d 997, 1002–03 (2d Cir.1991). Our Circuit *110 has, however, purposely and periodically restricted appellate standing in bankruptcy proceedings. *See In re Gucci*, 126 F.3d 380, 388 (2d Cir.1997) (explaining that “[t]he stringency of our rule is rooted in a concern that freely granting open-ended appeals to those persons affected by bankruptcy court orders will sound the death knell of the orderly disposition of bankruptcy matters”). Accordingly, the equally well-settled rule concerning appellate standing is that merely being a party to a bankruptcy proceeding does not confer appellate standing to challenge the confirmation of a reorganization plan. *See In re Cosmopolitan Aviation Corp.*, 763 F.2d 507, 513 (2d Cir.1985), *abrogated on other grounds by Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993). Although creditors generally have standing to challenge orders that affect estate property, *see Kane v. Johns-Manville Corp.*, 843 F.2d 636, 642 (2d

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

Cir.1988), “[t]his general rule is based upon the assumption that ‘that sort of order directly affects the funds available to meet their claims.’ ” *In re Ashford Hotels, Ltd.*, 235 B.R. 734, 738 (S.D.N.Y.1999) (quoting *In re Gucci*, 126 F.3d at 388). Where an order has *no* effect on the funds available to meet a creditor’s claims—where the creditor is not “directly and adversely affected pecuniarily by the challenged order”—then appellate standing is lacking. *Int’l Trade Admin. v. Rensselaer Polytechnic Inst.*, 936 F.2d 744, 747 (2d Cir.1991) (internal quotation marks omitted). Thus, notwithstanding the opinion issued today, courts within our jurisdiction have analyzed the “aggrieved person” standard sufficient to confer standing, by looking to whether the appellant at issue would receive any money under the Plan, or under the valuation of the estate. See *Freeman v. Journal Register Co.*, No. 09 Civ. 7296, 2010 WL 768942, at *3 (S.D.N.Y. Mar.8, 2010); *In re Taylor*, No. 00 Civ. 5021, 2000 WL 1634371, at *2 (S.D.N.Y. Oct.30, 2000); *Bartel v. Bar Harbor Airways, Inc.*, 196 B.R. 268, 271–72 (S.D.N.Y.1996); see also *In re Ashford Hotels*, 235 B.R. at 738.

The situation before us, however, includes an additional wrinkle not addressed by today’s opinion: Sprint is not merely an out-of-the-money unsecured creditor, but its alleged direct and adverse pecuniary effect is based entirely on an unliquidated claim. That is, not only does Sprint get nothing under the Plan as an unsecured creditor, but as of today, Sprint has failed to demonstrate it is entitled to a single cent from DBSD, much less \$2 million.

Sprint’s argument that it has standing to appeal the confirmation order because it “might do better still under alternative plans” thus remains entirely speculative. Despite the indisputably weak foundation of Sprint’s request, I address its misguided reliance on *Kane*, which Sprint interprets to mean that showing one “might” do better under an alternative plan is all that is required for standing. Sprint and the Court both misinterpret *Kane*. First, *Kane* reiterated the rule that standing in a bankruptcy appeal requires a showing of direct and adverse pecuniary effect. 843 F.2d at 641 (quoting *Cosmopolitan Aviation*, 763 F.2d at 513). Second, *Kane* did not disturb the general rule that a showing of pecuniary injury requires more than mere speculation that a party *might* have been better off with alternatives that could have been pursued. See *In re Joint E. and S. Dist. Asbestos Litig.*, 78 F.3d 764, 779 (2d Cir.1996). Third, the plaintiff in *Kane* was not in line behind undersecured senior creditors. In *Kane*, there was “a sum well in excess of \$600 million” set aside to satisfy the unsecured claims of asbestos victims. See *In re Johns-*

Manville Corp., 66 B.R. 517, 528 (1986). Thus, it was not mere speculation in *Kane* that *111 the plaintiff could have done better under alternative plans because it was undisputed that the plaintiff was entitled to *something*. Here, in stark contrast, senior creditors are unsecured by over \$100 million and Sprint has been unable to demonstrate it is owed *anything*.

While it may be true that our Court should not bar all appeals from out-of-the money unsecured creditors, I, respectfully, cannot join an opinion that characterizes Sprint as a run-of-the-mill, out-of-the-money, unsecured creditor who has been “pecuniarily affected.” The opinion does not adequately address the facts before the Court, nor a possibility inherent in today’s ruling, that a creditor with a claim as tangential as Sprint’s may succeed in preventing the reorganization of an entity that may ultimately owe it nothing.

I decline to decide on the facts of this case whether an out-of-the-money creditor must take an appeal from a valuation decision to have standing. Indeed, I find it is less significant that Sprint failed to pursue its challenge to the bankruptcy court’s factual findings regarding the estate’s valuation, than that it failed to prove it is owed any amount of money in the first instance. In this regard Sprint is more akin to the creditors in *In re Ashford*, 235 B.R. 734, than the Court acknowledges, distinguishing that case on the basis that the *Ashford* court “never accepted the appellants’ attempts to characterize themselves as creditors.” While *In re Ashford* specifically involved a party whose interest in the bankruptcy proceeding was that of a potential defendant to another lawsuit, Sprint’s situation is nevertheless analogous in that it has similarly been unable to demonstrate an affirmative interest in the bankruptcy proceeding. Moreover, *In re Ashford* firmly supports the proposition that “the Second Circuit has made it clear that the parties who should be able to appeal Bankruptcy Court Orders are limited.” 235 B.R. at 739 (citing *Kane*, 843 F.2d at 642).

Insofar as the Court characterizes the above discussion as addressing “the ultimate merits of Sprint’s claim,” the Court misunderstands the purpose of such a discussion. The question before us is whether Sprint has standing—that is, whether Sprint has been “directly and adversely affected pecuniarily by the challenged order,” *Rensselaer*, 936 at 747. The answer *requires* identifying the nexus between Sprint and the bankruptcy proceeding in the first instance, as it is a task of Herculean proportions to find that a pecuniary interest has been adversely affected where no loss has been identified, and no connection to the bankruptcy proceeding established. The

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

silence on this issue is, as the Court indicates, telling—yet it is more a testament to the oddity of the claim before us, than to the propriety of the standing analysis.

While the Court relies heavily on the fact that the parties did not brief the issue in the specific context of standing, our decision is based on the facts provided by the parties themselves. And just as the Court relies on the bankruptcy court's emphatically temporary allowance of Sprint's claim in its decision, I rely on the facts set forth by both parties, as found by two different courts below us, which neither party claims were clearly erroneous. *In re Baker*, 604 F.3d 727, 729 (2d Cir.2010). Indeed, I find it difficult to agree with a rule which disregards the very genesis of the claim upon which

Sprint stands before us now, in determining how, and to what extent, its interests are directly and pecuniarily affected.

Under no reasonable understanding of Sprint's claim can it show that it suffered a pecuniary injury as a result of the confirmation plan. Accordingly, Sprint should ***112** not have standing before this Court. For these reasons, I respectfully dissent.

All Citations

634 F.3d 79, 65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

Footnotes

- 1 The bankruptcy court allowed Sprint's claim against only one of the several DBSD entities. See *DBSD IV*, 427 B.R. at 249–50. The court did not decide whether it mattered that Sprint's claim was allowed against only one subsidiary among several, see *DBSD I*, 419 B.R. at 210, and no party argues here that it makes any difference. We therefore do not reach the issue.
- 2 The court did not designate DISH's vote on its Second Lien Debt claims, because DISH's stake in that class was too small to make any difference. See *DBSD II*, 421 B.R. at 137 n. 12.
- 3 “While the ‘pecuniary interest’ formulation is an often used and often useful test of standing in the bankruptcy context, it ‘is not the only test.’” *In re Zamel*, 619 F.3d 156, 162 (2d Cir.2010), quoting *In re Revco D.S., Inc.*, 898 F.2d 498, 499 (6th Cir.1990). The “public interest” may also provide standing to appeal, as in the case of a United States Trustee, *id.* (emphasis in original), or the Securities and Exchange Commission, see *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434, 459–60, 60 S.Ct. 1044, 84 L.Ed. 1293 (1940). The parties here do not argue that the public interest test, or any other test besides the pecuniary interest test, is relevant to this case, so we address standing under that test alone.
- 4 The Code treats a claim as impaired unless the plan leaves in place all rights to which the claim entitles its holder, except for certain rights to accelerate payments after default. See 11 U.S.C. § 1124.
- 5 Sprint's lawsuit against a DBSD entity has not yet been resolved. The claim therefore could turn out to be worth as much as \$211 million or as little as nothing, but we follow the bankruptcy court's tentative valuation for the purposes of this appeal.
- 6 We note that not all distributions of property to a junior class are necessarily “on account of” the junior claims or interests. For example, the Supreme Court has left open the possibility that old equity could take under a plan if it invests new value in the reorganized entity, at least as long as a “market valuation” tests the adequacy of its contribution. 203 *North LaSalle*, 526 U.S. at 458, 119 S.Ct. 1411. In such a situation, the party receiving the property may argue—though we do not now decide the correctness of such an argument—that it does not receive anything “on account of” its interest but only on account of its new investment. For another example, our decision does not stop a senior claim-holder from receiving property on account of its senior claim just because the claim-holder also happens to hold a junior claim on account of which it receives nothing. See *id.* at 452 n. 24, 119 S.Ct. 1411. There may well be other examples.
- 7 Most importantly, the Code now determines objections on a class-by-class basis, not creditor-by-creditor. See 11 U.S.C. § 1129(b)(2)(B); Markell, 44 *Stan. L.Rev.* at 88.
- 8 This House Report references an earlier version of the bill, as the House Committee on the Judiciary reported it to the full House on September 8, 1977. See *B Collier on Bankruptcy* App. Pt. 4(d) at 4–873, 4–988 (15th ed.2009). Section 1129(b)(2) received several largely stylistic changes between that version and its eventual passage, but none altered the operation of the absolute priority rule in any way relevant here.
- 9 Our conclusion with respect to Sprint's appeal in itself requires reversal of the district court's order and vacation of the bankruptcy court's confirmation of the reorganization plan. It remains appropriate to consider DISH's appeal, however, because DISH raises distinct objections to the plan that, if accepted, would require revision of different aspects of the plan.
- 10 Commissioner Douglas also described the Hilton claim-holders telling the other parties, in effect, “For a price you can have our vote.” 1937 Hearing, *supra*, at 182. In this respect, Douglas's memory may have served him wrong, since at

In re DBSD North America, Inc., 634 F.3d 79 (2011)

65 Collier Bankr.Cas.2d 201, Bankr. L. Rep. P 81,933

least the opinion of the court of appeals records nothing along these lines, unless one interprets “a price” broadly to include reinstatement of a lease or reassignment of management rights.

- 11 Based on a House committee report, some have cited a further case, *Aladdin Hotel Co. v. Bloom*, 200 F.2d 627 (8th Cir.1953), as an example of what the authors of the 1978 Code meant to overrule when they reenacted the good faith requirement as § 1126(e). See, e.g., *In re Pleasant Hill Partners, L.P.*, 163 B.R. 388, 392–93 (Bankr.N.D.Ga.1994), quoting H.R.Rep. No. 95–595, at 411 (1977). But the committee actually intended a different provision (originally designated § 1126(e), hence the confusion) to overrule *Aladdin Hotel*, not the good faith provision (which was originally designated § 1126(f)). When Congress removed the former provision, the latter became § 1126(e) in its place. See *In re Dune Deck Owners Corp.*, 175 B.R. 839, 845 n. 13 (Bankr.S.D.N.Y.1995). The relevant committee report provides no insight into the good faith provision that began as § 1126(f) and became § 1126(e), instead merely paraphrasing the statutory language. H.R.Rep. No. 95–595, at 411 (1977).
- 12 Courts have been especially wary of the good faith of parties who purchase claims against their competitors. See *In re MacLeod*, 63 B.R. at 655; see also *In re Fighter*, 118 F.3d at 640 (finding no bad faith in part because party was not competitor); *In re 255 Park Plaza Assocs.*, 100 F.3d at 1219 (same); *In re Pine Hill Collieries Co.*, 46 F.Supp. 669, 672 (E.D.Pa.1942) (finding no bad faith even for a competitor, but only because competitor had a prior interest in the debtor).
- 13 The fact that DISH bought the First Lien Debt at par is circumstantial evidence of its intent, though we do not put as much weight on the price as the bankruptcy court did. See *DBSD II*, 421 B.R. at 140. It is certainly true, as the Loan Syndications and Trading Association points out in an *amicus* brief, that purchasers may have many good business reasons for buying debt at par, especially when, as in this case, the debt is well secured and interest rates dropped between the original issuance of the debt and its purchase. Buying claims at or above par therefore could not provide the sole basis for designating a creditor's vote. Nevertheless, a willingness to pay high prices may tend to show that the purchaser is interested in more than the claim for its own sake. The weight to be given to such evidence is primarily an issue for the finder of fact, and we see no clear error in the bankruptcy court's reliance on the factor in this case.
- 14 We state no conclusion on whether the same result is appropriate for other tests that the Code imposes, such as in §§ 1129(a)(7) and 1129(a)(10). We likewise do not decide how the bankruptcy court should treat classes in which no creditor files a timely vote. Compare *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263, 1266 (10th Cir.1988) (holding that debtor's “inaction constituted an acceptance of the Plan”), with *In re M. Long Arabians*, 103 B.R. 211, 215–16 (9th Cir. BAP 1989) (holding that “[t]he holder of a claim must affirmatively accept the plan”).
- 15 DISH argues that “[t]he plain language of section 1126(c) dictates that in order for a class to be deemed to have accepted a plan of reorganization, it must have actively voted in favor of the plan,” and that, because “the votes of any entity designated ... are excluded from both the numerator and denominator in determining whether a class has accepted a plan,” DISH's class cannot be found to have voted in favor of the plan. This makes no sense. A class with no qualifying members cannot be required to accept a plan by an affirmative vote.
- 1 The Court's distinction between the levels of generality at which Sprint's standing can be considered, is largely academic: if we hold Sprint has no standing to appeal based on the lack of direct and adverse pecuniary effect, there is no standing to appeal either the Plan generally, or one provision of the Plan in particular.

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...



KeyCite Yellow Flag - Negative Treatment

Declined to Extend by [In re Veg Liquidation, Inc.](#), 8th Cir., July 26, 2019

137 S.Ct. 973

Supreme Court of the United States

Casimir CZYZEWSKI, et al., Petitioners

v.

[JEVIC HOLDING CORP.](#), et al.

No. 15–649.

|

Argued Dec. 7, 2016.

|

Decided March 22, 2017.

Synopsis

Background: Order was entered by the United States Bankruptcy Court for the District of Delaware, approving settlement that resulted in structured dismissal of Chapter 11 case, and former employees of debtor appealed. The District Court, [Sue L. Robinson, J.](#), 2014 WL 268613, affirmed, and former employees appealed. The Third Circuit Court of Appeals, [Hardiman](#), Circuit Judge, 787 F.3d 173, affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice [Breyer](#), held that:

[1] former employees had Article III standing, and

[2] a bankruptcy court may not approve a structured dismissal of a Chapter 11 case that provides for distributions that do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent.

Reversed and remanded.

Justice [Thomas](#) filed a dissenting opinion in which Justice [Alito](#) joined.

West Headnotes (21)

[1] Bankruptcy

Types of cases

Business may file for bankruptcy under either Chapter 7 or Chapter 11 of the Bankruptcy Code.

3 Cases that cite this headnote

[2] Bankruptcy

Liquidation, Distribution, and Closing

In a Chapter 7 case, a trustee liquidates the debtor's assets and distributes them to creditors.

8 Cases that cite this headnote

[3] Bankruptcy

In general; nature and purpose

In a Chapter 11 case, debtor and creditors try to negotiate a plan that will govern the distribution of valuable assets from the debtor's estate and often keep the business operating as a going concern. 11 U.S.C.A. §§ 1121, 1123, 1129, 1141.

5 Cases that cite this headnote

[4] Bankruptcy

Creation of estate; time

Bankruptcy

Interest of debtor in general

Upon filing a Chapter 11 petition, an estate is created comprising all property of the debtor. 11 U.S.C.A. § 541(a)(1).

3 Cases that cite this headnote

[5] Bankruptcy

Debtor in possession

Bankruptcy

Debtor in possession, in general

After a Chapter 11 petition is filed, a fiduciary, often the debtor's existing management team, is installed to manage the estate in the interest of the creditors; acting as "debtor in possession," this fiduciary may operate the business and perform certain bankruptcy-related functions, such as seeking to recover for the estate preferential or fraudulent transfers made to other persons. 11 U.S.C.A. §§ 363(c)(1), 547, 548, 1106–1108.

2 Cases that cite this headnote

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

[6] **Bankruptcy**

🔑 Notice to creditors; commencement

Bankruptcy

🔑 Proceedings, Acts, or Persons Affected

Upon the filing of a Chapter 11 petition, an “automatic stay” of all collection proceedings against the debtor takes effect. 11 U.S.C.A. § 362(a).

1 Cases that cite this headnote

[7] **Bankruptcy**

🔑 Confirmation; Objections

Bankruptcy

🔑 In General; Grounds in General

Chapter 11 foresees three possible outcomes: confirmation of a court-approved plan that may keep the business operating while helping creditors by providing for payments, conversion of the case to Chapter 7 for liquidation of the business and distribution of its assets, or dismissal of the Chapter 11 case. 11 U.S.C.A. §§ 726, 1112(a, b), 1123, 1129, 1141.

2 Cases that cite this headnote

[8] **Bankruptcy**

🔑 Effect; proceedings in converted case

Dismissal of a Chapter 11 case typically revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case; in other words, it aims to return to the prepetition financial status quo. 11 U.S.C.A. § 349(b)(3).

11 Cases that cite this headnote

[9] **Bankruptcy**

🔑 Judicial authority or approval

Bankruptcy

🔑 Effect; proceedings in converted case

Recognizing that conditions may have changed in ways that make a perfect restoration of the status quo difficult or impossible, the Bankruptcy Code permits the bankruptcy court, for cause, to alter a Chapter 11 dismissal's ordinary restorative

consequences, so as to provide for a structured dismissal. 11 U.S.C.A. § 349(b).

4 Cases that cite this headnote

[10] **Bankruptcy**

🔑 Compromises, Releases, and Stipulations

Bankruptcy

🔑 Effect; proceedings in converted case

“Structured dismissal” is a dismissal of a Chapter 11 case that alters a dismissal's ordinary consequences of restoration of the prepetition financial status quo, or which has other special conditions attached. 11 U.S.C.A. § 349(b).

12 Cases that cite this headnote

[11] **Bankruptcy**

🔑 Priorities

Bankruptcy Code sets forth a basic system of priority, which ordinarily determines the order in which the bankruptcy court will distribute assets of the estate: secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts, special classes of creditors, such as those who hold certain claims for taxes or wages, come next in a listed order, followed by low-priority creditors, including general unsecured creditors, and then equity holders, who receive nothing until all previously listed creditors have been paid in full. 11 U.S.C.A. §§ 507, 725, 726.

3 Cases that cite this headnote

[12] **Bankruptcy**

🔑 Order of distribution

Distributions of assets in a Chapter 7 liquidation must follow the order prescribed by the Bankruptcy Code. 11 U.S.C.A. §§ 725, 726.

1 Cases that cite this headnote

[13] **Bankruptcy**

🔑 Preservation of priority

Although, with the consent of affected parties, Chapter 11 plans may impose a different

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

ordering of distributions than that set forth in the Bankruptcy Code's priority scheme, a bankruptcy court cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. 11 U.S.C.A. § 1129(a)(7), (b)(2).

7 Cases that cite this headnote

[14] **Corporations and Business Organizations**

🔑 Sale or Transfer of All or Controlling Interest of Stock

In a "leveraged buyout," the buyer (B) typically borrows from a third party (T) a large share of the funds needed to purchase a company (C), and B then pays the money to C's shareholders; having bought the stock, B owns C, and B then pledges C's assets to T so that T will have security for its loan.

1 Cases that cite this headnote

[15] **Labor and Employment**

🔑 Time

Federal Worker Adjustment and Retraining Notification (WARN) Act and similar New Jersey act require a company to give workers at least 60 days' notice before their termination. Worker Adjustment and Retraining Notification Act, § 3, 29 U.S.C.A. § 2102; N.J.S.A. 34:21–2.

Cases that cite this headnote

[16] **Bankruptcy**

🔑 Employees' Claims

That portion of former employees' judgment against Chapter 11 debtor that counted as a priority wage claim was entitled to payment ahead of general unsecured claims against the estate. 11 U.S.C.A. § 507(a)(4).

Cases that cite this headnote

[17] **Bankruptcy**

🔑 Right of review and persons entitled; parties; waiver or estoppel

Chapter 11 debtor's former employees, who held priority wage claims against debtor by virtue

of their WARN Act judgment against it, had Article III standing to challenge bankruptcy court's approval of settlement agreement that settled fraudulent-conveyance proceeding and resulted in structured dismissal of case, and that provided that former employees would receive nothing on their WARN claims but lower-priority general unsecured creditors would be paid; former employees suffered a loss, in that, as a consequence of bankruptcy court's approval of structured dismissal, they lost chance to obtain a settlement that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves, and a decision in former employees' favor was likely to redress that loss. U.S.C.A. Const. Art. 3, § 1 et seq.; 11 U.S.C.A. § 507; Worker Adjustment and Retraining Notification Act, § 3, 29 U.S.C.A. § 2102.

3 Cases that cite this headnote

[18] **Federal Civil Procedure**

🔑 In general; injury or interest

For standing purposes, a loss of even a small amount of money is ordinarily an "injury." U.S.C.A. Const. Art. 3, § 1 et seq.

19 Cases that cite this headnote

[19] **Bankruptcy**

🔑 Judicial authority or approval

Bankruptcy

🔑 Effect; proceedings in converted case

Bankruptcy court may not approve a structured dismissal of a Chapter 11 case that provides for distributions that do not follow the Bankruptcy Code's ordinary priority rules without the affected creditors' consent.

15 Cases that cite this headnote

[20] **Bankruptcy**

🔑 Order of distribution

In Chapter 7 liquidations, priority is an absolute command; lower priority creditors cannot receive anything until higher priority

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

creditors have been paid in full. 11 U.S.C.A. §§ 725, 726.

2 Cases that cite this headnote

[21] Bankruptcy

🔑 Priorities

Courts cannot alter the balance struck by the Bankruptcy Code's priority provisions, not even in "rare cases."

2 Cases that cite this headnote

*975 Syllabus *

There are three possible conclusions to a Chapter 11 bankruptcy. First, debtor and creditors may negotiate a plan to govern the distribution of the estate's value. See, e.g., 11 U.S.C. §§ 1121, 1123, 1129, 1141. Second, the bankruptcy court may convert the case to Chapter 7 for liquidation of the business and distribution of its assets to creditors. §§ 1112(a), (b), 726. Finally, the bankruptcy court may dismiss the case. § 1112(b). A court ordering a *976 dismissal ordinarily attempts to restore the prepetition financial status quo. § 349(b)(3). Yet if perfect restoration proves difficult or impossible, the court may, "for cause," alter the dismissal's normal restorative consequences, § 349(b)—i.e., it may order a "structured dismissal." The Bankruptcy Code also establishes basic priority rules for determining the order in which the court will distribute an estate's assets. The Code makes clear that distributions in a Chapter 7 liquidation must follow this prescribed order. §§ 725, 726. Chapter 11 permits some flexibility, but a court still cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. §§ 1129(a)(7), (b)(2). The Code does not explicitly state what priority rules—if any—apply to the distribution of assets in a structured dismissal.

Respondent Jevic Transportation filed for Chapter 11 bankruptcy after being purchased in a leveraged buyout. The bankruptcy prompted two lawsuits. In the first, a group of former Jevic truckdrivers, petitioners here, was awarded a judgment against Jevic for Jevic's failure to provide proper notice of termination in violation of state and federal Worker Adjustment and Retraining Notification (WARN) Acts. Part of that judgment counted as a priority wage

claim under § 507(a)(4), entitling the workers to payment ahead of general unsecured claims against the Jevic estate. In the second suit, a court-authorized committee representing Jevic's unsecured creditors sued Sun Capital and CIT Group, respondents here, for fraudulent conveyance in connection with the leveraged buyout of Jevic. These parties negotiated a settlement agreement that called for a structured dismissal of Jevic's Chapter 11 bankruptcy. Under the proposed structured dismissal, petitioners would receive nothing on their WARN claims, but lower-priority general unsecured creditors would be paid. Petitioners argued that the distribution scheme accordingly violated the Code's priority rules by paying general unsecured claims ahead of their own. The Bankruptcy Court nevertheless approved the settlement agreement and dismissed the case, reasoning that because the proposed payouts would occur pursuant to a structured dismissal rather than an approved plan, the failure to follow ordinary priority rules did not bar approval. The District Court and the Third Circuit affirmed.

Held :

1. Petitioners have Article III standing. Respondents argue that petitioners have not "suffered an injury in fact," or at least one "likely to be redressed by a favorable judicial decision," *Spokeo, Inc. v. Robins*, 578 U.S. —, —, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 because petitioners would have gotten nothing even if the Bankruptcy Court had never approved the structured dismissal and will still get nothing if the structured dismissal is undone now. That argument rests upon the assumptions that (1) without a violation of ordinary priority rules, there will be no settlement, and (2) without a settlement, the fraudulent-conveyance lawsuit has no value. The record, however, indicates both that a settlement that respects ordinary priorities remains a reasonable possibility and that the fraudulent-conveyance claim could have litigation value. Therefore, as a consequence of the Bankruptcy Court's approval of the structured dismissal, petitioners lost a chance to obtain a settlement that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves. A decision in their favor is likely to redress that loss. Pp. 982 – 983.

2. Bankruptcy courts may not approve structured dismissals that provide for distributions that do not follow ordinary *977 priority rules without the consent of affected creditors. Pp. 983 – 987.

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

(a) Given the importance of the priority system, this Court looks for an affirmative indication of intent before concluding that Congress means to make a major departure. See *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1. Nothing in the statute evinces such intent. Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. Read in context, § 349(b), which permits a bankruptcy judge, “for cause, [to] orde[r] otherwise,” seems designed to give courts the flexibility to protect reliance interests acquired in the bankruptcy, not to make general end-of-case distributions that would be flatly impermissible in a Chapter 11 plan or Chapter 7 liquidation. Precedent does not support a contrary position. *E.g.*, *In re Iridium Operating LLC*, 478 F.3d 452 (C.A.2), distinguished. Cases in which courts have approved deviations from ordinary priority rules generally involve interim distributions serving significant Code-related objectives. That is not the case here, where, *e.g.*, the priority-violating distribution is attached to a final disposition, does not preserve the debtor as a going concern, does not make the disfavored creditors better off, does not promote the possibility of a confirmable plan, does not help to restore the *status quo ante*, and does not protect reliance interests. Pp. 983 – 986.

(b) Congress did not authorize a “rare case” exception that permits courts to disregard priority in structured dismissals for “sufficient reasons.” The fact that it is difficult to give precise content to the concept of “sufficient reasons” threatens to turn the court below’s exception into a more general rule, resulting in uncertainty that has potentially serious consequences—*e.g.*, departure from the protections granted particular classes of creditors, changes in the bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals, risks of collusion, and increased difficulty in achieving settlements. Courts cannot deviate from the strictures of the Code, even in “rare cases.” Pp. 986 – 987.

787 F.3d 173, reversed and remanded.

BREYER, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, GINSBURG, SOTOMAYOR, and KAGAN, JJ., joined. THOMAS, J., filed a dissenting opinion, in which ALITO, J., joined.

Attorneys and Law Firms

Danielle Spinelli, Washington, DC, for Petitioners.

Sarah E. Harrington for the United States as amicus curiae, by special leave of the Court, supporting the Petitioners.

Christopher Landau, P.C., Washington, DC, for Respondents.

Jack A. Raisner, Rene S. Roupinian, Robert N. Fisher, Outten & Golden LLP, New York, NY, Christopher D. Loizides, Loizides P.A., Wilmington, DE, Danielle Spinelli, Craig Goldblatt, Joel Millar, Jonathan Seymour, Wilmer Cutler Pickering Hale and Dorr LLP, Washington, DC, for Petitioners.

Christopher Landau, P.C., James P. Gillespie, P.C., Jason M. Wilcox, Kirkland & Ellis LLP, Washington, DC, for Respondents Sun Capital Partners, Inc., Sun Capital Partners IV, LP & Sun Capital Partners Management IV, LLC.

Domenic E. Pacitti, Linda Richenderfer, Klehr Harrison Harvey, Branzburg LLP, Wilmington, DE, for Respondents Jevic Holding Corp., Jevic Transportation, Inc. & Creek Road Properties, LLC.

*978 Peter S. Partee, Sr., Richard P. Norton, Hunton & Williams LLP, New York, NY, for Respondent CIT Group / Business Credit, Inc., as Agent for the Lender Group.

Robert J. Feinstein, James E. O'Neill, Pachulski Stang Ziehl & Jones LLP, Wilmington, DE, for Respondent Official Committee of Unsecured Creditors.

Opinion

Justice BREYER delivered the opinion of the Court.

Bankruptcy Code Chapter 11 allows debtors and their creditors to negotiate a plan for dividing an estate’s value. See 11 U.S.C. §§ 1123, 1129, 1141. But sometimes the parties cannot agree on a plan. If so, the bankruptcy court may decide to dismiss the case. § 1112(b). The Code then ordinarily provides for what is, in effect, a restoration of the prepetition financial status quo. § 349(b).

In the case before us, a Bankruptcy Court dismissed a Chapter 11 bankruptcy. But the court did not simply restore the prepetition status quo. Instead, the court ordered a distribution of estate assets that gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 plan (or in a Chapter 7 liquidation). See §§ 507, 725, 726, 1129. The

question before us is whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 *dismissal*.

In our view, a bankruptcy court does not have such a power. A distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.

I

A

1

[1] [2] [3] We begin with a few fundamentals: A business may file for bankruptcy under either Chapter 7 or Chapter 11. In Chapter 7, a trustee liquidates the debtor's assets and distributes them to creditors. See § 701 *et seq.* In Chapter 11, debtor and creditors try to negotiate a plan that will govern the distribution of valuable assets from the debtor's estate and often keep the business operating as a going concern. See, e.g., §§ 1121, 1123, 1129, 1141 (setting out the framework in which the parties negotiate).

[4] [5] [6] Filing for Chapter 11 bankruptcy has several relevant legal consequences. First, an estate is created comprising all property of the debtor. § 541(a)(1). Second, a fiduciary is installed to manage the estate in the interest of the creditors. §§ 1106, 1107(a). This fiduciary, often the debtor's existing management team, acts as “debtor in possession.” §§ 1101(1), 1104. It may operate the business, §§ 363(c)(1), 1108, and perform certain bankruptcy-related functions, such as seeking to recover for the estate preferential or fraudulent transfers made to other persons, § 547 (transfers made before bankruptcy that unfairly preferred particular creditors); § 548 (fraudulent transfers, including transfers made before bankruptcy for which the debtor did not receive fair value). *979 Third, an “automatic stay” of all collection proceedings against the debtor takes effect. § 362(a).

[7] [8] It is important to keep in mind that Chapter 11 foresees three possible outcomes. The first is a bankruptcy-court-confirmed plan. Such a plan may keep the business operating but, at the same time, help creditors by providing

for payments, perhaps over time. See §§ 1123, 1129, 1141. The second possible outcome is conversion of the case to a Chapter 7 proceeding for liquidation of the business and a distribution of its remaining assets. §§ 1112(a), (b), 726. That conversion in effect confesses an inability to find a plan. The third possible outcome is dismissal of the Chapter 11 case. § 1112(b). A dismissal typically “revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case”—in other words, it aims to return to the prepetition financial status quo. § 349(b)(3).

[9] [10] Nonetheless, recognizing that conditions may have changed in ways that make a perfect restoration of the status quo difficult or impossible, the Code permits the bankruptcy court, “for cause,” to alter a Chapter 11 dismissal's ordinary restorative consequences. § 349(b). A dismissal that does so (or which has other special conditions attached) is often referred to as a “structured dismissal,” defined by the American Bankruptcy Institute as a

“hybrid dismissal and confirmation order ... that ... typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case.” American Bankruptcy Institute Commission To Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations 270 (2014).

Although the Code does not expressly mention structured dismissals, they “appear to be increasingly common.” *Ibid.*, n. 973.

2

[11] The Code also sets forth a basic system of priority, which ordinarily determines the order in which the bankruptcy court will distribute assets of the estate. Secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts. 11 U.S.C. § 725. Special classes of creditors, such as those who hold certain claims for taxes or wages, come next in a listed order. §§ 507, 726(a)(1). Then come low-priority creditors, including general unsecured creditors. § 726(a)(2). The Code places equity holders at the bottom of the priority list. They receive nothing until all previously listed creditors have been paid in full. § 726(a)(6).

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

[12] [13] The Code makes clear that distributions of assets in a Chapter 7 liquidation must follow this prescribed order. §§ 725, 726. It provides somewhat more flexibility for distributions pursuant to Chapter 11 plans, which may impose a different ordering with the consent of the affected parties. But a bankruptcy court cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class. §§ 1129(a)(7), 1129(b)(2).

The question here concerns the interplay between the Code's priority rules and a Chapter 11 dismissal. Here, the Bankruptcy Court neither liquidated the debtor under Chapter 7 nor confirmed a Chapter 11 plan. But the court, instead of reverting to the prebankruptcy status quo, ordered *980 a distribution of the estate assets to creditors by attaching conditions to the dismissal (*i.e.*, it ordered a structured dismissal). The Code does not explicitly state what priority rules—if any—apply to a distribution in these circumstances. May a court consequently provide for distributions that deviate from the ordinary priority rules that would apply to a Chapter 7 liquidation or a Chapter 11 plan? Can it approve conditions that give estate assets to members of a lower priority class while skipping objecting members of a higher priority class?

B

[14] In 2006, Sun Capital Partners, a private equity firm, acquired Jevic Transportation Corporation with money borrowed from CIT Group in a “leveraged buyout.” In a leveraged buyout, the buyer (B) typically borrows from a third party (T) a large share of the funds needed to purchase a company (C). B then pays the money to C's shareholders. Having bought the stock, B owns C. B then pledges C's assets to T so that T will have security for its loan. Thus, if the selling price for C is \$50 million, B might use \$10 million of its own money, borrow \$40 million from T, pay \$50 million to C's shareholders, and then pledge C assets worth \$40 million (or more) to T as security for T's \$40 million loan. If B manages C well, it might make enough money to pay T back the \$40 million and earn a handsome profit on its own \$10 million investment. But, if the deal sours and C descends into bankruptcy, beware of what might happen: Instead of C's \$40 million in assets being distributed to its existing creditors, the money will go to T to pay back T's loan—the loan that allowed B to buy C. (T will receive what remains of C's assets because T is now a secured creditor,

putting it at the top of the priority list). Since C's shareholders receive money while C's creditors lose their claim to C's remaining assets, unsuccessful leveraged buyouts often lead to fraudulent conveyance suits alleging that the purchaser (B) transferred the company's assets without receiving fair value in return. See Lipson & Vandermeuse, *Stern, Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts*, 2013 Wis. L.Rev. 1161, 1220–1221.

This is precisely what happened here. Just two years after Sun's buyout, Jevic (C in our leveraged buyout example) filed for Chapter 11 bankruptcy. At the time of filing, it owed \$53 million to senior secured creditors Sun and CIT (B and T in our example), and over \$20 million to tax and general unsecured creditors.

[15] [16] The circumstances surrounding Jevic's bankruptcy led to two lawsuits. First, petitioners, a group of former Jevic truckdrivers, filed suit in bankruptcy court against Jevic and Sun. Petitioners pointed out that, just before entering bankruptcy, Jevic had halted almost all its operations and had told petitioners that they would be fired. Petitioners claimed that Jevic and Sun had thereby violated state and federal Worker Adjustment and Retraining Notification (WARN) Acts—laws that require a company to give workers at least 60 days' notice before their termination. See 29 U.S.C. § 2102; N.J. Stat. Ann. § 34:21–2 (West 2011). The Bankruptcy Court granted summary judgment for petitioners against Jevic, leaving them (and *this* is the point to remember) with a judgment that petitioners say is worth \$12.4 million. See *In re Jevic Holding Corp.*, 496 B.R. 151 (Bkrty.Ct.D.Del.2013). Some \$8.3 million of that judgment counts as a priority wage claim under 11 U.S.C. § 507(a) (4), and is therefore entitled to payment ahead of general unsecured claims against the Jevic estate.

*981 Petitioners' WARN suit against Sun continued throughout most of the litigation now before us. But eventually Sun prevailed on the ground that Sun was not the workers' employer at the relevant times. See *In re Jevic Holding Corp.*, 656 Fed.Appx. 617 (C.A.3 2016).

Second, the Bankruptcy Court authorized a committee representing Jevic's unsecured creditors to sue Sun and CIT. The Bankruptcy Court and the parties were aware that any proceeds from such a suit would belong not to the unsecured creditors, but to the bankruptcy estate. See §§ 541(a)(1), (6); *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 552–553 (C.A.3 2003) (en banc)

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

(holding that a creditor's committee can bring a derivative action on behalf of the estate). The committee alleged that Sun and CIT, in the course of their leveraged buyout, had “hastened Jevic's bankruptcy by saddling it with debts that it couldn't service.” *In re Jevic Holding Corp.*, 787 F.3d 173, 176 (C.A.3 2015). In 2011, the Bankruptcy Court held that the committee had adequately pleaded claims of preferential transfer under § 547 and of fraudulent transfer under § 548. *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bkrty.Ct.D.Del., Sept. 15, 2011).

Sun, CIT, Jevic, and the committee then tried to negotiate a settlement of this “fraudulent-conveyance” lawsuit. By that point, the depleted Jevic estate's only remaining assets were the fraudulent-conveyance claim itself and \$1.7 million in cash, which was subject to a lien held by Sun.

The parties reached a settlement agreement. It provided (1) that the Bankruptcy Court would dismiss the fraudulent-conveyance action with prejudice; (2) that CIT would deposit \$2 million into an account earmarked to pay the committee's legal fees and administrative expenses; (3) that Sun would assign its lien on Jevic's remaining \$1.7 million to a trust, which would pay taxes and administrative expenses and distribute the remainder on a pro rata basis to the low-priority general unsecured creditors, *but which would not distribute anything to petitioners* (who, by virtue of their WARN judgment, held an \$8.3 million mid-level-priority wage claim against the estate); and (4) that Jevic's Chapter 11 bankruptcy would be dismissed.

Apparently Sun insisted on a distribution that would skip petitioners because petitioners' WARN suit against Sun was still pending and Sun did not want to help finance that litigation. See 787 F.3d, at 177–178, n. 4 (Sun's counsel acknowledging before the Bankruptcy Court that “ ‘Sun probably does care where the money goes because you can take judicial notice that there's a pending WARN action against Sun by the WARN plaintiffs. And if the money goes to the WARN plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis’ ”). The essential point is that, regardless of the reason, the proposed settlement called for a structured dismissal that provided for distributions that did not follow ordinary priority rules.

Sun, CIT, Jevic, and the committee asked the Bankruptcy Court to approve the settlement and dismiss the case. Petitioners and the U.S. Trustee objected, arguing that the

settlement's distribution plan violated the Code's priority scheme because it skipped petitioners—who, by virtue of their WARN judgment, had mid-level priority claims against estate assets—and distributed estate money to low-priority general unsecured creditors.

The Bankruptcy Court agreed with petitioners that the settlement's distribution scheme failed to follow ordinary priority *982 rules. App. to Pet. for Cert. 58a. But it held that this did not bar approval. *Ibid.* That, in the Bankruptcy Court's view, was because the proposed payouts would occur pursuant to a structured dismissal of a Chapter 11 petition rather than an approval of a Chapter 11 plan. *Ibid.* The court accordingly decided to grant the motion in light of the “dire circumstances” facing the estate and its creditors. *Id.*, at 57a. Specifically, the court predicted that without the settlement and dismissal, there was “no realistic prospect” of a meaningful distribution for anyone other than the secured creditors. *Id.*, at 58a. A confirmable Chapter 11 plan was unattainable. And there would be no funds to operate, investigate, or litigate were the case converted to a proceeding in Chapter 7. *Ibid.*

The District Court affirmed the Bankruptcy Court. It recognized that the settlement distribution violated ordinary priority rules. But those rules, it wrote, were “not a bar to the approval of the settlement as [the settlement] is not a reorganization plan.” *In re Jevic Holding Corp.*, 2014 WL 268613, *3 (D.Del., Jan. 24, 2014).

The Third Circuit affirmed the District Court by a vote of 2 to 1. 787 F.3d, at 175; *id.*, at 186 (Scirica, J., concurring in part and dissenting in part). The majority held that structured dismissals need not always respect priority. Congress, the court explained, had only “codified the absolute priority rule ... in the specific context of plan confirmation.” *Id.*, at 183. As a result, courts could, “in rare instances like this one, approve structured dismissals that do not strictly adhere to the Bankruptcy Code's priority scheme.” *Id.*, at 180.

Petitioners (the workers with the WARN judgment) sought certiorari. We granted their petition.

II

[17] Respondents initially argue that petitioners lack standing because they have suffered no injury, or at least no injury that will be remedied by a decision in their favor.

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

See *Spokeo, Inc. v. Robins*, 578 U.S. —, —, 136 S.Ct. 1540, 1547, 194 L.Ed.2d 635 (2016) (explaining that, for Article III standing, a plaintiff must have “(1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision”). Respondents concede that the structured dismissal approved by the Bankruptcy Court contained distribution conditions that skipped over petitioners, ensuring that petitioners received nothing on their multimillion-dollar WARN claim against the Jevic estate. But respondents still assert that petitioners suffered no loss.

The reason, respondents say, is that petitioners would have gotten nothing even if the Bankruptcy Court had never approved the structured dismissal in the first place, and will still get nothing if the structured dismissal is undone now. Reversal will eliminate the settlement of the committee's fraudulent-conveyance lawsuit, which was conditioned on the Bankruptcy Court's approval of the priority-violating structured dismissal. If the Bankruptcy Court cannot approve that dismissal, respondents contend, Sun and CIT will no longer agree to settle. Nor will petitioners ever be able to obtain a litigation recovery. Hence there will be no lawsuit money to distribute. And in the absence of lawsuit money, Jevic's assets amount to about \$1.7 million, all pledged to Sun, leaving nothing for anyone else, let alone petitioners. Thus, even if petitioners are right that the structured dismissal was impermissible, it cost them nothing. And a judicial decision in their favor will gain them nothing. No loss. No redress.

***983** This argument, however, rests upon respondents' claims (1) that, without a violation of ordinary priority rules, there will be no settlement, and (2) that, without a settlement, the fraudulent-conveyance lawsuit has no value. In our view, the record does not support either of these propositions.

As to the first, the record indicates that a settlement that respects ordinary priorities remains a reasonable possibility. It makes clear (as counsel made clear before our Court, see Tr. of Oral Arg. 58) that Sun insisted upon a settlement that gave petitioners nothing only because it did not want to help fund petitioners' WARN lawsuit against it. See 787 F.3d, at 177–178, n. 4. But, Sun has now won that lawsuit. See 656 Fed.Appx. 617. If Sun's given reason for opposing distributions to petitioners has disappeared, why would Sun not settle while permitting some of the settlement money to go to petitioners?

As to the second, the record indicates that the fraudulent-conveyance claim could have litigation value. CIT and Sun, after all, settled the lawsuit for \$3.7 million, which would make little sense if the action truly had no chance of success. The Bankruptcy Court could convert the case to Chapter 7, allowing a Chapter 7 trustee to pursue the suit against Sun and CIT. Or the court could simply dismiss the Chapter 11 bankruptcy, thereby allowing petitioners to assert the fraudulent-conveyance claim themselves. Given these possibilities, there is no reason to believe that the claim could not be pursued with counsel obtained on a contingency basis. Of course, the lawsuit—like any lawsuit—*might* prove fruitless, but the mere *possibility* of failure does not eliminate the value of the claim or petitioners' injury in being unable to bring it.

[18] Consequently, the Bankruptcy Court's approval of the structured dismissal cost petitioners something. They lost a chance to obtain a settlement that respected their priority. Or, if not that, they lost the power to bring their own lawsuit on a claim that had a settlement value of \$3.7 million. For standing purposes, a loss of even a small amount of money is ordinarily an “injury.” See, e.g., *McGowan v. Maryland*, 366 U.S. 420, 430–431, 81 S.Ct. 1101, 6 L.Ed.2d 393 (1961) (finding that appellants fined \$5 plus costs had standing to assert an Establishment Clause challenge). And the ruling before us could well have cost petitioners considerably more. See *Clinton v. City of New York*, 524 U.S. 417, 430–431, 118 S.Ct. 2091, 141 L.Ed.2d 393 (1998) (imposition of a “substantial contingent liability” qualifies as an injury). A decision in petitioners' favor is likely to redress that loss. We accordingly conclude that petitioners have standing.

III

[19] We turn to the basic question presented: Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? Our simple answer to this complicated question is “no.”

[20] The Code's priority system constitutes a basic underpinning of business bankruptcy law. Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. In Chapter 7 liquidations, priority is an absolute command—lower priority creditors cannot receive anything until higher

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

priority creditors have been paid in full. See [11 U.S.C. §§ 725, 726](#). Chapter 11 plans provide somewhat more flexibility, but a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors. See [§ 1129\(b\)](#).

***984** The priority system applicable to those distributions has long been considered fundamental to the Bankruptcy Code's operation. See [H.R.Rep. No. 103–835, p. 33](#) (1994) (explaining that the Code is “designed to enforce a distribution of the debtor's assets in an orderly manner ... in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor”); [Roe & Tung, Breaking Bankruptcy Priority: How Rent–Seeking Upends The Creditors' Bargain](#), 99 Va. L. Rev. 1235, 1243, 1236 (2013) (arguing that the first principle of bankruptcy is that “distribution conforms to predetermined statutory and contractual priorities,” and that priority is, “quite appropriately, bankruptcy's most important and famous rule”); [Markell, Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations](#), 44 Stan. L. Rev. 69, 123 (1991) (stating that a fixed priority scheme is recognized as “the cornerstone of reorganization practice and theory”).

The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure. See [Whitman v. American Trucking Assns., Inc.](#), 531 U.S. 457, 468, 121 S.Ct. 903, 149 L.Ed.2d 1 (2001) (“Congress ... does not, one might say, hide elephants in mouseholes”). Put somewhat more directly, we would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans.

We can find nothing in the statute that evinces this intent. The Code gives a bankruptcy court the power to “dismiss” a Chapter 11 case. [§ 1112\(b\)](#). But the word “dismiss” itself says nothing about the power to make nonconsensual priority-violating distributions of estate value. Neither the word “structured,” nor the word “conditions,” nor anything else about distributing estate value to creditors pursuant to a dismissal appears in any relevant part of the Code.

Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. See [§ 349\(b\)\(1\)](#) (dismissal ordinarily reinstates a variety of avoided transfers and voided liens); [§ 349\(b\)\(2\)](#) (dismissal ordinarily vacates certain types of

bankruptcy orders); [§ 349\(b\)\(3\)](#) (dismissal ordinarily “revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case”); see also [H.R.Rep. No. 95–595, p. 338](#) (1977) (dismissal's “basic purpose ... is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case”).

[Section 349\(b\)](#), we concede, also says that a bankruptcy judge may, “for cause, orde[r] otherwise.” But, read in context, this provision appears designed to give courts the flexibility to “make the appropriate orders to protect rights acquired in reliance on the bankruptcy case.” [H.R.Rep. No. 95–595, at 338](#); cf., e.g., [Wiese v. Community Bank of Central Wis.](#), 552 F.3d 584, 590 (C.A.7 2009) (upholding, under [§ 349\(b\)](#), a Bankruptcy Court's decision not to reinstate a debtor's claim against a bank that gave up a lien in reliance on the claim being released in the debtor's reorganization plan). Nothing else in the Code authorizes a court ordering a dismissal to make general end-of-case distributions of estate assets to creditors of the kind that normally take place in a Chapter 7 liquidation or Chapter 11 plan—let alone final distributions that do ***985** not help to restore the *status quo ante* or protect reliance interests acquired in the bankruptcy, and that would be flatly impermissible in a Chapter 7 liquidation or a Chapter 11 plan because they violate priority without the impaired creditors' consent. That being so, the word “cause” is too weak a reed upon which to rest so weighty a power. See [United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.](#), 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) (noting that “[s]tatutory construction ... is a holistic endeavor” and that a court should select a “meanin[g] that] produces a substantive effect that is compatible with the rest of the law”); [Kelly v. Robinson](#), 479 U.S. 36, 43, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) (in interpreting a statute, a court “must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy” (internal quotation marks omitted)); cf. [In re Sadler](#), 935 F.2d 918, 921 (C.A.7 1991) (“‘Cause’ under [§ 349\(b\)](#) means an acceptable reason. Desire to make an end run around a statute is not an adequate reason”).

We have found no contrary precedent, either from this Court, or, for that matter, from lower court decisions reflecting common bankruptcy practice. The Third Circuit referred briefly to [In re Buffet Partners, L.P.](#), 2014 WL 3735804 (Bkrcty.Ct.N.D.Tex., July 28, 2014). The court in that case approved a structured dismissal. (We express no view about

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

the legality of structured dismissals in general.) But at the same time it pointed out “that not one party with an economic stake in the case has objected to the dismissal in this manner.” *Id.*, at *4.

The Third Circuit also relied upon *In re Iridium Operating LLC*, 478 F.3d 452 (C.A.2 2007). But *Iridium* did not involve a structured dismissal. It addressed an *interim* distribution of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf. See *id.*, at 459–460. The *Iridium* court observed that, when evaluating this type of preplan settlement, “[i]t is difficult to employ the rule of priorities” because “the nature and extent of the Estate and the claims against it are *not yet fully resolved*.” *Id.*, at 464 (emphasis added). The decision does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues.

We recognize that *Iridium* is not the only case in which a court has approved interim distributions that violate ordinary priority rules. But in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve. Courts, for example, have approved “first-day” wage orders that allow payment of employees' prepetition wages, “critical vendor” orders that allow payment of essential suppliers' prepetition invoices, and “roll-ups” that allow lenders who continue financing the debtor to be paid first on their prepetition claims. See *Cybergenics*, 330 F.3d, at 574, n. 8; D. Baird, *Elements of Bankruptcy* 232–234 (6th ed. 2014); Roe, 99 Va. L. Rev., at 1250–1264. In doing so, these courts have usually found that the distributions at issue would “enable a successful reorganization and make even the disfavored creditors better off.” *In re Kmart Corp.*, 359 F.3d 866, 872 (C.A.7 2004) (discussing the justifications for critical-vendor orders); see also *Toibb v. Radloff*, 501 U.S. 157, 163–164, 111 S.Ct. 2197, 115 L.Ed.2d 145 (1991) (recognizing “permitting business debtors to reorganize and restructure their debts in order to revive the debtors' businesses” and “maximizing the value of the bankruptcy estate” as purposes of the Code). By way of contrast, in a structured *986 dismissal like the one ordered below, the priority-violating distribution is attached to a final disposition; it does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not help to restore the *status quo ante*; and it does not protect reliance interests. In short, we cannot find in the violation

of ordinary priority rules that occurred here any significant offsetting bankruptcy-related justification.

Rather, the distributions at issue here more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards. See, e.g., *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (C.A.5 1983) (prohibiting an attempt to “short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets”); *In re Lionel Corp.*, 722 F.2d 1063, 1069 (C.A.2 1983) (reversing a Bankruptcy Court's approval of an asset sale after holding that § 363 does not “gran[t] the bankruptcy judge *carte blanche*” or “swallo[w] up Chapter 11's safeguards”); *In re Biolitec, Inc.*, 528 B.R. 261, 269 (Bkrcty.Ct.N.J.2014) (rejecting a structured dismissal because it “seeks to alter parties' rights without their consent and lacks many of the Code's most important safeguards”); cf. *In re Chrysler LLC*, 576 F.3d 108, 118 (C.A.2 2009) (approving a § 363 asset sale because the bankruptcy court demonstrated “proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority”), vacated as moot, 592 F.3d 370 (C.A.2 2010) (*per curiam*).

IV

We recognize that the Third Circuit did not approve nonconsensual priority-violating structured dismissals in general. To the contrary, the court held that they were permissible only in those “rare case[s]” in which courts could find “sufficient reasons” to disregard priority. 787 F.3d, at 175, 186. Despite the “rare case” limitation, we still cannot agree.

For one thing, it is difficult to give precise content to the concept “sufficient reasons.” That fact threatens to turn a “rare case” exception into a more general rule. Consider the present case. The Bankruptcy Court feared that (1) without the worker-skipping distribution, there would be no settlement, (2) without a settlement, all the unsecured creditors would receive nothing, and consequently (3) its distributions would make some creditors (high- and low-priority creditors) better off without making other (mid-priority) creditors worse off (for they would receive nothing regardless). But, as we have pointed out, the record provides equivocal support for the first two propositions. See *supra*, at 982 – 983. And, one can readily imagine other cases that turn on comparably dubious

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

predictions. The result is uncertainty. And uncertainty will lead to similar claims being made in many, not just a few, cases. See Rudzik, [A Priority Is a Priority Is a Priority—Except When It Isn't](#), 34 Am. Bankr. Inst. J. 16, 79 (2015) (“[O]nce the floodgates are opened, debtors and favored creditors can be expected to make every case that ‘rare case’”).

The consequences are potentially serious. They include departure from the protections Congress granted particular classes of creditors. See, e.g., [United States v. Embassy Restaurant, Inc.](#), 359 U.S. 29, 32, 79 S.Ct. 554, 3 L.Ed.2d 601 (1959) (Congress established employee wage priority “to alleviate in some degree the hardship that unemployment usually brings to workers and their families” when an employer files for bankruptcy); *987 H.R.Rep. No. 95–595, at 187 (explaining the importance of ensuring that employees do not “abandon a failing business for fear of not being paid”). They include changes in the bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals. See Warren, [A Theory of Absolute Priority](#), 1991 Ann. Survey Am. L. 9, 30. They include risks of collusion, i.e., senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors. See [Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership](#), 526 U.S. 434, 444, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) (discussing how the absolute priority rule was developed in response to “concern with ‘the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage’” (quoting H.R. Doc. No. 93–137, pt. I, p. 255 (1973))). And they include making settlement more difficult to achieve. See Landes & Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J. Law & Econ. 249, 271 (1976) (arguing that “the ratio of lawsuits to settlements is mainly a function of the amount of uncertainty, which leads to divergent estimates by the parties of the probable outcome”); see also [RadLAX Gateway Hotel, LLC v. Amalgamated Bank](#), 566 U.S. 639, 649, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) (noting the importance of clarity and predictability in light of the fact that the “Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law”).

[21] For these reasons, as well as those set forth in Part III, we conclude that Congress did not authorize a “rare case” exception. We cannot “alter the balance struck by the statute,” [Law v. Siegel](#), 571 U.S. —, —, 134 S.Ct. 1188, 1198, 188 L.Ed.2d 146 (2014), not even in “rare cases.” Cf. [Norwest](#)

[Bank Worthington v. Ahlers](#), 485 U.S. 197, 207, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (explaining that courts cannot deviate from the procedures “specified by the Code,” even when they sincerely “believ[e] that ... creditors would be better off”). The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Justice THOMAS, with whom Justice ALITO joins, dissenting.

Today, the Court answers a novel and important question of bankruptcy law. Unfortunately, it does so without the benefit of any reasoned opinions on the dispositive issue from the courts of appeals (apart from the Court of Appeals' opinion in this case) and with briefing on that issue from only one of the parties. That is because, having persuaded us to grant certiorari on one question, petitioners chose to argue a different question on the merits. In light of that switch, I would dismiss the writ of certiorari as improvidently granted.

We granted certiorari to decide “[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme.” Pet. for Cert. i. According to petitioners, the decision below “deepened an existing ... split” among the Courts of Appeals on this question. *Id.*, at 8; see *id.*, at 15–16 (citing [In re AWECO, Inc.](#), 725 F.2d 293, 298 (C.A.5 1984), and [In re Iridium Operating LLC](#), 478 F.3d 452, 464 (C.A.2 2007)). After we granted certiorari, however, petitioners recast the question presented to ask “[w]hether a Chapter 11 case may be terminated by a ‘structured dismissal’ that distributes estate property in violation of the Bankruptcy Code’s priority scheme.” Brief for Petitioners i. Although both questions *988 involve priority-skipping distributions of estate assets, the recast question is narrower—and different—than the one on which we granted certiorari. It is also not the subject of a circuit conflict.

I think it is unwise for the Court to decide the reformulated question today, for two reasons. First, it is a “novel question of bankruptcy law” arising in the rapidly developing field of structured dismissals. [In re Jevic Holding Corp.](#), 787 F.3d 173, 175 (C.A.3 2015). Experience shows that we would greatly benefit from the views of additional courts of appeals on this question. We also would have benefited from full, adversarial briefing. In reliance on this Court’s

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242...

Rules prohibiting parties from changing the substance of the question presented, see Rule 24.1(a); see also Rule 14.1(a), respondents declined to brief the question that the majority now decides, see Brief for Respondents 52. Second, deciding this question may invite future petitioners to seek review of a circuit conflict only then to change the question to one that seems more favorable. “I would not reward such bait-and-switch tactics.” *City and County of San Francisco v. Sheehan*, 575 U.S. —, —, 135 S.Ct. 1765, 1779, 191 L.Ed.2d 856 (2015) (Scalia, J., concurring in part and dissenting in part); see also *Visa, Inc. v. Osborn*, — U.S. —, —, 136 S.Ct. 2543, 195 L.Ed.2d 867 (2016) *post*, *p.* —.

Accordingly, I would dismiss the writ as improvidently granted. I respectfully dissent.

All Citations

137 S.Ct. 973, 197 L.Ed.2d 398, 85 USLW 4115, 77 Collier Bankr.Cas.2d 596, 63 Bankr.Ct.Dec. 242, Bankr. L. Rep. P 83,082, 41 IER Cases 1613, 17 Cal. Daily Op. Serv. 2766, 2017 Daily Journal D.A.R. 2805, 26 Fla. L. Weekly Fed. S 495

Footnotes

- * The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

590 B.R. 75

United States District Court, D. Delaware.

IN RE: [NUVERRA ENVIRONMENTAL SOLUTIONS, INC.](#), et al., Debtors.

David Hargreaves, Appellant,

v.

[Nuverra Environmental Solutions, Inc.](#), et al., Appellees.

Case No. 17-10949-KJC (Jointly Administered)

|
Civ. No. 17-1024-RGA|
Signed 08/21/2018**Synopsis**

Background: General unsecured creditor objected to debtors' proposed Chapter 11 plan. The Bankruptcy Court entered order cramming the plan down over creditor's objection, and creditor appealed.

Holdings: The District Court, [Andrews, J.](#), held that:

[1] creditor's appeal was equitably moot;

[2] debtors' proposed plan did not "unfairly discriminate" in favor of unsecured creditors holding trade and business-related claims and against creditors holding other general unsecured claims; and

[3] debtors had rational basis for placing, in separate class from other general unsecured creditors, unsecured creditors which held trade and business-related claims.

Dismissed or, alternatively, affirmed.

West Headnotes (20)

[1] **Bankruptcy**

🔑 Conclusions of law; de novo review

Bankruptcy

🔑 Discretion

Bankruptcy

🔑 Clear error

On appeal, district court reviews bankruptcy court's legal determinations de novo, its factual findings for clear error, and its exercise of discretion for abuse thereof. [Fed. R. Bankr. P. 8013](#).

[Cases that cite this headnote](#)

[2] **Bankruptcy**

🔑 Moot questions

Equitable mootness is narrow doctrine by which a bankruptcy appellate court deems it prudent, for practical reasons, to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plan of reorganization.

[Cases that cite this headnote](#)

[3] **Bankruptcy**

🔑 Moot questions

Court assesses equitable mootness through the application of prudential considerations that address concerns unique to bankruptcy proceedings.

[Cases that cite this headnote](#)

[4] **Bankruptcy**

🔑 Moot questions

In deciding whether bankruptcy appeal is equitably moot, court proceeds in two analytical steps by considering, first, whether a confirmed plan has been substantially consummated, and if so, whether granting the relief requested on appeal will fatally scramble the plan and/or significantly harm third parties who have justifiably relied on plan confirmation.

[Cases that cite this headnote](#)

[5] **Bankruptcy**

🔑 Presumptions and burdens of proof

Reorganized Chapter 11 debtors, as parties asserting that appeal from order confirming their

prepackaged reorganization plan was equitably moot, bore burden of overcoming strong presumption that appeals from plan confirmation orders, even those not only approved by confirmation but implemented thereafter, need to be decided.

[Cases that cite this headnote](#)

[6] **Bankruptcy**

🔑 Moot questions

Appeal from unstayed order of bankruptcy court confirming proposed Chapter 11 plan, pursuant to which, due to contributions voluntarily made by secured creditors, unsecured trade and business creditors that otherwise would have received no distribution on their claims would be paid in full, while other general unsecured creditors would receive a lesser benefit of distribution of 4 to 6%, was equitably moot once plan was substantially consummated, despite objecting unsecured creditor's contention that district court, without unwinding plan, could simply order that he receive same treatment as trade and business creditors; court could not direct that objecting unsecured creditor receive treatment different from each other creditor in his class, and even if it could, it was unclear from where any additional distribution to him would come, as court could not compel secured creditors to increase their contributions.

[Cases that cite this headnote](#)

[7] **Bankruptcy**

🔑 Moot questions

Even when a court applies doctrine of equitable mootness, it does so with a scalpel rather than an axe, and may fashion whatever relief is practicable instead of declining review simply because full relief is unavailable.

[Cases that cite this headnote](#)

[8] **Bankruptcy**

🔑 Fairness and Equity; "Cram Down."

Pertinent inquiry for court, in deciding whether Chapter 11 plan may be "crammed down" over

objection of impaired dissenting class, is not whether the plan discriminates, but whether any proposed discrimination is "unfair." 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[9] **Bankruptcy**

🔑 Fairness and Equity; "Cram Down."

Courts generally examine the facts and circumstances of the particular case in deciding whether any "unfair discrimination" exists, such as will preclude "cramdown" of proposed Chapter 11 plan. 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[10] **Bankruptcy**

🔑 Fairness and Equity; "Cram Down."

In deciding whether proposed Chapter 11 plan "unfairly discriminates" against impaired dissenting class, so as to preclude its "cramdown," courts are concerned with whether there is a reasonable basis for the discrimination, and whether the debtor can confirm and consummate a plan without the proposed discrimination. 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[11] **Bankruptcy**

🔑 Confirmation; Objections

Rebuttable presumption of "unfair discrimination," such as may prevent court from "cramming down" a proposed Chapter 11 plan, arises when there is (1) a dissenting class, (2) another class of the same priority, and (3) a difference in the plan's treatment of the two classes that results in either a materially lower percentage recovery for the dissenting class, measured in terms of the net present value of all payments, or regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution. 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[12] Bankruptcy

🔑 Fairness and Equity; "Cram Down."

Whether the discriminatory treatment in proposed Chapter 11 plan should be deemed "unfair," so as to prevent court from "cramming down" the plan over the objection of impaired dissenting class, is to be viewed based on its effect on the dissenting class. 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[13] Bankruptcy

🔑 Unsecured creditors and equity holders, protection of

Debtors' proposed Chapter 11 plan did not "unfairly discriminate" in favor of unsecured creditors holding trade and business-related claims and against creditors holding other general unsecured claims, and could be "crammed down" over objection of an impaired dissenting unsecured creditor, though trade creditors, as result of contributions voluntarily made by secured creditors, would receive a 100% distribution on their claims while other general unsecured creditors would receive a distribution of only 4 to 6%, where unsecured creditors as whole were out of money, and neither the trade nor other general unsecured creditors would have received any distribution at all but for contributions of secured creditors in making funds available for distribution, predominantly, to creditors important to debtors' business. 11 U.S.C.A. § 1129(b)(1).

[Cases that cite this headnote](#)

[14] Bankruptcy

🔑 Confirmation; Objections

Congress intended to afford bankruptcy judges broad discretion to decide the propriety of proposed Chapter 11 plans in light of the facts of each case.

[Cases that cite this headnote](#)

[15] Bankruptcy

🔑 Provisions for satisfaction of claims; relation to recovery in liquidation

Bankruptcy

🔑 Preservation of priority

While vertical gifting that funds distribution to holder of claim or interest that is junior to the claims of impaired dissenting class may be improper, as violative of absolute priority rule, there is no per se prohibition against all gifting in plan, whereby one class, by carve-out or contribution, makes funds available for distribution to other creditors.

[Cases that cite this headnote](#)

[16] Bankruptcy

🔑 Classification of claims

Plan proponent has significant flexibility in classifying claims and interests into different classes in proposed Chapter 11 plan, as long as a rational legal or factual basis for separate classification exists, and as long as all claims or interests within a particular class are substantially similar. 11 U.S.C.A. § 1122(a).

[Cases that cite this headnote](#)

[17] Bankruptcy

🔑 Classification of claims

Bankruptcy court's focus, when analyzing whether the claims within a given class are substantially similar, such that they may be classified together, should be on the legal character of the claims as they relate to the assets of the Chapter 11 debtor. 11 U.S.C.A. § 1122(a).

[Cases that cite this headnote](#)

[18] Bankruptcy

🔑 Classification of claims

Bankruptcy court's focus, when analyzing whether the claims within a given class are substantially similar, such that they may be classified together, should be on the legal attributes of the claims and not upon the status or circumstances of the claimant; emphasis is not upon the holder so much as it is upon that which is held. 11 U.S.C.A. § 1122(a).

Cases that cite this headnote

[19] **Bankruptcy**

🔑 Classification of claims

Classification of claims or interests in proposed Chapter 11 plan must be reasonable, and claims or interests cannot be grouped together for arbitrary or fraudulent purposes. 11 U.S.C.A. § 1122(a).

Cases that cite this headnote

[20] **Bankruptcy**

🔑 Classification of claims

Chapter 11 debtors had rational basis for placing, in separate class from other general unsecured creditors, unsecured creditors which held trade and business-related claims, and with which it was important for debtors to maintain business relationships, and such separate classification, with trade creditors to receive a 100% distribution using funds voluntarily contributed by secured creditors, did not prevent bankruptcy court from confirming debtors' proposed reorganization plan. 11 U.S.C.A. § 1122(a).

Cases that cite this headnote

Attorneys and Law Firms

*78 Steven K. Kortanek, Esq., Drinker Biddle & Reath LLP, Wilmington, DE; James H. Millar, Esq. (argued), Clay J. Pierce, Esq., and Stacy A. Lutkus, Esq., Drinker Biddle & Reath LLP, New York, NY, attorneys for Appellant David Hargreaves.

Pauline K. Morgan, Esq., Kenneth J. Enos, Esq., and Jaime Luton Chapman, Esq., Young Conaway Stargatt & Taylor, LLP, Wilmington, DE; Frederic Sosnick, Esq. (argued), and Sara Coelho, Esq., Shearman & Sterling LLP, New York, NY, attorneys for Appellees, Reorganized Debtors.

MEMORANDUM

ANDREWS, UNITED STATES DISTRICT JUDGE:

Presently before the Court is the appeal (D.I. 1) of David Hargreaves with respect to the Bankruptcy Court's Order Confirming the Amended Prepackaged Plans of Reorganization of Nuverra Environmental Solutions, Inc. and its Affiliated Debtors, dated July 25, 2017 (B.D.I. 366)¹ ("Confirmation Order"). The merits of the appeal are fully briefed. Also before the Court is *79 the Reorganized Debtors' motion to dismiss the appeal (D.I. 31) ("Motion to Dismiss") on the basis of equitable mootness. For the reasons set forth below, the appeal meets the criteria for equitable mootness, and the Court rules in the alternative that the Confirmation Order is affirmed.

I. BACKGROUND

The appeal arises from Debtors' plan of reorganization, pursuant to which secured creditors, who would not receive 100% recovery on their secured claims, made a gift to general unsecured creditors, who would otherwise receive no distribution under the Bankruptcy Code's priority scheme, in order to enable the Debtors to reorganize. Even though unsecured creditors would receive no distribution absent the gift, Appellant has appealed the Confirmation Order based on the fact that the plan placed general unsecured claims of the same priority into separate classes and provided disparate treatment.

The relevant facts are uncontested. In the months leading up to the bankruptcy filing, Debtors struggled with liquidity and negotiated with certain creditors toward a prepackaged plan of reorganization. On April 28, 2017, Debtors commenced a prepetition solicitation of votes on the negotiated plan. (See B.D.I. 14). On May 1, 2017, Debtors commenced their chapter 11 cases ("Petition Date"), at which time Debtors had approximately \$500 million in secured debt and an uncontroverted value of approximately \$302.5 million. (See B.D.I. 14 at Art. VIII). On the Petition Date, Debtors filed an initial plan of reorganization, which was amended on June 21, 2017 (B.D.I. 366) ("Plan").

According to Reorganized Debtors, to ensure that the Debtors' businesses remain viable and positioned for growth, the Plan eliminated approximately \$500 million of funded debt through the conversion to equity of certain 12.5%/10% senior secured second lien notes due 2021 (the "2021 Notes"), the Debtors' 9.875% unsecured senior notes due 2018 ("2018 Notes"), a term loan facility provided for under the term

loan agreement dated April 15, 2016 (the “Term Loan Facility”), and a \$12.5 million senior secured, super-priority debtor in possession term credit facility (the “DIP Term Loan Facility”). Significant concessions by senior creditors² funded gifted distributions to holders of out-of-the-money general unsecured claims under the Plan.

The Reorganized Debtors argue that the Plan treated unsecured creditors in distinct ways based upon their respective legal rights, their importance to the ongoing operation and the profitability of the Debtors' businesses, and the practical limitations impeding the Debtors' ability to provide such creditors with a recovery. (*See* D.I. 37 at 8; 7/21/17 Hr'g Tr. 60:1-62:5). Creditors holding claims derived from the purchase of 2018 Notes, which were classified in Class A6, received a combination of stock and cash by virtue of the gifted distributions from senior creditors, with an aggregate recovery to holders in Class A6 valued at approximately 4-6%. (*See* 7/21/17 *80 Hr'g Tr. at 30:23-25). In contrast, trade and certain other creditors related to the Debtors' business and operations (“Trade and Business-Related Claims”), classified in Class A7, B7, and C7,³ were reinstated under the Plan, and, therefore, holders of such claims were entitled to receive a 100% recovery by virtue of the gifted distributions. (*See* B.D.I. 14 at 12).

Class A6 voted to reject the Plan.⁴ Because the Plan was nonconsensual, Debtors had the burden of “show[ing] that the plan meets the additional requirements of § 1129(b), including the requirements that the plan does not unfairly discriminate against dissenting classes and the treatment of the dissenting classes is fair and equitable.” *In re Exide Techs.*, 303 B.R. 48, 58 (Bankr. D. Del. 2003). These requirements were addressed in the Debtors' confirmation brief and declaration in support. (*See* B.D.I. 302, 338).

Appellant, who held approximately \$450,000 of the 2018 Notes that had been classified in Class A6, objected to confirmation of the Plan (B.D.I. 290) on the grounds that (i) Appellant would receive a distribution of less value than certain of the Debtors' other unsecured creditors who also held unsecured claims (i.e., Trade and Business-Related Claims); and (ii) the classification scheme contemplated in the Plan was improper. Appellant was the sole objector to confirmation of the Plan. (7/24/17 Hr'g Tr. at 3:24-4:3). At the confirmation hearing on July 21, 2017, Appellant made arguments and examined and presented witnesses. (*See* 7/21/17 Hr'g Tr.). Appellant offered no evidence to controvert assertions with respect to the existing debt and value of Debtors' businesses.

(*See id.*) Following the evidentiary hearing and argument on July 21, 2017, the Bankruptcy Court took the matter under advisement and made a bench ruling via telephonic hearing on July 24, 2017, overruling Appellant's objection and confirming the Plan. (*See* 7/24/17 Hr'g Tr.).

The Bankruptcy Court made the specific finding that “[u]nsecured creditors, including among others, trade creditors and holders of 2018 [N]otes are out of the money because they sit behind over \$500 million dollars of secured debt in the company that has an uncontroverted value of approximately \$300 million dollars.” (7/24/17 Hr'g Tr. at 4:4-10). Addressing Appellant's classification objection, the Bankruptcy Court determined that separate classification of trade creditors and noteholders was reasonable on the basis that trade creditors were critical to the success of the reorganized debtors. (*See id.* at 5:5-6:24). Addressing Appellant's unfair discrimination objection, the Bankruptcy Court determined that, while the disparate treatment of Class A6 gave rise to a rebuttable presumption of unfair discrimination (*id.* at 9:12-14), that presumption was rebutted because Class A6 is “indisputably out of the money and not, otherwise, entitled to any distribution under the bankruptcy *81 code's priority scheme and provided further that the proposed classification and treatment of the unsecured creditors fosters a reorganization of these debtors.” (*Id.* at 8:24-9:3). The Bankruptcy Court determined that its decision was consistent with leading cases governing the issue of gifting (9:14-12:12) and rejected Appellant's argument that the gift was from estate property, violated the absolute priority rule, and thus the Plan was not “fair and equitable.” (*See id.*) The Bankruptcy Court overruled the objection, confirmed the Plan (*id.* at 13:24-14:5), and further held that any request for a stay of the Confirmation Order beyond the 10-day period included therein “would serve no purpose” as a stay was not warranted. (*See id.* at 14:19-15:3).

Appellant filed a timely notice of appeal on July 25, 2017. (D.I. 1). Contemporaneously, Appellant filed an emergency motion for stay of the Confirmation Order pending appeal (D.I. 3) (“Stay Motion”) and a related motion for expedited consideration (D.I. 4). On August 3, 2017, the Court denied the Stay Motion on the basis that Appellant was unlikely to succeed on the merits of the appeal and had failed to establish irreparable harm absent a stay. (D.I. 20). On October 16, 2017, Debtors filed the Motion to Dismiss. (D.I. 31). The parties have fully briefed the Motion to Dismiss (D.I. 31, 32, 36, 40) and the merits of the appeal (D.I. 29, 37, 41). On May 14,

2018, the Court held oral argument on both the Motion to Dismiss and the merits of the appeal. (D.I. 44).

II. CONTENTIONS

Appellant raises the following issues on appeal: (i) whether the Bankruptcy Court erred by concluding that the Plan did not discriminate unfairly in finding that the “gift” under the Plan made by secured creditors to unsecured creditors providing varying levels of claim recovery did not constitute unfair discrimination under [§ 1129\(b\)\(1\) of the Bankruptcy Code](#); and (ii) whether the Bankruptcy Court erred by concluding that the Plan properly classified 2018 Note claims separately from other general unsecured claims. (*See* D.I. 22 at ¶ 1-3).⁵

With respect to equitable mootness, Reorganized Debtors argue that the Plan has been substantially consummated. Reorganized Debtors assert that, if I agree with Appellant that the Plan unfairly discriminated against and/or improperly classified Class A6 claims, correcting those errors would require a wholesale reversal of the Plan, restoration of the Reorganized Debtors' estates to the *status quo ante* prior to the Effective Date, and disgorgement of the gifted distributions, which is not possible as a practical matter and which would necessarily harm third parties who reasonably relied on plan confirmation. (*See* D.I. 31 at 3).

According to Appellant, this argument fails, as “[t]he Debtors can easily pay [him] the full amount of his claim if his appeal is successful” as such “additional recovery by [Appellant] does not present a risk of fatally scrambling the Plan; nor does it present a risk of significant harm to third parties.” (*See* D.I. 36 at 1, 12). Appellant urges the Court to use its remedial powers to fashion the relief he proposes: an order directing Reorganized Debtors *82 to pay 100% of Appellant's claim, plus several months' interest, so he may “receive the same treatment of holders of general unsecured creditors in Class A7.” (*See id.* at 12-13).

With respect to the merits, Appellant argues that the Bankruptcy Court erred in concluding that the Plan did not improperly classify Class A6 Claims separately from other general unsecured claims. Appellant argues the separate classification was motivated “solely for the discriminatory purpose of not having to pay holders of the 2018 Notes Claims in full.” (*See* D.I. 29 at 14; 31-35). Appellant argues that even if the Plan's separate classification of general unsecured claims was proper, the Plan unfairly discriminates in its

treatment of 2018 Note claims, and that the Bankruptcy Court erred in its application of the Markell test (discussed below). (*See id.* at 15-18). Appellant argues that the Bankruptcy Court failed to properly consider whether Debtors had rebutted the presumption of unfair discrimination and relied instead merely on gifting. (*See id.* at 16-18). Appellant argues that such a gift cannot rebut the presumption of unfair discrimination under the Markell test, and that the entire concept of gifting has been flatly rejected by the Third Circuit. (*See id.* at 28-29).

Conversely, Reorganized Debtors argue that Appellant relies on cases that prohibit the use of gifts in contravention of the absolute priority rule, which is not at issue in this appeal. (*See* D.I. 37 at 14). “That body of law prohibits the gifting of a distribution from a senior class of creditors in a manner that skips over an intermediary junior class of dissenting creditors – “vertical gifting” – because it violates the strict requirements of the absolute priority rule.” (*Id.*) The distribution in this case concerns unequal gifts by a secured creditor to two classes of junior creditors – horizontal gifting – which is not foreclosed under Third Circuit law. (*See id.* at 25). According to Reorganized Debtors, courts in this circuit have held that such a horizontal gift is not unfair discrimination against the class that does not receive the larger gift when (i) the creditor that does not receive the larger gift is not entitled to a distribution under a plan, and (ii) no class junior to the creditor receives a distribution under the plan. (*See id.* at 12-13). Debtors argue that confirmation of the Plan is consistent with controlling caselaw on the issue as well as the legislative history of [§ 1129\(b\)](#), which makes clear that unfair discrimination is not an absolute rule, but is instead evaluated case by case from the dissenting “class's own perspective.” (*See id.* at 12 (citing H.R. Rep. No. 595, 1st Sess. 417 (1977)). Finally, the Reorganized Debtors contend that the Bankruptcy Court correctly concluded that the Plan's classification complied with legal standards in this circuit, which permit separate classification of trade and bondholder claims based on their legal attributes. Reorganized Debtors argue the uncontroverted record supports the Bankruptcy Court's finding that separate classification of Trade and Business-Related Claims serves the rational purpose of fostering the Debtors' reorganization. (*See id.* at 35-43).

III. JURISDICTION

[1] The Court has jurisdiction to hear an appeal from a final judgment of the Bankruptcy Court pursuant to [28 U.S.C. § 158\(a\)\(1\)](#). In reviewing the bankruptcy court's determinations, this Court “review[s] the bankruptcy court's

legal determinations *de novo*, its factual findings for clear error and its exercise of discretion for abuse thereof.” See *In re Trans World Airlines, Inc.*, 145 F.3d 124, 130 (3d Cir. 1998) (noting that both the Third Circuit and the district court “exercise the same standard of review”) (internal quotations and citations omitted).

*83 IV. DISCUSSION

A. The Appeal Meets the Criteria for Equitable

Mootness

[2] [3] [4] [5] “ ‘Equitable mootness’ is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization.” *Tribune*, 799 F.3d at 277. A court assesses equitable mootness through the application of “prudential” considerations that address “concerns unique to bankruptcy proceedings.” *In re Philadelphia Newspapers, LLC*, 690 F.3d 161, 168 (3d Cir. 2012). The Third Circuit’s recent decisions have synthesized the test for equitable mootness as “proceed[ing] in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.” *In re Tribune Media Co.*, 799 F.3d 272, 278 (3d Cir. 2015) (quoting *In re SemCrude*, 728 F.3d 314, 321 (3d Cir. 2013)). Reorganized Debtors, as the proponents of an equitable mootness dismissal, “bear[] the burden of overcoming the strong presumption that appeals from confirmation orders of reorganization plans – even those not only approved by confirmation but implemented thereafter (called ‘substantial consummation’ or simply ‘consummation’) – need to be decided.” *Id.* at 278.

1. Whether the Plan Has Been Substantially Consummated

The Bankruptcy Code defines “substantial consummation” to mean:

- (A) transfer of all or substantially all of the property proposed by the plan to be transferred;
- (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the

management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

11 U.S.C. § 1101(2). Appellant concedes that the Plan has been substantially consummated. (See D.I. 36 at 12 (conceding that “the Plan has been substantially consummated”); see also D.I. 44 at 17:20-18:2). The record supports this conclusion.⁶

If it is established that substantial consummation has occurred, the next step for a court considering equitable mootness is to “look to whether granting relief will require undoing the plan as opposed to modifying it in a manner that does not cause its collapse.” *84 *SemCrude*, 728 F.3d at 321. A court “should also consider the extent that a successful appeal, by altering the plan or otherwise, will harm third parties who have acted reasonably in reliance on the finality of plan confirmation.” *Id.*

2. Granting Appellant Higher Individual Recovery than Class A6

[6] Appellant apparently does not seek revocation of the Plan and the imposition of a new chapter 11 plan in its place. (D.I. 44 at 17:19-18:2). Although Appellant’s confirmation objection sought denial of Plan confirmation only, Appellant argues “that does not mean that the only relief available after the substantial consummation of the Plan is a complete unwinding of the Plan and a return to bankruptcy for the Debtors.”⁷ (D.I. 36 at 13). Rather than apply equitable mootness and dismiss his appeal, however, Appellant contends that the Court should exercise its remedial powers and fashion relief in a way that would not upset the Plan – *i.e.*, “by ordering payment of his claim in full” so Appellant may “receive the same treatment as the holders of general unsecured creditors in Class A7.” (See *id.* at 12-13).

The Third Circuit instructs that the “starting point is the relief an appellant specifically asks for.” *Tribune*, 799 F.3d at 278 (citations omitted). The only specific relief Appellant proposes is “full recovery” which is a much higher individual recovery than other holders of claims in Class A6. (See D.I. 44 at 23:22-24:9) Thus, in considering available relief to cure unfair discrimination, the Court’s “starting point” is an order directing Reorganized Debtors to “provide [Appellant] with the same treatment as general unsecured creditors – payment

of 100 cents on the dollar plus interest” – as compared with the 4-6% recovery provided to other members of Class A6. (*Id.*) According to Appellant, “because no bondholder other than Mr. Hargreaves filed a timely objection to the Plan, there is no danger that paying Mr. Hargreaves would require additional payments to any other bondholder.” (*See id.*) That such relief would result in disparate treatment of Appellant's claim as compared with all other bondholder claims in Class A6 – precisely the issue that predicates the appeal – is of little concern to Appellant and of much concern to the Court. Appellant offers no support for his position that a remedy exists that allows him to receive, on appeal, treatment better than other creditors in the same class. (*See* D.I. 44 at 20:23-21:1).

However, it is not Appellant's burden to show that his success on appeal will not require undoing the plan; rather, it is the burden of the Reorganized Debtors, as the moving party, to demonstrate that the prudential factors weigh in favor of dismissal. *In re One2One Commc'ns, LLC*, 805 F.3d 428, 436 (3d Cir. 2015). Reorganized Debtors argue that the higher individual relief proposed by Appellant would necessarily upset the Plan. As Reorganized Debtors argue, there is no mechanism under the *85 Bankruptcy Code by which Appellant's claim can be paid in full outside of the confirmed Plan without paying in full the other members of Class A6. (*See* D.I. 31 at 16-17). Having placed the 2018 Noteholders in the same class, Reorganized Debtors argue, it would violate § 1123(a)(4) of the Bankruptcy Code to provide Appellant alone with a full recovery. Section 1123(a)(4) requires that “a plan shall ... provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment” 11 U.S.C. § 1123(a)(4). This section prohibits preferential treatment of a single bondholder who holds the exact same claims based upon the exact same instrument as other bondholders. Appellant's argument that § 1123(a)(4) of the Bankruptcy Code does not prohibit disparate treatment, so long as creditors “ha[d] an equal opportunity to recover on their claims” is unpersuasive and not supported by the cases cited. (*See* D.I. 36 at 15, n.5).

The Court agrees with the conclusion reached in *In re Genesis Health Ventures, Inc.*, 280 B.R. 339 (D. Del. 2002) (“*Genesis II*”). There, appellant was a bondholder who appealed plan confirmation on the basis that his small percentage recovery, in the form of new common shares and warrants, was the result of the debtors' incorrect application of valuation methodologies which understated the enterprise value of the

reorganized entity and the securities issued to senior secured lenders under the plan. *See id.* at 342. Debtors moved to dismiss the appeal as equitably moot, and the Court granted the dismissal, finding, *inter alia*:

[T]he Plan in this case was consented to by all of the creditors except for Class G5 bondholders like Appellant. Class G5 creditors have allowed claims in the amount of \$387 million. Appellant is a creditor holding \$20 million of Genesis bonds. Under the Bankruptcy Code, creditors of the same class are to be treated in the same manner unless they consent to receive less favorable treatment. 11 U.S.C. § 1123(a)(3)-(4); 11 U.S.C. § 1129(b)(1) (prohibiting unfair discrimination among creditors when plan is confirmed over objection of non-consenting creditors). The relief Appellant proposes, i.e., the issuance of additional shares to him, would be unfair to the other creditors in Appellant's own class, and thus, prohibited under the Bankruptcy Code.

Id. at 346. Moreover, even assuming the Court could grant the higher individual recovery to Appellant without violating the Bankruptcy Code, it is unclear which party the Court may order to fund such a recovery. Appellant clearly seeks payment from the Reorganized Debtors' business. (*See* D.I. 44 at 23:18-21). However, the gifted distributions were funded by the collective, agreed concessions of various senior lenders, and the Court cannot order those creditors to supplement a gift made voluntarily. The only way to accomplish this would include a regifting by the former holders of 2021 Notes, which would require their vote in chapter 11.

Appellant argues that a higher individual recovery may be granted, but the cases cited by Appellant do not support such relief. Appellant argues, “The Third Circuit has repeatedly found that payments of small percentage amounts of a reorganized debtors' enterprise value would not fatally scramble a plan.” (*See* D.I. 36 at 13-14). Appellant argues that in *Philadelphia Newspapers*, the court found that appellants'

claim would not unravel plan as it accounted for only 1.7% of amount buyer paid to acquire debtors' assets. See *In re Philadelphia Newspapers, LLC*, 690 F.3d 161, 170-71 (3d Cir. 2012). In that case, appellant sought payment of administrative *86 expense claims, which, if ultimately allowed in a successful appeal, would be paid from an account established under the plan for the payment of such claims and the payment would represent only a small percentage of the money coming into the estate by virtue of the asset sale consummated under the plan. See *id.* at 167. As that appeal concerned the allowance of administrative expenses, however, success on appeal would not entitle appellant to a greater recovery than other holders of administrative expense claims.

Appellant also cites *Zenith*, where the court similarly noted that appellant sought “the disgorgement of \$76,500 in professional fees, a tiny sum in the context of the reorganization of a company valued at \$300 million.” See *United States Tr. v. Official Comm. of Equity Sec. Holders (In re Zenith Elecs. Corp.)*, 329 F.3d 338, 346 (3d Cir. 2003). In *Zenith*, the United States Trustee appealed the award, and sought the disgorgement of \$76,500 in professional fees awarded to counsel to an unofficial committee. The District Court dismissed the Trustee's appeal as equitably moot, and the Third Circuit reversed, observing that “far from causing the reorganization plan to unravel, the Trustee's appeal, if successful, would return money to the estate.” *Id.* at 346. As Reorganized Debtors correctly observe, the appeals in both *Philadelphia Newspapers* and *Zenith* each concerned whether appellant's claim should have been allowed. Here, there is no dispute over the allowance of Appellant's claim – all of the claims of holders of 2018 Notes, including Appellant's, were allowed, but received limited recoveries under the Plan. These cases do not support a higher individual recovery by Appellant than other members of Class A6.

At oral argument, *Tribune* was cited as Appellant's “best case” in support of his request for full recovery. (See D.I. 44 at 20:4-18). The *Tribune* court declined to dismiss one of two appeals as equitably moot and suggested that disgorgement to satisfy appellant-trustee's claim was an available remedy. See *Tribune*, 799 F.3d at 283. The court observed that there was no chance the plan modification would unravel the plan, as the dispute concerned class entitlement to a \$30 million recovery in the context of a \$7.5 billion reorganization. See *id.* However, the appeal in that case concerned an intercreditor dispute over whether one of two classes of creditors was entitled to funds under the relevant contract.⁸ *Tribune* was

not a case where one member of a class sought relief on appeal in the form of a higher individual recovery than the recovery provided to other members of the same class, as here. If successful on appeal, the relief sought in *Tribune* would have gone to the entire class: “disgorgement could be ordered against those Class 1F holders who have received more than their fair share, and the Litigation Trust's waterfall can be restructured to make sure that [Class] 1E gets its recovery to the exclusion of Class 1F.” *Id.* at 282-83.

These decisions do not support the higher individual relief Appellant requests. While the cases support the notion that granting relief on a successful appeal is unlikely to unravel the plan where the relief would represent only a small percentage of the overall reorganization, those cases say nothing about a case like this *87 one, where granting appellant relief that is a small percentage of the overall reorganization would violate § 1123(a)(4) of the Bankruptcy Code.

Finally, Appellant cites *SemCrude* in support of his argument that he is entitled to higher individual recovery than the rest of Class A6 because he alone objected to the plan and appealed. (See D.I. 36 at 16; D.I. 44 at 16:22-17:8). In *SemCrude*, appellants argued that the plan improperly discharged their claims arising from statutory liens and property rights and sought an opportunity to assert those claims in an adversary proceeding. See *SemCrude*, 728 F.3d at 320. The court found no reason to believe that granting relief would cause the plan to collapse. See *id.* at 324. “Even if Appellants are successful on their claims, ... the amounts involved will not require a sufficient redistribution of assets to destabilize the financial basis of the settlement.” *Id.* Although *SemCrude* did draw a distinction between granting individual relief to appellant (versus parties who failed to appeal), that distinction is inapposite under these facts. As Reorganized Debtors correctly argue, any creditor may elect to consent to a release of its claims, which is effectively what the Third Circuit concluded the nonappealing creditors did in *SemCrude*.⁹ There is no analogue in the Bankruptcy Code for an individual creditor to withhold consent to a distribution in order to get a higher distribution under a plan than other creditors in the same class.

3. Other Practicable Relief

[7] The Third Circuit instructs that “even when a court applies the doctrine of equitable mootness, it does so with a scalpel rather than an axe. To that end, a court may fashion

whatever relief is practicable instead of declining review simply because full relief is not available.” *Tribune*, 799 F.3d at 278 (internal citations and quotations omitted). Assuming Appellant is successful on appeal, however, it is unclear what other practicable relief I may grant at this point. To meet their burden, the Reorganized Debtors assert that there is no practicable relief that can be granted with respect to the unfair discrimination and improper classification arguments at issue in this appeal that would not collapse the Plan and harm third parties who justifiably relied on plan confirmation. (See D.I. 31 at 12-18; D.I. 32).

Debtors argue that to address the unfair discrimination issue, the only possible remedy would be to provide equal recoveries to all unsecured creditors. (See D.I. 31 at 13). Reorganized Debtors argue that they do not have \$40 million in cash that would be required to pay claims of former holders of the 2018 Notes in full. (See *id.*) Even if sufficient cash were available, there would be no practical way to distribute it, according to Reorganized Debtors, as the 2018 Notes were cancelled under the Plan, and the indenture trustee for the 2018 Notes discharged of its duties and obligations under the governing indenture. (See *id.* at 14). As Reorganized Debtors lack sufficient cash to pay bondholders in full, the only other relief would be to recover funds and balance recoveries among general unsecured creditors. In *Tribune*, the Third Circuit noted that “if funds can be recovered from third parties without a plan coming apart, it weighs heavily against barring an appeal as equitably moot, both in our Court and other circuits.” *Tribune*, 799 F.3d at 279. Reorganized Debtors argue that this is not such a case. According to Reorganized Debtors, ordering disgorgement and recovery of the gifted distributions, and redistributing those distributions evenly among Classes A6 and A7, “would involve a massive, and likely impossible, disgorgement exercise.”

Although it is possible to conceive of a disgorgement scenario to recover all Gifted Distributions that had been provided to all unsecured creditors in order to redistribute them among former holders of Class A6 Claims and General Unsecured Claims, such a recovery effort would be virtually (if not actually) impossible to accomplish. The exercise would involve seeking the disgorgement of Reorganized Nuverra Common Stock, which is freely trading on NYSE American. Courts in this Circuit have recognized that there is no practical way to retrieve distributions from public security holders ... It is for that reason that the Third Circuit has “most frequently found that a plan could not be retracted when the reorganized debtor issued [publicly] traded debt or securities.”

(D.I. 31 at 14 (quoting *One2One*, 805 F.3d at 436)). Additionally, Reorganized Debtors assert that a disgorgement of payments from customers and vendors who have continued doing business with the Reorganized Debtors “would irreparably damage [those] relationships ... and disrupt ongoing operations, jeopardizing stakeholder recoveries.”

The Reorganized Debtors operate in a variety of remote areas where the vendor base is limited, and many are small businesses. [F]ailing to pay vendors in some of these locations would have led those vendors to refuse to do business with the Reorganized Debtors, creating significant operational problems in areas where those vendors are not replaceable. [A] disgorgement exercise that involves the clawback of payments to vendors and suppliers would in turn lead to the loss of credit, vendors, and suppliers, which would cause significant harm to all stakeholders, especially senior creditors who own the Reorganized Debtors' equity and depend on the success of the Reorganized Debtors' businesses to achieve a recovery in these cases.

(See D.I. 32 at 8, ¶ 14 (affidavit of CRO)). Thus, disgorgement would require the claw back, not only of cash payments made to hundreds of individual creditors, but also the claw back of stock that is trading on the national stock exchange, and which now may be held by third parties who purchased those securities in the ordinary course. (See *id.*) This case is therefore unlike the *Tribune* case in which the Third Circuit suggested disgorgement as a possible remedy. *Tribune*, 799 F.3d at 282. There, the court notably observed that the money at issue “has gone to a readily identifiable set of creditors against whom disgorgement can be ordered.” *Id.* Unlike *Tribune*, the disgorgement required in this case to grant equal recovery to Class A6 will require undoing the Plan and necessarily result in harm to third parties.

With respect to the second issue on appeal, as the Bankruptcy Court observed, Appellant “objects to the debtors’ classification scheme for the same reason [as his unfair discrimination objection] arguing that classification of unsecured claims in more than one class is improper and calls for disparate treatment.” (7/24/17 Hr’g Tr. *89 at 5:1-4). To address the improper classification issue, Reorganized Debtors argue that the only possible remedy would require “having the Reorganized Debtors go back into chapter 11 in order to develop an amended plan that classifies all unsecured claims in the same class and provides all creditors in the single class with the same treatment.” (See D.I. 31 at 16-17). Reorganized Debtors argue that, having repaid the DIP Loans on the Effective Date, they no longer have access to liquidity to fund a second trip through chapter 11, which makes a forced liquidation through chapter 7 a likely outcome. (See *id.* at 4). “If the Reorganized Debtors were forced to re-enter bankruptcy to revise their plan, I believe liquidation is a likely possibility, given that the Reorganized Debtors lack financing for a second Chapter 11 case, and had an extremely difficult time obtaining financing for the case they just emerged from.” (D.I. 32 at 8, ¶ 15 (affidavit of CRO)). As with the remedy of providing equal recovery to general unsecured creditors, reclassifying the claims to balance distributions and to achieve the same result would “require undoing the plan as opposed to modifying it in a manner that does not cause its collapse,” and would result in harm to third parties who have justifiably relied on the Plan. *SemCrude*, 728 F.3d at 321.

The Bankruptcy Court recognized the overall harm to the Debtors and other third parties that may result on appeal: “the consequences of an adverse ruling on appeal of a reversal of this confirmation order on appeal, frankly, the risks lie with the other constituents in this case, not with [Appellant] ...” (7/24/17 Hr’g Tr. at 14:24-15:3). The Court is unable grant Appellant higher individual recovery than other members of his class within the confines of the Bankruptcy Code. Because correcting unfair discrimination and improper classification issues would require undoing the Plan and would necessarily harm third parties, and because it is unclear what other practicable relief the Court may grant, the appeal meets the criteria for equitable mootness.

B. The Confirmation Order Is Affirmed

Although I find the appeal meets the criteria for equitable mootness, the Court can “readily resolve the merits of [the] appeal against the appealing party,” so I hold, in the alternative, that the Confirmation Order is affirmed. See *Tribune*, 799 F.3d at 278.

[8] Under § 1129(b)(1) of the Bankruptcy Code, a plan may be “crammed down” on a dissenting impaired class only if it “does not discriminate unfairly” and is “fair and equitable” with respect to the non-accepting impaired class. See 11 U.S.C. § 1129(b)(1); see also *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005) (“*Armstrong I*”), *aff’d*, 432 F.3d 507 (3d Cir. 2005) (“*Armstrong II*”). “[T]he pertinent inquiry is not whether the plan discriminates but whether the proposed discrimination is ‘unfair.’ ” *In re Tribune Co.*, 472 B.R. 223, 242 (Bankr. D. Del. 2012) (quoting *In re Armstrong World Indus., Inc.*, 348 B.R. 111, 121 (D. Del. 2006) (“*Armstrong III*”)). The main issue on appeal is whether the Plan “discriminates unfairly” in a manner that would prevent the Plan from being confirmed in accordance with § 1129(b)(1).

[9] [10] [11] [12] The concept of unfair discrimination is not defined in the Bankruptcy Code. See *Armstrong III*, 348 B.R. at 121. Courts typically examine the facts and circumstances of the particular case to determine whether unfair discrimination exists. *90¹⁰ Various tests have emerged in the caselaw, with the hallmarks being “whether there is a reasonable basis for the discrimination, and whether the debtor can confirm and consummate a plan without the proposed discrimination.” *Id.* at 121 (internal quotation omitted). The Third Circuit has not yet discussed the standard that should apply when assessing unfair discrimination, but courts within this jurisdiction have applied the test set forth by Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 249 (1998). Under the Markell test, a rebuttable presumption of unfair discrimination arises when there is:

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

class in connection with its proposed distribution.

See, e.g., *Tribune*, 472 B.R. at 241 (adopting and applying Markell test); *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 612 (Bankr. D. Del. 2001) (“*Genesis I*”) (applying Markell test). As Reorganized Debtors correctly point out, in applying the Markell test, “the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class.” *Tribune*, 472 B.R. at 244. This is consistent with the legislative history of § 1129(b)(1), which makes clear that “[t]he criterion of unfair discrimination is not derived from the fair and equitable rule or from the best interest of creditors test. Rather it preserves just treatment of a dissenting class from the class's own perspective.” H.R. Rep. No. 595, 1st Sess. 417 (1977).

1. The Bankruptcy Court Correctly Determined that the Plan Did Not Unfairly Discriminate

[13] Appellant argues that the Bankruptcy Court improperly applied the Markell test and blindly relied on the gifting doctrine in determining that the presumption of unfair discrimination was rebutted in this case. (See D.I. 29 at 15-18). I note that the Markell test did not address a situation in which the classes in which disparate treatment was occurring both were receiving their recoveries solely on account of a gift from a senior class.¹¹ Indeed, Markell says nothing about gifting. Notwithstanding this distinction, the Court finds no error in the Bankruptcy Court's application of the Markell test. Its application is consistent with the decisions of other courts in this circuit which have examined gifted distributions.

Looking to percentage recovery between Classes A6 and A7, the Bankruptcy Court determined that the Plan's treatment “gives rise to a rebuttable presumption of unfair discrimination that the [D]ebtors must overcome.” (7/24/17 Hr'g Tr. at 9:12-14). *91 The Bankruptcy Court found the presumption rebutted. Specifically, the Bankruptcy Court found that the gift here “constitute[d] no unfair discrimination” (*id.* at 8:23-24) because “class A6 was indisputably out of the money and not, otherwise, entitled to any distribution under the Bankruptcy Code's priority scheme and provided further that the proposed classification and treatment of other unsecured creditors fosters a

reorganization of these debtors.” (*Id.* at 8:24-9:9). As noted above, in applying the Markell test, and identifying unfair discrimination, the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class. See H.R. Rep. No. 595, 1st Sess. 417 (1977). For example, in *Tribune*, the bankruptcy court applied the Markell test to a plan that involved classes that benefitted from differing treatment, receiving an increase in their recovery of between 47.8% and 53% on a dollar basis, which was caused by the forced sharing of a “Disputed Allocation.” See *Tribune*, 472 B.R. at 244. The Bankruptcy Court held that, in applying the Markell test, “the analysis for determining whether the discriminatory treatment is unfair should be viewed by its effect on the dissenting class.” *Id.* In reaching its conclusion that there was no unfair discrimination, the *Tribune* court only focused on the amount that the reallocation decreased the recovery to the dissenting class, and did not consider the large increase in recoveries to the other similarly-situated classes. See *id.* at 244.¹²

Similarly, here, distributions to holders of Trade and Business-Related Claims have no impact on the distributions to holders of unsecured claims in Class A6. The record is clear that unsecured creditors are entitled to nothing under the Bankruptcy Code's priority scheme, and an increased distribution to unsecured creditors holding Trade and Business-Related Claims does not diminish the distribution to holders of claims in Class A6. If holders of Trade and Business-Related Claims did not receive this increased recovery, the surplus distribution would revert to secured creditors, not holders of claims in Class A6. As Appellant and his class were not entitled to a distribution in the first place, providing a greater distribution to a different class of unsecured creditors does not alter the distribution to which Appellant is entitled.

Appellant argues that the Bankruptcy Court erred by failing to address whether the two bases for rebuttal specifically mentioned by Markell were satisfied. Rebuttal of the presumption is discussed briefly by Markell:

The unfair discrimination in these situations is only presumptive. The plan proponent may overcome the presumption based on different percentage recoveries by showing that a lower recovery for the dissenting class is consistent with the results that

would obtain outside of bankruptcy, or that a greater recovery for the other class is offset by contributions from that class to the reorganization. The presumption of unfairness based on differing risks may be overcome by a showing that the risks are allocated in a manner consistent with the prebankruptcy expectations of the parties.

Markell, 72 Am. Bankr. L.J. at 228.

In either case—disparity of recovery or disparity of risk—the plan proponent *92 can rebut the presumption of unfairness by proving that the difference in treatment is attributable to differences in the prepetition status of the creditors. In the case of a difference in the present value of the recovery, the presumption may also be overcome by a demonstration that contributions will be made by the assenting classes to the reorganization, and that these contributions are commensurate with the different treatment. In such cases, while discrimination exists, it is not unfair.

Id. at 250. Appellant argues that if the Bankruptcy Court had considered Markell's bases for rebuttal, neither prong would have been met here, as (i) ad unsecured creditors would be entitled to exactly the same percentage recovery outside of the Plan, and (ii) there is no proof that the holders of [Trade and Business-Related Claims] will infuse any new value into the reorganization.” (See D.I. 29 at 17).

[14] While Appellant argues these are the “only” bases for rebutting the presumption of unfair discrimination (see *id.* at 16), neither Markell nor any of the cases cited by Appellant suggest any limitations on the case-specific facts and circumstances which might rebut the presumption of unfair discrimination. As Reorganized Debtors correctly argue, “the Markell test is not the only basis for rebutting a presumption

of unfair discrimination, and the Bankruptcy Court was not required to evaluate these bases for rebuttal” (See D.I. 37 at 23). As noted above, Markell did not address a situation where, as here, the classes in which disparate treatment was occurring both were receiving their recoveries solely on account of a gift from a senior class. A reading of Markell does not support the limitations on the Bankruptcy Court's analysis that Appellant asserts, nor would such limitations be consistent with the Bankruptcy Court's broad discretion to consider case-specific facts in the context of plan confirmation.¹³

In *Genesis I*, a case with virtually identical facts, the court found the presumption of unfair discrimination was rebutted in the horizontal gifting context. See *Genesis I*, 266 B.R. at 612. As in this case, the plan in *Genesis I* provided a gift to certain, but not ad, classes of unsecured creditors out of the recoveries of secured creditors. See *id.* at 600-01. In that case, the unsecured creditors holding punitive damage litigation claims classified in classes G7 and M7 were to receive no recovery, while the other classes of general unsecured creditors (classes G4 and M4) received the gift. *Id.* Holders of claims in classes G7 and M7 objected, arguing, among other things, that the plan unfairly discriminated against them in light of the recovery to unsecured creditors in classes G4 and M4. In assessing unfair discrimination, the court in *Genesis I* applied the Markell test and concluded that, while the disparate treatment gave rise to the presumption of unfair discrimination, the presumption was rebutted:

[T]he recovery by Classes G4 and M4 of a dividend in the form of New Common Stock and Warrants is based on the agreement of the Senior Lenders to allocate a portion of the value they would have otherwise received to Classes G4 and G5. The disparate treatment ... is a permissible allocation by the secured creditors of a portion of the distribution to which they would otherwise be entitled, rather than unfair discrimination *93 against Classes G7 and M7 by the proponents of the plan.

Id. at 612. Thus, *Genesis I* found that the presumption of unfair discrimination was rebutted where the distribution

was based on the agreement of senior lenders to allocate a portion of the value to which they would have otherwise been entitled under the Bankruptcy Code. *See id.* Although gifting is not a basis for rebuttal specifically mentioned by Markell, the *Genesis I* court found this permissible allocation sufficient to rebut the presumption of unfair discrimination. The Bankruptcy Court's ruling here is consistent with *Genesis I*.¹⁴

As unfair discrimination is not defined in the Bankruptcy Code, courts must examine the facts and circumstances of the particular case to determine whether unfair discrimination exists. The Third Circuit has yet to mandate application of the Markell test in determining whether a plan discriminates unfairly, and Markell's useful analysis is not exhaustive of the facts and circumstances that may rebut a presumption of unfair discrimination. Under the facts of this case, the holders of Class A6 were not harmed by the disparate recovery provided to Trade and Business-Related Claims, and ad unsecured creditors did significantly better than they would have outside of chapter 11 or under a plan of liquidation. To the extent the Bankruptcy Court did not specifically address the Markell bases for rebuttal in its bench ruling, Appellant cites no case law in support of such a limited, formulaic application. The Bankruptcy Court's analysis is consistent with the Markell analysis undertaken in *Genesis I*. I find no error in the Bankruptcy Court's conclusion that the Plan did not unfairly discriminate, which is based on uncontroverted, case-specific facts and consistent with applicable case law and legislative history concerning unfair discrimination.

2. The Third Circuit Has Not Foreclosed Horizontal Gifting, and the Vertical Gifting Cases Cited by Appellant Are Inapposite

[15] In determining that the Plan did not unfairly discriminate, the Bankruptcy Court relied on *Genesis I*, a case with virtually identical facts, which examined whether a horizontal gift – like the one at issue in this case – unfairly discriminated against other classes. (7/24/17 Hr'g Tr. at 10:12-12:12). As noted above, in *Genesis I*, senior creditors who were not being paid in full shared a portion of their distributions with junior classes (Classes G4 and M4) but not with creditors holding punitive *94 damages claims (Classes G7 and M7). *See Genesis I*, 266 B.R. at 612. There, the Bankruptcy Court held that “the disparate treatment between Classes G4 and G7 and Classes M4 and M7 is a permissible allocation by the secured creditors of a portion

of the distribution to which they would otherwise be entitled, rather than unfair discrimination against [dissenting classes] by the proponents of the plan.” *Id.* Here, the Bankruptcy Court found “this situation [i.e., the Plan] to be consistent with the gift contained in the plan proposed in *Genesis*, which the *Armstrong* court viewed favorably.” (7/24/17 Hr'g Tr. at 10:16-19).

Appellant argues that the Bankruptcy Court's approval of the Plan was erroneous, as “multiple appellate courts have held that a plan may not use gifting to circumvent § 1129(b)'s express provisions” in rulings following *Genesis I*, including the *Armstrong* decisions in this circuit. (*See* D.I. 29 at 22-30). Reorganized Debtors distinguish “vertical gifting” from “horizontal gifting.” They argue that any “[n]egative treatment of gifting in the caselaw applies [only] to vertical gifting, which violates the absolute priority rule, a different provision of the Bankruptcy Code implicating different concerns.” (D.I. 37 at 25-28). “The absolute priority rule, as codified, ensures that ‘the holder of any claim or interest that is junior to the claims of [an impaired dissenting] class will not receive or retain under the plan on account of such junior claim or interest any property.’ ” *Armstrong II*, 432 F.3d at 513 (quoting 11 U.S.C. § 1129(b)(2)(B)(ii)). Reorganized Debtors argue that the absolute priority rule is not implicated here, as “there is no higher priority dissenting creditor being deprived of a gift (i.e., no class skipping) because equity, which is the class junior to Class A6, received no distribution under the Plan.” (D.I. 37 at 25). Contrary to Appellant's contention that gifting has been “flatly rejected” in this circuit, Reorganized Debtors argue that the Third Circuit in *Armstrong II* purposefully carved out *Genesis I*'s horizontal gift ruling from its decision prohibiting vertical gifting in violation of the absolute priority rule. (*See id.*)

The Court agrees with Reorganized Debtors that *Armstrong II* did not “flatly reject” the concept of gifting. *Armstrong II* considered whether vertical gifting violated the “fair and equitable” requirement for cram-down, which invokes the absolute priority rule of 11 U.S.C. § 1129(b)(2)(B)(ii). The Third Circuit concluded – based upon its consideration of the absolute priority rule, not any consideration of whether there was “unfair discrimination” – that the distribution of warrants to equity holders, which skipped over an objecting class of unsecured creditors, violated the absolute priority rule. *See Armstrong II*, 432 F.3d at 513. “Under the statute, a plan is fair and equitable with respect to an impaired, dissenting class of unsecured claims if (1) it pays the class's claims in full, or if (2) it does not allow holders of any junior claims or interests

to receive or retain any property under the plan ‘on account of’ such claims or interests.” *Id.* at 512 (citing 11 U.S.C. § 1129(b)(2)(B)(i)-(ii)). The Third Circuit concluded that the plain language of the statute makes clear that a plan cannot give property to junior claimants over the objection of a more senior class that is impaired, and noted that “section 1129 was at least designed to address ‘give-up’ situations where a senior class gave property to a class junior to the dissenting class.” *Id.* at 513.

Unlike that case, the gift at issue here does not involve vertical class skipping as it does not provide a distribution to a class junior to the dissenting Class A6. As the *95 Bankruptcy Court noted,¹⁵ *Armstrong I* also distinguished *Genesis I* on the facts as involving a distribution of property subject to the senior creditor's liens that was “carved out” voluntarily for junior claimants. See *Armstrong I*, 320 B.R. at 539. The Third Circuit adopted this reading of that case in *Armstrong II*, characterizing the *Genesis I* decision as having allowed a secured creditor to “(1) give up their proceeds under the reorganization plan to holders of unsecured and subordinated claims, without including the holders of punitive damages in the arrangement, and (2) allocate part of their value under the plan to the debtor's officers and directors as an employment incentive package.” *Armstrong II*, 432 F.3d at 513-14; see also *In re World Health Alternatives, Inc.*, 344 B.R. 291, 298-99 (Bankr. D. Del. 2006) (discussing *Armstrong II* and *Genesis I* and concluding that *Armstrong II* distinguished, but did not disapprove of, *Genesis I*, and that secured creditors may give up a portion of their lien for the benefit of junior creditors without violating the Bankruptcy Code). *Armstrong I* reviewed relevant case law, including *Genesis I*, *In re MCorp. Financial, Inc.*, 160 B.R. 941 (S.D. Tex. 1993), and *In re SPM Mfg. Corp.*, 984 F.2d 1305 (1st Cir. 1993), and rejected a blanket rule that all gifting is permissible. *Armstrong I*, 320 B.R. at 539-40. The Third Circuit agreed:

We adopt the District Court's reading of [the *MCorp-Genesis I* line of] cases, and agree that they do not stand for the unconditional proposition that creditors are generally free to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the absolute

priority rule, as codified in 11 U.S.C. § 1129(b)(2)(B).

Armstrong II, 432 F.3d at 514. Reorganized Debtors do not advance a blanket rule that all gifting is permissible. Reorganized Debtors' position is merely that “courts in this circuit have held that such a horizontal gift is not unfair discrimination against the class that does not receive the larger gift when (i) the creditor that does not receive the larger gift is not entitled to a distribution under a plan, and (ii) no class junior to the creditor receives a distribution under the plan.” (D.I. 37 at 12-13). The horizontal gifting in *Genesis I* does not violate the absolute priority rule and remains good law.

Appellant cites several cases in support of his argument, but because they are vertical gifting cases, they do not change the outcome here. Appellant cites *In re ICL Holding Co., Inc.*, 802 F.3d 547 (3d Cir. 2015), but that case addressed priority skipping payments in violation of the absolute priority rule and did not address issues of unfair discrimination. (See D.I. 29 at 24). Appellant also relies on the *DBSD* case from the Second Circuit. See *Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD)*, 634 F.3d 79, 86-87 (2d Cir. 2011). That case also involved a class-skipping gift to a class junior to the dissenting creditor in violation of the absolute priority rule. The Second Circuit held that the gifting of shares and warrants by second lien secured creditors to the debtor's sole shareholder was impermissible where the company's general unsecured creditors did not receive full satisfaction of their claims. See *id.* at 87. In short, these decisions focus on vertical class skipping in violation of the absolute priority rule and do not support Appellant's argument that the gifted distributions in this case are impermissible.

*96 Appellant cites just one case addressing horizontal gifting, *In re Sentry Operating Co. of Texas*, 264 B.R. 850 (Bankr. S.D. Tex. 2001), which as Reorganized Debtors correctly argue, is nonbinding and factually distinguishable. There, the plan sought to pay trade claims in full, while providing only a *de minimis* distribution to other general unsecured creditors. See *id.* at 851. In finding unfair discrimination, the *Sentry* court also emphasized that the secured lender was controlled by a competitor of the debtors, and that a large portion of the trade claims to be paid were to parties with “whom [the secured lender's] parent does substantial business.” *Id.* at 856. Although the *Sentry* court concluded that there was a presumption of unfair

discrimination, and stated that a secured creditor should not be permitted to “decide which creditors get paid and how much those creditors get paid” (*id.* at 865), the presence of a possible conflict of interest was evident. The *Sentry* court noted that the class of trade claims to be paid included creditors who “appear to be paid for reasons other than preservation of value.” *Id.* at 864.

3. The Bankruptcy Court Did Not Err in Finding a Rational Basis for Separate Classification of Class A6 Claims

[16] [17] [18] [19] Section 1122(a) of the Bankruptcy Code provides that, except as otherwise provided in § 1122(b) of the Bankruptcy Code, “a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.” 11 U.S.C. § 1122(a). “Section 1122 of the Code provides that claims that are not ‘substantially similar’ may not be placed in the same class; it does not expressly prohibit placing ‘substantially similar’ claims in separate classes.” *In re Coram Healthcare Corp.*, 315 B.R. 321, 348 (Bankr. D. Del. 2004). Courts have held that there is significant flexibility in classifying claims and interests into different classes as long as a rational legal or factual basis for separate classification exists and all claims or interests within a particular class are substantially similar. *See, e.g., Jersey City*, 817 F.2d at 1060-61 (approving classification of general unsecured creditors into separate classes of doctors’ indemnification claims, medical malpractice claims, employee benefit claims, and trade claims). “[I]n analyzing whether claims within a given class are substantially similar, the focus of the classification should be on the legal character of the claim as it relates to the assets of the debtor.” *In re W.R. Grace & Co.*, 475 B.R. 34, 109-10 (D. Del. 2012), *aff’d*, 729 F.3d 332 (3d Cir. 2013) (internal citations and quotation marks omitted). The “primary analysis centers upon the legal attributes of the claims and not upon the status or circumstances of the claimant. Emphasis is not upon the holder so much as it is upon that which is held.” *In re FF Holdings Corp.*, 1998 U.S. Dist. LEXIS 10741, *13 (D. Del. Feb. 17, 1998) (quoting *In re Northeast Dairy Cooperative Fed., Inc.*, 73 B.R. 239, 250 (Bankr. N.D.N.Y. 1987)). In determining whether the separate classification of substantially similar claims is permissible. “[i]t is a well-recognized principle that the classification of claims or interests must be ‘reasonable’ and cannot be grouped together

for arbitrary or fraudulent purposes.” *W.R. Grace*, 475 B.R. at 110.

[20] Addressing Appellant’s argument that the Plan improperly classified his claims separately from other general unsecured claims, the Bankruptcy Court noted that the proper analysis “focused on how the legal character of the claim relates to the assets of the debtor and whether the claims exhibit a similar effect on the bankruptcy estate.” (7/24/17 Hr’g Tr. at 5:23-25). Based on the character and effect of *97 the claims, the Bankruptcy Court found the Plan’s separate classification of those claims to be reasonable and based on a “justifiable rationale.”

[T]he debtors are entitled to flexibility in classifying claims [and] interests into different classes so long as a rational[,], legal, or factual basis for separate classifications exists and all claims or interest[s] within a particular class are substantially similar.

On[e] such justifiable rationale for separately classifying certain trade creditors from others is the debtors’ intention of a continuing business relationship with such trade creditors as here. In its submissions, the debtors clearly explain that separate classification is necessary to maintain ongoing business relationships that [t]he debtors need to ensure the continuance of operations.

In *Coram*, the Bankruptcy Court determined that separate classification of unsecured noteholders and trade creditors was reasonable because each group represented a voting interest that was sufficiently distinct from one another to merit a separate voice in the reorganization.

Here, I similarly find that the plan reasonably classifies the 2018 noteholders separately from the other unsecured claims including intercompany claims, other general unsecured claims, and [what] I’ll refer to as litigation claims including tort and disputed contract claims, all related to activities arising out of day-to-day operations of the companies.

(*Id.* at 6:1-24).

Appellant argues on appeal that “[t]he purported justification for separate classification [of those substantially similar claims] – that is, note claims on the one hand versus claims ‘arising out of day-to-day operations,’ on the other – does not pass muster under the law.” (D.I. 29 at 31-32). Appellant argues that litigation claims being paid in full include liabilities arising out of “negative outcomes,”

including “lawsuits involving employment, commercial, and environmental issues, other claims for injuries and damages, and various shareholder and class action litigation, among other matters.” (See D.I. 29 at 34 (citing 7/21/17 Hr’g Tr. 40:1-42:6)). “Other than saying that those claims arose from ‘day-to-day operations,’ the Bankruptcy Court failed to identify any business reason for paying those litigation claims in full, while simultaneously paying holders of the 2018 Notes Claims received less than 10 cents on the dollar.” (*Id.*) According to Appellant, “It is difficult to fathom what possible business reason could exist.” (*Id.*). Conversely, Reorganized Debtors argue that the Bankruptcy Court correctly found that fostering the Debtors’ reorganization formed a rational basis for separate classification of the Trade and Business-Related Claims. (See D.I. 37 at 14-15). “Creditors holding Trade and Business-Related Claims were paid in full in recognition of the impossibility of partially impairing them during an expedited case, the relatively small amount that this body of creditors represents, and their importance to the smooth operation and success of the Debtors’ business.” (*Id.* at 36-37).

Numerous cases permit separate classification of trade claims from noteholder claims on the grounds that such claims have different legal attributes. In *Coram*, the chapter 11 plan separately classified trade creditors from other unsecured claims, including noteholder claims, and the noteholders argued that such separate classification of substantially similar claims was improper. See *Coram*, 315 B.R. at 348-49. The court found that the legal attributes of the noteholder claims were different from the trade claims because the *98 noteholder claims “arose from the purchase of notes, not the provision of services to the [d]ebtors” like the trade claims. See *id.* at 349. Accordingly, the court concluded that the claims were not substantially similar and that separate classification was proper. *Id.* at 351 (“[W]e are convinced that the Noteholders do represent a voting interest that is sufficiently distinct from the trade creditors to merit a separate voice in this reorganization case.”). As in *Coram*, the Plan here permissibly classified claims arising from the purchase of the 2018 Notes separately from claims arising from the Debtors’ operations and businesses, Classes A7, B7, and C7. Claims in Class A6 (2018 Note Claims) are legally distinct in nature from claims in the other classes of general unsecured claims. Creditors in Class A6 derive their claims from the 2018 Note indenture, a single debt instrument governing the 2018 Notes. In contrast, the holders of claims in Classes A7, B7 and C7, containing Trade and Business-Related Claims, all have claims that arose in connection with

the Debtors’ business operations, not indentures or similar financial instruments, including certain contingent litigation claims related to the Debtors’ operations and businesses.

Reorganized Debtors further cite decisions by “[n]umerous courts [that] have held that separate classification and treatment of trade claims is acceptable if the separate classification is justified because they are essential to a reorganized debtor’s ongoing business.”¹⁶ Appellant disputes this argument, arguing that the separate classification was motivated “solely for the discriminatory purpose of not having to pay holders of the 2018 Notes Claims in full.” (D.I. 29 at 14). However, Appellant’s only argument in support of discriminatory purpose is circular: essentially, that the separate classification otherwise “makes no sense.” (See *id.* at 33). “The origin of a given unsecured claim has nothing to do with whether a business reason exists for providing that claim with better treatment going forward.” (*Id.*). Appellant’s argument regarding discriminatory purpose is unavailing. The Bankruptcy Court’s decision rested on its finding that the separate classification of trade creditors from noteholders fosters the reorganization. This finding is supported by the record, including Debtors’ CRO’s confirmation hearing testimony that the separate classification and treatment of the Trade and Business-Related Claims was necessary (i) to “preserve what little trade credit the company did have remaining,” (ii) because the businesses are typically operated in smaller towns with limited vendors, and (iii) because not paying any particular vendor would likely tarnish the reputation of the Debtors and harm relationships with other current or future potential *99 vendors. (7/21/17 Hr’g Tr. 60:24-62:5; see also B.D.I. 338 at ¶ 37). Nothing in the record indicates that Appellant’s claims were placed in Class A6 for arbitrary or fraudulent purposes, which is also belied by the Class A6 vote.¹⁷ The Court finds no error in the Bankruptcy Court’s determination that a rational basis for separate classification exists and that the classification was reasonable.

V. CONCLUSION

The Plan has been substantially consummated, and there is no practical relief that could be granted to Appellant that would not violate express provisions of the Bankruptcy Code, fatally scramble the Plan, and significantly harm third parties who have justifiably relied on plan confirmation. Therefore, the appeal meets the criteria for equitable mootness. Alternatively, the Bankruptcy Court’s ruling is

consistent with existing precedent, and the Confirmation Order is affirmed.

A separate order will be entered.

1. The Motion to Dismiss (D.I. 31) is GRANTED.
2. Alternatively, the Confirmation Order (B.D.I. 366) is AFFIRMED.
3. The Clerk is directed to CLOSE Civ. No. 17-1024-RGA.

ORDER

For the reasons set forth in the accompanying Memorandum, this 21 day of August, 2018, IT IS HEREBY ORDERED that:

All Citations

590 B.R. 75

Footnotes

- 1 The docket of the Chapter 11 cases, captioned *In re Nuverra Environmental Solutions, Inc.*, No. 17-10949 (KJC) (Bankr. D. Del.), is cited herein as “B.D.I. ____.” The transcript of the confirmation hearing, at B.D.I. 362, is cited herein as “7/21/17 Hr’g Tr. at ____,” and the transcript of the Bankruptcy Court’s oral decision, at B.D.I. 363, is cited herein as “7/24/17 Hr’g Tr. at ____.” The *Appendix of Appellant David Hargreaves* (D.I. 33-35) is cited herein as “A ____.”
- 2 Specifically, holders of 2021 Notes and lenders under the Term Loan Facility and DIP Term Loan Facility voluntarily agreed to accept a lower recovery on their secured claims than they were entitled to receive. The DIP Term Loan Facility and Term Loan Facility converted to equity at a discount, receiving distributions of equity worth less than the face value of the debt converted. (See 7/21/17 Hr’g Tr. 7:21-8:13). The 2021 Notes also converted into equity, receiving recoveries of less than 54.5% of their claims, and voluntarily agreeing to forgo any Plan distributions on account of approximately \$190 million in unsecured deficiency claims relating to the 2021 Notes, claims that otherwise would have ranked equally with all other unsecured claims. (See B.D.I. 338 at ¶ 37).
- 3 Included among the Trade and Business-Related Claims were certain contingent litigation claims related to the Debtors’ business operations, including tort and personal injury suits that the Debtors believed would be covered under insurance as well as litigation claims to which the Debtors had counterclaims. (See 7/21/17 Hr’g Tr. at 59:14-17; 57:23-58:9).
- 4 Despite having approximately 80% in number of holders vote to accept the plan, the plan failed to gain the support of 50% in dollar amount. (See B.D.I. 154, A746 (voting declaration)). Under § 1126(c) of the Bankruptcy Code, “[a] class of claims has accepted a plan if such plan has been accepted by creditors that hold ... at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors ... that have accepted or rejected such plan.” 11 U.S.C. § 1126(c).
- 5 Appellant identified the following additional issue on appeal but failed to address it in merits briefing: “whether the Bankruptcy Court erred by concluding that the Plan was fair and equitable even though it allows the Debtors to retain equity interests in their subsidiaries despite all unsecured creditors not being paid in full.” (Compare D.I. 22 & 29). Accordingly, I do not consider this issue.
- 6 The Reorganized Debtors filed a declaration of their Chief Restructuring Officer (“CRO”) Robert Albergotti (D.I. 32) (“Albergotti Decl.”), in which he attests, *inter alia*, that, beginning on the Effective Date, Reorganized Debtors entered into certain financing exit facilities and security agreements in order to repay obligations under the Debtors’ pre-Effective Date asset based lending facility and debtor-in possession lending facility; make certain required payments under the Plan; pay costs and expenses incurred in connection with the Plan; and for working capital, transaction expenses, and other general corporate expenses. (See Albergotti Decl. at ¶¶ 6-9). Additionally, on the Effective Date, (i) Reorganized Debtors issued approximately 12 million shares of reorganized Nuverra common stock (that is freely tradable on a national stock market) and 118,137 warrants to purchase shares, with an exercise term expiring 5 years from the Effective Date, or, in certain instances, as specified in the Plan; and (ii) all shares of the Debtors pre-Effective Date common stock and outstanding equity interests in the Debtors were cancelled and discharged. (See *id.* at ¶ 10). Additionally, cash distributions were made under the Plan and all prepetition debt was either repaid or cancelled. (See *id.* at ¶ 11).
- 7 Reorganized Debtors argue that Appellant never sought full payment of his claim below, and only sought denial of plan confirmation, and cannot be heard to make such a request now:

Appellant takes a 180-degree turn from the substantive position that he raises in the Appeal by suggesting that a claim of unfair discrimination could be satisfied by discriminating in favor of him relative to other holders of claims in his class. Appellant now identifies the sole remedy he seeks on appeal as the payment in full of his claims, and only his claims...

By re-casting the issue in that manner, Appellant has abandoned his contention that the Plan's distribution scheme could be changed to address his unfair discrimination and classification arguments, effectively conceding that doing so would fatally scramble the Plan.

(See D.I. 40 at 1-2).

- 8 “[T]he Trustees contend that they are beneficiaries of a subordination agreement that guarantees that they will receive any recovery that goes to the holders of the PHONES and EGI Notes ahead of a class of trade and other creditors (Class 1F) ... The merits question presented by the Trustees' appeal is straightforward: does the Plan unfairly allocate Class 1E's recovery to 1F?” *Tribune*, 799 F.3d at 282-83.
- 9 As the *SemCrude* court observed: “We also fail to see any indication that allowing Appellants to proceed with their claims would result in a deluge of other Producers filing their own adversary proceedings. Unlike with Appellants, we are unaware of any evidence in the record showing that other Producers objected to the discharge of their claims or asserted the right to an adversary proceeding. In return for the distributions they received under the plan, other Producers were required to dismiss with prejudice any adversary proceedings they had filed. Absent their objecting at the time of plan confirmation to this dismissal requirement (as well as to the discharge of their claims), they cannot now attempt to restart those actions.” *SemCrude*, 728 F.3d at 324.
- 10 See *In re 203 N. LaSalle St. Ltd. P'ship*, 190 B.R. 567, 585 (Bankr. N.D. Ill. 1995) (noting “the lack of any clear standard for determining the fairness of a discrimination in the treatment of classes under a Chapter 11 plan,” and that “the limits of fairness in this context have not been established”), *aff'd*, 195 B.R. 692 (N.D. Ill. 1996), *aff'd*, 126 F.3d 955 (7th Cir. 1997), *rev'd on other grounds*, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).
- 11 Reorganized Debtors argue that the Markell test was intended to fill in the blanks on how a court should assess disparate treatment of claims outside of a scenario where distributions are based solely on gifts. (See D.I. 44 at 38:20-25). The Court expresses no opinion on this argument.
- 12 See also *LaSalle*, 126 F.3d at 969 (factually predating Markell, and finding, in part, that, “the disparity between [the trade claims and the nonrecourse deficiency claims], with the trade creditors receiving 100 percent and Bank America receiving sixteen percent, is not unfair [because] Bank America does better than it would have under chapter 7, and the trade creditors do no worse.”)
- 13 “[I]t remains clear that Congress intended to afford bankruptcy judges broad discretion to decide the propriety of plans in light of the facts of each case.” *In re Jersey City Med. Ctr.*, 817 F.2d 1055, 1060-61 (3d Cir. 1987).
- 14 Reorganized Debtors further argue that, despite not being required to evaluate Markell's specific bases for rebuttal, the Bankruptcy Court's ruling does address them, including “factual findings that support rebuttal of any presumption of unfair discrimination under the Markell framework.” (See D.I. 37 at 23). Reorganized Debtors argue that Markell's first basis for rebuttal – that a lower recovery for the dissenting class is consistent with the results that would obtain outside of bankruptcy – is present here, as there was no value in the Debtors' businesses to make any payment to unsecured creditors. The Bankruptcy Court found as much when it concluded that unsecured creditors “sit behind over \$500 million dollars of secured debt in the company that has an uncontroverted value of approximately \$300 million dollars.” (7/24/17 Hr'g Tr. at 4:4-8). Appellant does not challenge the Bankruptcy Court's factual determination regarding the Appellant's entitlements to proceeds of the Debtors' estates, nor does he offer any explanation of how, from the perspective of the 2018 Notes, recoveries could be any better outside of bankruptcy. Reorganized Debtors argue that Markell's second basis for rebuttal – that a greater recovery for the other class is offset by contributions from that class to the reorganization – is also present here. The Bankruptcy Court made findings indicating that the ongoing business relationships provided by business creditors created value which justified the Plan's classification and treatment of unsecured creditors. (*Id.* at 6:6-24).
- 15 The Bankruptcy Court noted in its bench ruling that *Armstrong* had distinguished the very similar “arrangement in *Genesis [I]* as an ordinary carve-out of the senior creditor's lien for the junior claimant's benefit” but did not reject it. (See 7/27/17 Hr'g Tr. at 11:8-12:9).
- 16 See, e.g., *Coram*, 315 B.R. at 349 (approving separate classification of trade creditors from other unsecured claims, including noteholder claims); *Jersey City Med. Ctr.*, 817 F.2d at 1061 (upholding separate classification of trade creditors as reasonable because of the differences between physician claims, medical malpractice claims, employee benefit claims, and trade creditor claims); *FF Holdings*, 1998 U.S. Dist. LEXIS 10741, at *16 (finding that separate classification of trade claims is permitted “if the separate classification is justified by a ‘reasonable purpose,’ legitimate basis, or necessary business objective.”); *In re Adelphia Commc'ns Corp.*, 368 B.R. 140, 247 (Bankr. S.D.N.Y. 2007) (finding it was within the debtor's discretion to separately classify the trade claims from other unsecured claims because the trade claims reserves would be shielded from the risk of certain of the unliquidated claims in the other unsecured claims class); *In*

In re Nuverra Environmental Solutions, Inc., 590 B.R. 75 (2018)

- re Richard Buick, Inc.*, 126 B.R. 840, 852 (Bankr. E.D. Pa. 1991) (upholding full payment of trade claims but only 5% recovery for other unsecured claims because full payment of the trade claims was necessary to the future success of the debtor's business).
- 17 The record reflects that, of the holders of Class A6 claims who voted on the Plan, approximately 80% in number voted to accept the Plan. (See B.D.I. 154, A746 (voting declaration)).

End of Document

© 2019 Thomson Reuters. No claim to original U.S. Government Works.

AMERICAN BANKRUPTCY INSTITUTE

Case 17-11502-KG Doc 209 Filed 09/14/17 Page 1 of 111

1

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE: . Chapter 11
SHORT BARK INDUSTRIES, INC., .
et al, . Case No. 17-11502 (KG)
Debtors. . Courtroom No. 3
824 Market Street
Wilmington, Delaware 19801
Monday, September 11, 2017
.

TRANSCRIPT OF HEARING
BEFORE THE HONORABLE KEVIN GROSS
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

For the Debtors: David M. Klauder, Esq.
BIELLI & KLAUDER, LLC
1204 North King Street
Wilmington, Delaware 19801

For the U.S. Trustee: Richard L. Schepacarter, Esq.
OFFICE OF THE U.S. TRUSTEE
844 King Street, Suite 2207
Wilmington, Delaware 19801

For the Official Committee
of Unsecured Creditors: Michael Busenkell, Esq.
GELLERT, SCALI, BUSENKELL
& BROWN, LLC
1201 North Market Street
Suite 1800
Wilmington, Delaware 19801

(Appearances Continued)

Audio Operator: Electronically Recorded
by Ginger Mace, ECRO

Transcription Company: Reliable
1007 N. Orange Street
Wilmington, Delaware 19801
(302) 654-8080
Email: gmatthews@reliable-co.com

Proceedings recorded by electronic sound recording, transcript
produced by transcription service.

APPEARANCES: (Continued)

For the Official Committee
of Unsecured Creditors:

Wojciech F. Jung, Esq.
LOWENSTEIN SANDLER, LLP
1251 Avenue of the Americas
Floor 17
New York, New York 10020

For Diversitex:

Andrew L. Cole, Esq.
LECLAIRRYAN
800 North King Street, Suite 303
Wilmington, Delaware 19801

For LSQ:

Domenic E. Pacitti, Esq.
KLEHR HARRISON HARVEY
BRANZBURG, LLP
919 North Market Street, Suite 1000
Wilmington, Delaware 19801

For Holliston Holdings:

Mark E. Felger, Esq.
COZEN O'CONNOR
1201 North Market Street
Suite 1001
Wilmington, Delaware 19801

For Jerry Armstrong
Consulting:

Zachary I. Shapiro, Esq.
Brendan Schlauch, Esq.
RICHARDS, LAYTON & FINGER, PA
One Rodney Square
920 North King Street
Wilmington, Delaware 19801

INDEX

<u>WITNESS</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
----------------	---------------	--------------	-----------------	----------------

FOR THE DEBTORS

MARK IAMMARTINO	7*	19	46, 51	50
By The Court	51			

*Direct via Proffer

	<u>Page</u>
<u>ARGUMENT BY MR. JUNG</u>	53
<u>ARGUMENT BY MR. KLAUDER</u>	61
<u>ARGUMENT BY MR. PACITTI</u>	63
<u>ARGUMENT BY MR. SCHLAUCH</u>	66
<u>ARGUMENT BY MR. SCHEPACARTER</u>	67
<u>ARGUMENT BY MR. COLE</u>	94
<u>FURTHER ARGUMENT</u>	100
<u>COURT DECISION</u>	105

<u>Exhibit</u>	<u>Evid.</u>
UST-1 through UST-4	35

1 (Proceedings commence at 11:01 a.m.)

2 (Call to order of the Court)

3 THE COURT: Good morning, everyone. Thank you. You
4 may be seated. It's good to see everyone.

5 UNIDENTIFIED: Good morning, Your Honor.

6 MR. KLAUDER: Good morning, Your Honor.

7 THE COURT: Mr. Klauder, good morning.

8 MR. KLAUDER: Good morning. David Klauder on behalf
9 of the debtors.

10 THE COURT: Yes, sir.

11 MR. KLAUDER: Your Honor, we're here on a specially
12 set hearing by Your Honor --

13 THE COURT: Yes.

14 MR. KLAUDER: -- with respect to two matters that are,
15 essentially, one matter; that's the debtors' request for a
16 financing order. As Your Honor knows, we've entered into
17 multiple interim orders --

18 THE COURT: Yes.

19 MR. KLAUDER: -- to get us to this point. We're
20 hopeful we've, at least on the financing end, get to the final
21 stage of that.

22 Interrelated with that is the joint motion that was
23 filed, joint motion between the committee and the debtors, that
24 would approve the financing, but also the related compromise
25 that's set out in the financing --

1 THE COURT: Right.

2 MR. KLAUDER: -- that would resolve the committee's
3 objections to the financing and to the sale process. So that's
4 how we're proceeding today, Your Honor.

5 I think what makes sense -- and I talked to others
6 prior to the hearing. We have two objections --

7 THE COURT: Yes.

8 MR. KLAUDER: -- one by the U.S. Trustee, who takes
9 issue -- two objections, one by the U.S. Trustee and one by
10 Diversitex, who's one of our vendor creditors.

11 THE COURT: Yes.

12 MR. KLAUDER: I don't think either of those parties
13 has an objection with the debtors getting final financing
14 approval, and generally with the terms of the financing that's
15 -- that Your Honor has approved going forward in this case.
16 We've circulated a budget that will go with a final financing
17 order in whatever form it is. The objections, of course,
18 relate to the compromise portion of the final financing --

19 THE COURT: Yes.

20 MR. KLAUDER: -- and I think that's where the focus of
21 the hearing will go towards.

22 Rather than getting into opening statements and the
23 like, I did talk to the other parties and the counsel for the
24 objectors, and we think it makes sense to proceed as follows:

25 The debtors are going to put forward a proffer. That

1 proffer will address, of course, the final financing approval,
2 and why that's critical and necessary, and will also address
3 the compromise issues and any -- and some factual issues
4 related thereto. That proffer will be Mr. Iammartino, the CRO
5 --

6 THE COURT: Yes.

7 MR. KLAUDER: -- who's in the courtroom; he'll be
8 subject to any cross-examination if any parties would like to -
9 - would like to do some cross-examination. And then I think
10 we'll go to argument. We can proceed however --

11 THE COURT: That's fine.

12 MR. KLAUDER: -- Your Honor would like on that.

13 THE COURT: Yes.

14 MR. KLAUDER: Probably the objectors -- or probably
15 the movants will go forward with their argument, and then the
16 objectors, but we can proceed however Your Honor would like.

17 THE COURT: All right. All right. I think for the
18 movants to proceed first would be well in the argument portion,
19 and then I'll hear from the objectors --

20 MR. KLAUDER: Thank you, Your Honor.

21 THE COURT: -- from the committee, and then the
22 objectors.

23 MR. KLAUDER: If I may proceed with the proffer?

24 THE COURT: Yes.

25 MR. KLAUDER: Thank you, Your Honor.

1 In support of the -- and please bear with me, it is a
2 little bit lengthy, but it does address a number of the issues
3 we think are important to get out on the record.

4 THE COURT: Okay.

5 MR. KLAUDER: In support of the joint motion for the
6 final approval of the DIP factoring agreement with LSQ and the
7 related compromise set within that -- set within that DIP
8 factoring agreement, the debtors would like to proffer the
9 testimony of Mr. Mark Iammartino, the debtors' chief
10 restructuring officer.

11 If called to testify, Mr. Iammartino would testify as
12 follows:

13 That he was appointed the chief restructuring officer
14 for the debtors on July 17th, 2017, which appointment was
15 subsequently approved by this Court. Mr. Iammartino is a
16 managing director at MorrisAnderson in Chicago, and we've -- he
17 has testified prior in this -- in this case, and his expertise
18 has been set out on the record on previous -- in previous
19 hearings.

20 With respect to the matter before Your Honor today,
21 Mr. Iammartino would testify that, since being retained over
22 the past six weeks, he has worked extremely hard to get up to
23 speed with respect to the debtors' business operations and cash
24 needs, while this bankruptcy continues to a potential 363 sale
25 transaction.

1 Mr. Iammartino has spoken with numerous people,
2 including the debtors' current CFO, other accounting management
3 individuals with the debtor, the former CRO, representatives of
4 LSQ, in order to discuss and determine the budget for the
5 debtors over this period of time. In addition, Mr. Iammartino
6 has kept committee professionals apprised of, not only the
7 budgetary needs, but the actual performance of the debtors over
8 this six-week period.

9 Mr. Iammartino would testify that various interim
10 budgets have been drafted, revised, and ultimately approved by
11 this Court. Mr. Iammartino would testify that all parties have
12 now agreed on a budget to go with a final DIP factoring order
13 that will give the debtors the necessary financing to get this
14 case through the sale process and closing.

15 Mr. Iammartino would testify that, in his opinion, the
16 debtors' entry into a final DIP order along the terms set out
17 in the motion that are in front of the Court today is
18 reasonable and necessary and in the best interest of the
19 creditors and estates. Moreover, Mr. Iammartino would testify
20 that he does not believe the debtors could obtain financing on
21 better terms than what is proposed in the finance packet --
22 financing package before the Court today.

23 Mr. Iammartino would also testify that, as it relates
24 to the compromise between the debtors, LSQ, and the committee,
25 as set out in the joint motion and proposed final DIP factoring

1 order that was attached to the joint motion, that the parties
2 negotiated the terms of that compromise over the weeks after
3 the committee was formed.

4 In particular, the committee asserted, both in filings
5 and in hearings before this Court, and in discussions with the
6 debtors, that they had numerous objections to the terms of the
7 originally proposed DIP factoring and sale process, and that
8 they were prepared to litigate those objections before this
9 Court. In addition, Mr. Iammartino would testify that the
10 committee served substantial discovery requests on the debtors,
11 and as he understands it, on LSQ, as well, that sought numerous
12 categories of documents, along with deposition notices for the
13 debtors and LSQ. The debtors have begun to expend substantial
14 resources, which are very limited in this case, in responding
15 to those discovery requests.

16 Mr. Iammartino would testify that, a few days prior to
17 the scheduled final DIP hearing on August 18th, which was the
18 original date scheduled for the final DIP hearing, the debtors
19 were informed by LSQ and the committee that it had reached
20 consensus on a deal that would resolve the committee objections
21 to the DIP factoring and the sale process. LSQ and the
22 committee then briefed the debtors on the specific terms of
23 that deal, so that the debtors could make a separate
24 determination as to whether to support such a deal.

25 Mr. Iammartino would testify that he consulted with

1 counsel, and ultimately determined that this agreement, which
2 would end a potentially lengthy and costly contested matter,
3 was in the best interests of the debtors and the estates, and
4 as such, the debtors would support that agreement.

5 Mr. Iammartino would testify that this agreement
6 provides much needed certainty and finality for the debtors and
7 the estates, as it relates to the financing necessary for the
8 debtors to consummate a 363 sale transaction on the time line
9 for the sale process previously approved by this Court.
10 Without this agreement, the debtors were facing, at minimum, a
11 hotly contested financing dispute with the committee, and
12 possibly other creditors.

13 The debtors risked not only the significant cost of
14 the estate and professional fee time related to that dispute,
15 but also the potential that the financing, either would not be
16 approved, or it would be modified to the point that LSQ would
17 no longer choose to continue financing in this case. Without
18 that financing, Mr. Iammartino would testify, the debtors would
19 have to immediately shut down operations, lay off the 500 plus
20 employees, and convert this case to a Chapter 7.

21 Mr. Iammartino would testify that he has reviewed the
22 two objections to the joint motion, and he believes that
23 certain issues raised in those objections are either unfounded
24 or not applicable here.

25 First, Mr. Iammartino would testify that he

1 understands that the proposed distribution to general unsecured
2 creditors, as set out in that compromise, is being classified
3 as a gift from LSQ to general unsecured creditors, carved out
4 of the collateral of LSQ.

5 The debtors agree that LSQ has a first lien on
6 substantially all of the debtors' assets, except for a
7 subordinate lien to People's Bank of East Tennessee, which is
8 owed approximately \$78,000, which has a first lien on the
9 debtors' equipment. I under -- Mr. Iammartino would testify
10 that he understands that LSQ has agreed that People's Bank will
11 be paid first with respect to that asset; and, therefore, their
12 rights will not be prejudiced.

13 In addition, Mr. Iammartino would testify that, after
14 conducting research and diligence internally, that he is
15 comfortable and believes that LSQ was owed on the petition date
16 over \$9 million. As such, it is the debtors' position that LSQ
17 has first right and claim to the proceeds of the sale, subject,
18 of course, to the People's Bank issue that I just described.
19 Therefore, without the agreement, LSQ would receive all the
20 proceeds from the sale of the assets, subject to the carveouts
21 that were previously agreed to by LSQ. The debtors reviewed
22 the agreement between LSQ and the committee, noted that no new
23 releases were granted pursuant to that agreement, and that the
24 committee retained challenge rights to the debtors' release of
25 LSQ.

1 Second, Mr. Iammartino would testify that, based on
2 the current claim pool, that he believes the unsecured creditor
3 distribution is appropriate under the circumstances of this
4 case. Although a bar date has not been set in this case, the
5 debtors have filed their schedules, and believe that the
6 creditor breakdown is as follows: Approximately \$17 million of
7 secured claims listed on the debtors' schedule, approximately
8 471,000 of priority unsecured claims were listed on the
9 debtors' schedules, and approximately 6.6 million of general
10 unsecured claims.

11 Mr. Iammartino would testify that, of the approximate
12 17 million of secured claims, the debtors believe that LSQ's
13 claim is approximately 9.8 million, which, again, the debtors
14 believe is in first priority on substantially all of the
15 assets, again, subject to the one lien to People's Bank --

16 THE COURT: Right.

17 MR. KLAUDER: -- on the equipment.

18 Because the debtors' proposed stalking horse agreement
19 calls for a purchase price with a ceiling of 3.2 million, not
20 including accounts receivable, the debtors believe that all
21 secured creditors, except LSU -- LSQ, are completely under-
22 secured, and as such, would constitute general unsecured
23 claims.

24 Mr. Iammartino would testify that the asserted
25 priority claims, as set out in the schedules, include

1 prepetition wages to the debtors' employees of \$177,843.66. In
2 addition, priority claims, as listed on the schedules, include
3 \$180,526 to the debtors' employees in accrued vacation pay.
4 Mr. Iammartino would testify that employee claims, either have
5 been, or will be satisfied as follows:

6 Amounts have been authorized and paid as a result of
7 this Court's order of July 13th, 2017, that provided for
8 prepetition wages to be authorized to be paid. And any
9 remaining employee obligations, including the accrued vacation
10 pay to employees, is provided for in the budget before the
11 Court, and will be satisfied in full.

12 Finally, with respect to priority claims, Mr.
13 Iammartino would testify that the debtors have listed a
14 liability to the -- to a Puerto Rican government agency for
15 alleged personal property taxes that are owed. That government
16 agency goes by the acronym CRIM, C-R-I-M.

17 The debtors believe that, at the very least, they have
18 a defense to that priority claim, in that the obligation, while
19 originally a tax obligation, was memorialized, or was
20 subsequently entered -- subsequently memorialized into an
21 installment payment agreement that the debtors would make due
22 on the obligations owed to CRIM. It is under that agreement
23 that the debtors defaulted on or did not pay that created the
24 prepetition obligation. And as such, the debtors are going to
25 take the position that such is not a priority claim, and is,

1 otherwise, a general unsecured claim. In addition, Mr.
2 Iammartino would testify that counsel informed him that the
3 CRIM agency was served with a copy of the motion, and has not
4 filed an objection, either formal or informal, to the joint
5 motion that's before Your Honor today.

6 Finally, with respect to priority claims, Mr.
7 Iammartino would testify that he's -- that, other than what was
8 just recited, that he does not believe or is not aware of any
9 other priority claims currently owed by the debtors.

10 Next, Mr. Iammartino would testify that he does not
11 believe there will be any unpaid administrative claims of the
12 estate. All professional fees for retained professionals will
13 be paid pursuant to the budget agreed to by with -- agreed to
14 with LSQ, and that includes the committee professional fee
15 carveout that is part of the joint motion and the compromise
16 set out in there. All post-petition expenses of the debtors
17 have been paid on a go-forward basis, and are otherwise
18 provided for in the budget.

19 In addition, Mr. Iammartino would testify that he has
20 conducted an analysis to determine whether any party could
21 assert a 503(b)(9) administrative claim against the debtors.
22 Based on that analysis, and except for Diversitex, which I'll
23 get to in a moment, no 503 -- no other 503(b)(9) claims have
24 been asserted against the debtors, and he does not believe any
25 will be asserted, as the debtors were generally prepaying their

1 materials in the 90 days prior to the filing of the bankruptcy.

2 As for Diversitex, Mr. Iammartino would testify that
3 they have asserted, or at least in a motion filed before this
4 Court have asserted, a 503(b)(9) claim of approximately
5 \$347,000. He would testify that he has conducted an exhaustive
6 analysis of that alleged administrative claim, and he does not
7 believe it is a valid 503(b)(9) claim, based on previous --
8 what I previously testified, with respect to the way the
9 debtors were conducting business in the 90 days prior to the
10 filing.

11 And in the alternative, he believes that such claim
12 can be entirely offset by a large preference claim that the
13 debtor has against Diversitex. In fact, he would testify that,
14 on September 8th, the debtors filed a complaint against
15 Diversitex in this court that, among other things, sought
16 avoidance of \$859,530.28 in preferential transfers made by the
17 debtors to Diversitex within the 90 days of filing. And the
18 debtors are prepared to prosecute that preference claim at this
19 time. As such, the asserted preference claim more than doubles
20 any alleged 503(b)(9) claim of Diversitex.

21 Mr. Iammartino would testify that, under this
22 agreement, avoidance action claims are being left with the
23 estates, and will not be subject to LSQ's liens. He would
24 testify that, pursuant to the debtors' schedules filed in this
25 case, payments made within 90 days have been estimated as

1 equaling approximately \$3.1 million -- that does not include
2 payments to LSQ -- and within one year to insiders as
3 approximately \$378,000. To the extent that these payments
4 constitute avoidable transfers, any recoveries would not be
5 subject to LSQ's liens.

6 In addition, Mr. Iammartino would testify that there
7 has been no violation of any party's due process rights here.
8 Counsel has informed him that all known creditors and parties-
9 in-interest have been served with the joint motion. There's a
10 COS, certificate of service, on the -- at Docket Number 185,
11 that indicates that; and that, for the employees, there was no
12 need to serve them specifically with the motion, as their
13 claims have been or will be satisfied, as testified previously,
14 and their rights are not -- their rights are not affected by
15 the relief requested in this motion.

16 Finally, Mr. Iammartino would testify that he does not
17 believe, in any way, that the debtors have breached their
18 fiduciary duty by supporting this settlement. In fact, he
19 would testify the opposite, that the debtors have properly
20 exercised their fiduciary duty, and used their reasonable
21 business judgment to support this agreement, which allows for
22 necessary and critical financing for the debtors to continue in
23 operation -- operations, preserve the value of the debtors'
24 business for the sale process by continuing those operations,
25 continuing the employment for over 500 employees, stopping the

1 litigation burn on these estates that have very limited
2 resources, and providing some means to have a distribution to
3 creditors, where a significantly under-secured first lien
4 creditor has a lien on substantially all the assets. For these
5 reasons, the debtors believe the relief requested in the joint
6 motion is reasonable, necessary, and in the best interest of
7 the estate and all creditors.

8 And that would conclude the proffer, Your Honor.

9 THE COURT: All right. How much is the CRIM claim, if
10 you know?

11 MR. KLAUDER: Approximately \$100,000.

12 THE COURT: Okay. That's not just the installment;
13 that's the total amount?

14 MR. KLAUDER: Yes, the total.

15 THE COURT: All right. And I don't have a copy of the
16 budget, that was not provided.

17 MR. KLAUDER: I have that for you right now, Your
18 Honor.

19 THE COURT: All right.

20 MR. KLAUDER: If I may approach?

21 THE COURT: You sure may. Thank you, Mr. Klauder.
22 Thank you. All right.

23 Well, that's Mr. Iammartino's proffer. Does anyone
24 wish to cross-examine him?

25 THE COURT: Mister -- yes. Mr. Schepacarter and Mr.

1 Cole.

2 (Participants confer)

3 THE COURT: Who goes first?

4 MR. SCHEPACARTER: Well, I'm closer. I think I'm
5 going first.

6 THE COURT: All right.

7 (Laughter)

8 THE COURT: Mr. Iammartino, if you'll step forward to
9 be cross-examined. And if you'll remain standing while you're
10 ...

11 THE CLERK: Raise your right hand.

12 M A R K I A M M A R T I N O, WITNESS FOR THE DEBTORS,
13 AFFIRMED.

14 THE CLERK: Please state your full name, spelling your
15 last name, please.

16 THE WITNESS: Mark Iammartino, I-a-m-m-a-r-t-I-n-o.

17 THE CLERK: You may be seated.

18 THE COURT: Thank you, Mr. Iammartino.

19 MR. SCHEPACARTER: Good morning, Your Honor. Richard
20 Schepacarter for the United States Trustee.

21 THE COURT: Yes. Good morning.

22 MR. SCHEPACARTER: Your Honor, I have some exhibits I
23 want to hand up to the Court. May I approach?

24 THE COURT: Yes, you may.

25 MR. SCHEPACARTER: I have, also, copies for counsel --

1 THE COURT: All right. Good.

2 MR. SCHEPACARTER: -- and for the witness.

3 THE COURT: Thank you, yes.

4 MR. SCHEPACARTER: Here, Your Honor.

5 THE COURT: Thank you, sir.

6 MR. SCHEPACARTER: One question, while I'm handing out
7 the exhibits. Does the witness have a copy of the budget --

8 THE WITNESS: Not in front of me, no.

9 MR. SCHEPACARTER: -- or can he be provided with a
10 copy?

11 (Participants confer)

12 MR. SCHEPACARTER: I want to approach the witness with
13 it.

14 THE COURT: All right.

15 THE WITNESS: Thanks.

16 (Participants confer)

17 (Pause in proceedings)

18 CROSS-EXAMINATION

19 BY MR. SCHEPACARTER:

20 Q Good morning, Mr. Iammartino. I trust that the debtors'
21 business survived the most recent hurricane that came through.

22 A It's having some operational issues, but it's better than
23 we could have hoped for.

24 Q Okay. Well, that's good news.

25 I'm going to have you turn to the first exhibit that I gave

1 you. I've marked that as U.S. Trustee 1. I'll give you a few
2 moments to look at that document. Oh, I didn't give you a
3 copy?

4 A No. The only thing I have is the budget.

5 Q Oh.

6 (Participants confer)

7 THE COURT: There will be little glitches, won't
8 there, Mr. Schepacarter?

9 MR. SCHEPACARTER: Yeah. I made my own copies; I
10 didn't make enough, though. It never fails.

11 BY MR. SCHEPACARTER:

12 Q Okay. If you could, turn to that Exhibit 1 that I've
13 marked.

14 A Okay.

15 Q And tell me what that document is.

16 A This was the asset purchase agreement between the company
17 between the company and Holliston Holdings.

18 Q Okay. And are you familiar with that agreement?

19 A I am.

20 Q And you've seen it before, correct?

21 A I have seen it before.

22 Q And if I turn to sort of the last page to it, the signature
23 page, there's a signature there on page -- actually, it's
24 marked as "49 of 51" at the top, by the Court's designation.

25 Do you see that? There's a signature there or --

1 A Yes.

2 Q -- there purports to be. Is that your signature?

3 A It is.

4 Q Okay. And you've read this document previously?

5 A I have.

6 Q Okay. And everything contained in there is true, correct,
7 and accurate, to the best of your knowledge?

8 A Yes, I believe so.

9 Q And this document has not been amended?

10 A No.

11 Q Okay. All right. You would agree, if we turn to the first
12 page of that document, that the agreement is between,
13 basically, two parties; it's Short Bank Industries and EXO SBI
14 -- which are the debtors, correct?

15 A That is correct.

16 Q Okay. And it's also between Holliston Holdings, which is
17 the purchaser.

18 A Correct.

19 Q Okay. And it's -- you would also agree that it's for the
20 sale of the debtors' assets, if I have your attention to the
21 next page, which is Section 1.1? It talks about the sale of
22 the assets.

23 A Yes.

24 Q And it says, at the closing, sellers will sell, assign, and
25 transfer all of their rights and interests to the purchaser of

1 all of the equipment, correct?

2 A Correct.

3 Q Okay. And if I look down that document, and I have
4 Subparagraphs (a) through (n), that lists all the assets that
5 are being sold, correct?

6 A Yes.

7 Q Okay. And there's also excluded assets, as well, correct?

8 A Yes.

9 Q Which is Section 1.2?

10 Okay. Now if I could have you turn to Page 9 of 51, at the
11 top; that's the Court's designation of pages. At Paragraph
12 3.3, and that talks about the title and condition of the
13 purchased assets. And you would testify, or you would agree
14 with me that the warranty there is that the sellers are the
15 sole and exclusive owners of, and have good, valid, and
16 marketable title to all those assets, correct?

17 A That is correct.

18 Q Okay. All right. So you would agree that those assets
19 that are being sold are the property of the debtors.

20 A Yes.

21 Q Okay. Okay. Now, if you could, turn to the next exhibit,
22 which is marked as UST-2. I gave you that, right? Okay. At
23 least let me -- the packet is correct?

24 A Yes, I have it.

25 Q All right. The same documents are in there.

1 And what does that document purport to be?

2 A This is the final DIP agreement.

3 Q Okay. And you can see at the top it's marked as having
4 been filed at Docket Entry 162-1, correct?

5 A Correct.

6 Q And you would agree that this is a true and correct copy of
7 that order?

8 A Yes.

9 Q Okay. And if I have you turn to Page -- if I have you turn
10 to Page 8 of that document, which at the top says "9 of 35."

11 A Okay.

12 Q And Subparagraph (b) to Paragraph 5 generally discusses
13 that the debtors have granted a security interest in all of its
14 assets to LSQ, correct?

15 A That is correct.

16 Q Okay. And as you -- as was part of your proffer, part of
17 your testimony was that LSQ has a first priority lien on all of
18 the debtors' assets, correct?

19 A That is correct.

20 Q Okay. Now, if I have you turn to Page -- at the top, it
21 says "28 of 35."

22 A (Witness reviews exhibit)

23 Q Okay. And at the -- and starting at the bottom of Page 28
24 of 35, there's a Paragraph 19. And you would agree that that
25 Paragraph 19 is the embodiment of the settlement between and

1 among the debtors, LSQ, and the Official Committee of Unsecured
2 Creditors, which we'll call the "committee."

3 A Yes.

4 Q Okay. Okay. And Paragraph 19(I), which is paragraph -- or
5 Page 31 of 35, indicates that there's going to be a carveout
6 from the sale proceeds, to be distributed to the general
7 unsecured creditors, correct?

8 A Correct.

9 Q Okay. And you would also agree that, as part of this
10 agreement, there are certain things that had been resolved, but
11 certain things which have not been resolved, as a result of
12 this agreement, correct? With respect to the committee.

13 A I'm not sure what hasn't been resolved --

14 Q Okay.

15 A -- what specifics.

16 Q For example, one of the things that has not been -- has not
17 been resolved is the roll-up issue, correct?

18 A Subject to this hearing, correct.

19 Q Okay. And another issue that's still outstanding, and
20 could be subject to further litigation, is the -- is part of
21 the -- hold on a second, let me get my notes together -- is
22 part of the prepetition claim of LSQ; that's still subject to -
23 -

24 A Yes, my understanding --

25 Q -- negotiation --

1 A -- is LSQ and --

2 Q -- and/or --

3 A -- the committee is --

4 Q -- litigation, correct?

5 A -- still looking at that.

6 Q Okay. And also, with respect to -- up until the sale
7 closing, the release that's given to LSQ by the committee, of
8 certain claims.

9 A Yes.

10 Q Even though the debtors -- and you would agree that the
11 debtors have released their claims, whatever they are, as part
12 of this agreement.

13 A Yes, that's my understanding.

14 Q Okay. Okay. Now the negotiations, were you part of the
15 negotiations for this agreement?

16 A We were involved, to the extent that once -- before
17 anything was finalized, the terms of the settlement between the
18 committee and LSQ were brought to us to review --

19 Q Okay.

20 A -- and opine on.

21 Q And the parties to this agreement, have there been any
22 other parties to this agreement, other than the debtors, the --
23 LSQ, and the committee?

24 A The only other ancillary issue there would be the release
25 of Lisa Janke.

1 Q Okay. All right. Have any other parties been consulted
2 with respect to this agreement?

3 A No.

4 Q Okay. Okay. Now you indicated that some of the employee
5 claims have already been paid, correct?

6 A That is correct.

7 Q Okay. And in the budget -- and that's why I wanted you to
8 have a copy of it -- I think part of your proffer was that some
9 of the employees or the balance of the claims are going to be
10 paid?

11 A That is correct.

12 Q Am I correct in that? Okay.

13 Have they been paid, as of today?

14 A The wages that were due to employees at petition dates --

15 Q Uh-huh.

16 A -- by order of the Court, originally, those have been paid
17 in the week after petition.

18 Q Okay.

19 A The accrued vacation has not yet been paid.

20 Q Okay. The -- that's the one that has not been paid.

21 A That's correct.

22 Q Okay.

23 A And that's what you'll see in the last week of the budget.

24 Q Okay. And where in the budget would I find that those
25 claims would be paid in full?

1 A You'll see the third line, under "Cash Disbursements," it
2 reads, "Accrued Vacation Obligations," and there's an amount of
3 \$200,000 in Week 13.

4 Q Okay. That's under "Disbursements"?

5 A Correct.

6 Q Okay. I'm not finding that. Oh, okay. It's under here.
7 Okay.

8 (Participants confer)

9 BY MR. SCHEPACARTER:

10 Q And that will satisfy the entire amount of the prepetition
11 --

12 A Yes, we --

13 Q -- accrued vacation?

14 A -- believe so.

15 Q Okay. All right. Okay. Now, since we're on that topic,
16 I'll have you turn to UST-3, which has been marked for
17 identification.

18 A (Witness reviews exhibits)

19 Q Okay. And can you tell me what this document is?

20 A This was part of the schedules.

21 Q Okay. And the schedules that were filed in this case, you
22 reviewed them before they were filed?

23 A I did.

24 Q Okay. And you actually signed the petition and the
25 schedules and the statement of financial affairs?

1 A Yes, I did.

2 Q Okay. And to the best of your knowledge, information, and
3 belief, is everything contained in herein true, correct, and
4 accurate?

5 A Yes.

6 Q Okay. All right. Let me -- let's go through this list
7 slightly, if you can.

8 Broward County Tax Collector, there's a claim there for
9 "Unknown." Is that claim being paid as part of the DIP
10 financing?

11 A No, that was there more provisionally, since we were not as
12 sure if there were anything beyond that the tax collector may
13 assert.

14 Q Uh-huh.

15 A But we're not aware of any actual payments --

16 Q Okay.

17 A -- owed to them, currently.

18 Q All right. And I'm guessing this is the CRIM claim, the
19 second one, that's 2.2?

20 A That is correct.

21 Q It's listed at 100,838, and then 10,838.

22 A That's correct.

23 Q Okay. Is the 10,838 going to be paid?

24 A This is the issue that we brought up before --

25 Q Uh-huh.

1 A -- in regards to the personal property taxes have been
2 converted into notes.

3 Q Uh-huh.

4 A And our belief is that, instead of being taxes, they're now
5 an unsecured obligation.

6 Q Okay. But if I have you look at that listing for that
7 creditor, I'm assuming that their address is correct, to the
8 best of your knowledge, correct?

9 A Right.

10 Q Okay. Now it's listed that there -- that, as of the
11 petition filing date, the claim is -- and it has checked those
12 boxes, "Contingent," "Unliquidated," and "Disputed," and none
13 of those boxes are checked, correct?

14 A That is correct.

15 Q Okay. And lower in that box, it indicates that the claim
16 is not subject to any offset, correct?

17 A That's correct.

18 Q Okay. And you've listed, or the debtors have listed, in
19 schedules that you signed, that there's a ten-thousand-eight-
20 hundred-and-thirty-eight-dollar priority claim, correct?

21 A Yes, that's correct.

22 Q Okay. Okay. If you can, turn to the next page, which is
23 24 of 63.

24 A (Witness reviews exhibit)

25 Q Okay. Now that's also a CRIM claim?

1 A That's correct. That's for current year personal property
2 taxes.

3 Q Okay. And again, this is listed as not being contingent,
4 unliquidated, or disputed, correct?

5 A That's correct.

6 Q And you would agree that this claim is not subject to
7 offset, as set forth in the schedules, correct?

8 A Agreed.

9 Q Okay. Now the eleven-thousand-five-hundred-dollar claim,
10 you've marked that as a priority claim. Is that being paid?

11 A It will need to be paid out of proceeds in the estate,
12 whether it's coming from the sale of avoidances or other
13 preference actions.

14 Q Okay. But it's not being paid as a result of this
15 settlement --

16 A Not as --

17 Q -- that's before --

18 A -- part of --

19 Q -- the Court --

20 A -- the budget.

21 Q -- today.

22 A No.

23 Q Okay. Okay. Now there's two, and I'll take them together
24 for the sake of brevity. Delaware Division of Corporations and
25 the IRS, they're both listed as "Unknown." Any explanation for

1 that, that you can --

2 A Again, that was more belts-and-suspenders. We are not
3 aware of any obligations to either of those, as the company --

4 Q Okay.

5 A -- has been loss-making for a number of years --

6 Q Okay.

7 A -- and has not, historically, had to pay income taxes.

8 Q Okay. And there's another one there, it's 2.6. It looks
9 like "Municipal" -- it looks like it may be a town or
10 something.

11 A Right. It's a small municipal tax --

12 Q Okay.

13 A -- based on volume of business.

14 Q All right. I'm not going to try to pronounce it because
15 I'll --

16 A It's hard with the Spanish stuff.

17 Q -- I will not do it justice, whatsoever.

18 Four hundred and forty-two dollars, is that being paid as a
19 part of this settlement before the Court today?

20 A Not as part of that, but that was a small enough amount, we
21 would probably put that under a contingency in the budget, if
22 necessary, to pay.

23 Q Okay. All right. And then the various employees, you
24 didn't list all their names, correct?

25 A No, we did not.

1 Q Okay. And how many employees does the debtor have?

2 A Roughly, 500, at any given point in time.

3 Q Okay. All right. Now I'm going to have you turn to the
4 last document, which I've marked as UST-4. And that -- can you
5 tell me what this document is?

6 A This is the creditor matrix.

7 Q Okay. And with respect to that creditor matrix, there's a
8 signature, it's an electronic signature, but you've reviewed
9 this document and signed it, correct?

10 A I did.

11 Q And again, to that everything contained herein is true,
12 correct, and accurate, to the best of your knowledge, correct?

13 A Correct.

14 Q Okay. All right. Now the employees are not listed on this
15 list, either, are they?

16 A No, we did not individually list employees.

17 Q Okay. All right. Were the employees --

18 THE COURT: Mr. Schepacarter, I have a list of -- oh,
19 I'm sorry, of creditors; no amounts. Is that correct?

20 MR. SCHEPACARTER: Is that UST-4?

21 THE COURT: Yes.

22 MR. SCHEPACARTER: Yeah, I believe that there's no
23 amounts there. That is what they call the "creditor matrix" --

24 THE COURT: All right.

25 MR. SCHEPACARTER: -- which is the mailing -- the

1 basis that the Court uses, the Clerk's Office uses to mail out
2 all the notices in the case because there's no claims agent --

3 THE COURT: Understood.

4 MR. SCHEPACARTER: -- and it's less than 200.

5 THE COURT: Right. Thank you.

6 MR. SCHEPACARTER: There's a 191, to be exact, so ...

7 BY MR. SCHEPACARTER:

8 Q So, to the best of your knowledge, the employees were not
9 served with any copy of this motion, correct?

10 A Correct.

11 Q Okay. And you had testified earlier, as part of your
12 proffer, was the fact that Docket Entry 185 is a certificate of
13 service that was filed with respect to the motion that was
14 served out. And none of the employees are listed on that
15 certificate of service, either, correct?

16 A No. That is correct.

17 Q And there's no union for the employees at all?

18 A No, there is not.

19 Q Okay. All right.

20 MR. SCHEPACARTER: Just a few more, Your Honor.

21 THE COURT: Yes.

22 (Pause in proceedings)

23 BY MR. SCHEPACARTER:

24 Q Okay. As part of your proffer, you indicated that there's
25 avoidance actions being left in the estate.

1 A That is correct.

2 Q Roughly \$3.2 million, we'll say. Okay.

3 And to your knowledge, today, is there any plan to
4 prosecute those by the debtor; is the debtor, basically, going
5 to prosecute those avoidance actions?

6 A We've not made any final decisions as to which ones we may
7 or may not pursue.

8 Q Okay. But is it the debtors' intention, at this point, to
9 make a -- to do an analysis, and then prosecute those claims?

10 A Absolutely.

11 Q Okay. Okay. And other than the litigation, the complaint
12 that's been filed against Diversitex, no other complaints have
13 been filed?

14 A No, that's the only one --

15 Q Okay.

16 A -- filed, at this point.

17 Q Okay. All right. What was the debtors' purpose for filing
18 that; do you know?

19 A Mostly to establish that we do not believe that there is a
20 substantial 503(b)(9) claim due to Diversitex at this time.

21 Q Okay. Okay.

22 (Pause in proceedings)

23 Okay. And your -- to the best of your knowledge, there's
24 no other 503(b)(9) claims?

25 A The company was mostly paying for all significant

1 materials, prepayments.

2 Q Okay. Have any other -- to your knowledge, have any other
3 503(b)(9) claims been asserted?

4 A No.

5 MR. SCHEPACARTER: Okay. All right, Your Honor, I am
6 going to pass the witness, but before I do so, I wanted to move
7 into evidence exhibits -- U.S. Trustee Exhibits 1 through 4, I
8 would move those into evidence. And then I would ask Your
9 Honor to take judicial notice of the certificate that was filed
10 under Docket Entry 185.

11 THE COURT: All right. Any objection?

12 MR. KLAUDER: No objection.

13 THE COURT: All right. Then Exhibits 1 through 4 of
14 the United States Trustee are admitted. And I do take judicial
15 notice of the certificate of service.

16 (Exhibits UST-1 through UST-4 received in evidence)

17 MR. SCHEPACARTER: Okay. All right. As I indicated,
18 Your Honor, I'm passing the witness, reserving my right to
19 recross upon whatever other cross that's done, as well as any
20 other redirect that's --

21 THE COURT: All right.

22 MR. SCHEPACARTER: -- that's proffered. Thank you,
23 Your Honor.

24 THE COURT: That's fine, Mr. Schepacarter.

25 MR. SCHEPACARTER: Thank you.

1 THE COURT: Thank you.

2 Mr. Cole.

3 MR. COLE: Thank you, Your Honor.

4 THE COURT: Good morning.

5 MR. COLE: Good morning, Your Honor.

6 CROSS-EXAMINATION

7 BY MR. COLE:

8 Q Mr. Iammartino, I have a couple of questions about
9 your proffer, regarding the 503(b)(9) claim of Diversitex and
10 the preference complaint against Diversitex.

11 On the 503(b)(9), did you review the 503(b)(9) motion
12 that was filed by Diversitex?

13 A I did.

14 Q When did you review that?

15 A The day it was filed, which I believe was mid last week.

16 Q And you said that you had conducted an analysis with
17 respect to the motion?

18 A That is correct.

19 Q When did you complete the analysis?

20 A Partly that week, and partly probably about a month ago, we
21 had started looking at data.

22 Q Okay. Did you review the debtors' books and records and
23 compare them with the exhibits that were attached to the
24 503(b)(9) motion?

25 A I did.

1 Q Does the debtor acknowledge that it received goods from
2 Diversitex during the 20 days preceding the petition date?

3 A We received some goods, but not in the full amount that was
4 asserted in the motion.

5 Q With respect to the goods that you determined, according to
6 the books and records of the debtor, were received within the
7 20 days preceding the petition date, did you also confirm that
8 those goods had not been paid for?

9 A The -- of the invoices on that motion, I believe the first
10 one, for roughly \$19,000, that was received outside the twenty-
11 day period before petition. And then, for the others, we
12 received goods in about the amounts of that invoice, plus the
13 ten percent surcharge that we were paying.

14 Q And the debtor did not pay for those goods. Is that
15 correct?

16 A The money -- so, when shipment was being made -- let's say
17 there was \$100,000 worth of materials being shipped. The
18 agreement was that the debtors would pay 110 percent of that
19 shipment. And so, if \$100,000 worth of shipments were being
20 sent, we'd pay \$110,000. What would then happen is the
21 companies were applying that payment to past-due invoices from
22 before that period.

23 Q Right. So the invoices -- the goods themselves that you
24 received during the 20 days were not, in fact, paid for; the
25 amounts that were paid were, in fact, applied to invoices from

1 prior periods. Is that correct?

2 A Yeah, the amounts were applied to prior periods.

3 Q Okay. So your assertion earlier is that the 503(b)(9)
4 claim that's asserted by Diversitex is -- and I can't remember
5 the exact words. But what was the result of your analysis of
6 this?

7 A So the companies had paid, I think, 850,000, thereabouts,
8 in payments during the 90 days prior to petition. And I
9 believe that most of that was paid contemporaneously with the
10 exchange of goods, except we also then paid ten percent above
11 that, that went to past-due invoices. And then the way the
12 payments were applied were to past-due invoices, as opposed to
13 the current shipments, but those payments were required to be
14 made in order to have goods released.

15 Q But the payments themselves, by agreement with the debtor,
16 is it correct to say that those payments were applied to prior
17 invoices?

18 A Yes, they were applied to prior invoices.

19 Q So the invoices for the goods that were received within the
20 20 days before the petition date remained unpaid on the
21 petition date. Is that fair?

22 A Those specific invoices did not have payments applied to
23 them.

24 Q So, with respect to the 503(b)(9) claim for goods
25 delivered, but not paid for, and received by the debtor within

1 the 20 days before the petition date, other than with respect
2 to the first invoice for approximately 19,000, which you
3 identified, do you dispute that the rest of those goods were
4 received within the 20 days before the petition date?

5 A No, I believe the goods were received, and it's just a
6 matter of how the payments were applied.

7 Q Okay.

8 A Whether or not that payment was applied to prior invoices,
9 and that controls, or if it applied to the current shipments,
10 which is what generated the amount being paid, controls.

11 Q Okay. But the invoices for those goods were not, in fact,
12 paid.

13 A The payments were applied to the older invoices.

14 Q Right.

15 A So those invoices were not having payments applied to them,
16 right.

17 Q So going back to my initial question. What was the result
18 of your analysis of the 503(b)(9) claim asserted by Diversitex?

19 A We believe that there's actually sale preference exposure
20 to Diversitex.

21 Q Okay. And that's not the question I'm asking. Put aside
22 the preference exposure --

23 A Uh-huh.

24 Q -- because that's a separate and distinct issue.

25 What was the result of your analysis with respect to the

1 503(b)(9) claim, in isolation, as presented?

2 A I have the belief that it was more of a contemporaneous
3 exchange; in that, we had paid for the goods that were coming
4 in, despite how the payments had been applied to prior
5 invoices.

6 Q Well, that's inconsistent with suing the debtor -- or suing
7 Diversitex for return of all payments received in the 90 days,
8 isn't it?

9 A Well, I think, if -- if we were to be wrong in that legal
10 conclusion, and someone were to determine that the payments
11 were not paid -- or the shipments before the 20 days were not
12 paid, well, then I believe we would have a preference claim for
13 that full amount. So there's a bit of a chicken-and-the-egg
14 here.

15 Q I agree. But none of those issues have been resolved yet,
16 correct?

17 A No, they have not.

18 Q Okay. And so the 503(b)(9), in isolation, you've said that
19 goods were received within the 20 days, and you said that the
20 invoices for those goods were not, in fact, paid because the
21 payments received by the debtor during that period were applied
22 to prior invoices.

23 A Yes, they were applied to prior invoices.

24 Q All right. Let me shift to the preference complaint. The
25 -- and thank you. We did receive that on Friday afternoon.

1 A Uh-huh.

2 Q The analysis done with respect to the preference, did you -
3 - when did you conduct the preference analysis with respect to
4 the claim against Diversitex?

5 A We had created a list of all payments made prior -- 90 days
6 prior, as part of the schedule preparation.

7 Q And did you analyze any defenses, with respect to the
8 preference claim against Diversitex?

9 A To a certain extent, we looked at what goods had been
10 received throughout that ninety-day period.

11 Q Did you conduct a new value defense analysis?

12 A A what defense?

13 Q Did you conduct a new value defense analysis with respect
14 to the payments received by Diversitex?

15 A Yes, as to what was a contemporaneous exchange --

16 Q Or subsequent --

17 A -- or to just --

18 Q -- new value.

19 A -- new goods coming, yes. We have the amount of new goods
20 that were received in those 90 days.

21 Q So you had said before. What were the terms that the
22 debtor was paying Diversitex on; what was the agreement with
23 respect to shipments and payments?

24 A It was 110 percent of current shipment.

25 Q Okay. So for -- in other words, for every \$100 in goods

1 that Diversitex was shipping, is it fair to say that Diversitex
2 was insisting upon a payment of \$110 before it made that
3 shipment?

4 A That is correct.

5 Q So each of those shipments would offset -- would either be
6 a contemporaneous exchange, or would offset a prior payment,
7 with respect to any preference exposure. Is that correct?

8 A To the extent of the goods that we received, yes.

9 Q Okay. And that would be 100 cents on every \$1.10 that was
10 paid.

11 A Yes.

12 Q And so, when you conducted your new value defense, what was
13 the result of your new value analysis; what was the dollar
14 figure exposure that you realized?

15 A I don't have the exact number in front of me, but I believe
16 the net difference between -- excuse me -- the materials
17 received and what we had paid was I believe we had paid a
18 little over -- or a little under \$100,000 more than materials
19 received.

20 Q So, if the 503(b)(9) claim -- and again, I'm taking it in
21 isolation, and not applying any offsets to it.

22 A Uh-huh.

23 Q If the 503(b)(9) claim was the amount asserted by
24 Diversitex -- and I'm just asking for you to assume this for
25 the purposes of doing this calculation -- less than nineteen-

1 thousand-dollar invoice, what was the approximate amount of the
2 remaining 503(b)(9) claim asserted by Diversitex?

3 A Well, if the 503(b)(9) claim were to be upheld, we would
4 not have received -- in that regard, we would not have received
5 those current shipments, so to speak. And so then I think the
6 preference exposure would have been higher.

7 Q I'm sorry. You have to repeat that again.

8 A So, if we received 750,000 ish of materials, and paid
9 850,000, yes, there's about a hundred-thousand-dollar delta.

10 Q Okay. But -- so let's just look at the 503(b)(9) for a
11 moment, in isolation. I believe we filed it for what, about
12 three forty, three fifty?

13 A Yes.

14 Q And you said about three -- about -- I'm sorry -- 20,000 of
15 it was goods that you claim were received prior to the 20 days?

16 A Yes.

17 Q All right. And that would -- in fairness, we weren't sure
18 about that; we didn't know what the shipment time was.

19 A Uh-huh.

20 Q We included it, but we footnoted it, and made sure that it
21 was understood that we weren't asserting that in isolation. So
22 that's 346,976, less roughly \$20,000. So that leaves what,
23 about a three-hundred-and-twenty-six-thousand-dollar --

24 A That's correct.

25 Q -- 503(b)(9) claim? Okay.

1 And again, this is assuming that payments were applied to
2 prior invoices, and not to current invoices.

3 A Uh-huh.

4 Q Okay. And the preference exposure, if you applied new
5 value or contemporaneous exchange, whichever -- however flavor
6 it fits into, the net difference -- and Diversitex was shipping
7 right through the petition date, right?

8 A Correct.

9 Q They were basically keeping this debtor in business, in a
10 lot of ways.

11 A Well, it certainly is important to get the materials.

12 Q It was -- and certainly we felt we were helping out the
13 debtor.

14 A Uh-huh.

15 Q And I think the debtor probably felt the same way --

16 A Absolutely.

17 Q -- at the time.

18 But that net difference in that relationship, which
19 continued straight through the petition date, you said was
20 roughly \$100,000.

21 A That's correct.

22 Q And again, this is before applying any other initial
23 preference defenses; this is just a mathematical application of
24 --

25 A Uh-huh.

1 Q -- contemporaneous exchange or new value.

2 So there's a delta between the 503(b)(9) claim and the
3 preference analysis of -- what is it, approximately \$235,000?

4 A Yes, that math would be correct.

5 MR. COLE: Okay. No further questions, Your Honor.

6 THE COURT: All right, Mr. Cole. Thank you, sir.

7 Would anyone like to redirect?

8 MR. PACITTI: Well, Your Honor, I'm not a movant, so I
9 don't know if I should ask questions on a cross or a redirect,
10 but we certainly support the motion.

11 THE COURT: Well, you're certainly a party to the
12 motion, or to the --

13 MR. PACITTI: No, we're not a party --

14 THE COURT: -- to the --

15 MR. PACITTI: -- to the motion.

16 THE COURT: -- to the settlement.

17 MR. PACITTI: Certainly to the settlement.

18 THE COURT: To the settlement. So I think you have
19 standing to question.

20 MR. PACITTI: Okay. But in the form of --

21 THE COURT: And --

22 MR. PACITTI: -- cross or redirect? I don't want to -
23 -

24 THE COURT: I think it's redirect.

25 MR. PACITTI: -- run afoul of the rules of evidence.

1 THE COURT: I think it's --

2 MR. PACITTI: I'm sorry?

3 THE COURT: I think it's redirect --

4 MR. PACITTI: Okay.

5 THE COURT: -- given your -- given the status and your
6 -- and who you are.

7 MR. PACITTI: Okay. Thank you, Your Honor. I just
8 have a couple of questions that relate to the agreement. I'm
9 sorry.

10 REDIRECT EXAMINATION

11 BY MR. PACITTI:

12 Q Mr. Iammartino, can you turn to U.S. Trustee Exhibit 1?

13 A Sure.

14 Q Page 3, Section 1.2(c).

15 A (Witness reviews exhibit)

16 Q Do you see there, listed as "Accounts" and "Accounts
17 Receivable"? Are they excluded assets under the asset purchase
18 agreement?

19 A Accounts receivable are excluded from the --

20 Q Okay.

21 A -- asset purchase agreement.

22 Q And those accounts receivable of the company have already
23 been acquired by LSQ, in the context of the factoring
24 arrangement. Isn't that correct?

25 A That's correct.

1 Q Okay. So LSQ owns those at this point.

2 A Yes, they do.

3 Q Okay. And isn't it --

4 MR. PACITTI: There was my cross, Your Honor. I
5 apologize.

6 THE COURT: That's all right.

7 BY MR. PACITTI:

8 Q Mr. Iammartino, the amount of the accounts receivable that
9 have been acquired by LSQ throughout this case are in excess of
10 a million dollars, at least, at this point.

11 A Yes.

12 Q Isn't that correct?

13 A Yes.

14 MR. PACITTI: That's all I have, Your Honor.

15 THE COURT: Thank you. Thank you, Mr. Pacitti.

16 MR. KLAUDER: Your Honor, I --

17 THE COURT: Mr. Klauder, do you have any redirect?

18 MR. KLAUDER: Redirect, briefly.

19 THE COURT: Yes.

20 REDIRECT EXAMINATION

21 BY MR. KLAUDER:

22 Q Mr. Iammartino, I just want to clarify one item. The U.S.
23 Trustee, Mr. Schepacarter, asked you, when you were going
24 through the schedules and the like, whether you had reviewed
25 those, which -- of course, you said you did, and signed off on

1 those. He also indicated, did you review and sign the
2 petition. Now --

3 A Oh, I did not sign the petition.

4 Q Okay. You were not employed as the CRO, at the time the
5 petition was filed, correct?

6 A No, I became CRO a week after petition.

7 Q Okay. I just wanted to clarify that. Thank you.

8 THE COURT: All right.

9 BY MR. KLAUDER:

10 Q With respect to this Diversitex issue, let's see if we can
11 clarify this a bit because it's a little bit confusing --

12 A Uh-huh.

13 Q -- with the analysis. The -- essentially, this allocation
14 issue is what this comes down to. And you've done some
15 analysis. Is this still a sort of disputed item, an issue that
16 needs to be kind of worked out, as to how it gets allocated?

17 A That's correct. We have not had any substantive
18 conversations yet with Diversitex about how to resolve.

19 Q All right. So, notwithstanding that, you authorized the
20 debtors to file the preference complaint, correct?

21 A That is correct.

22 Q All right. And the -- explain this to me again, the way
23 this would work with respect to the 503(b)(9) versus the
24 preference claim, and how you determined -- or how you're
25 trying to determine how this falls into what bucket.

1 A The 503(b)(9), to the extent that the payments were made
2 with the company having received goods in that amount, and so
3 out of the \$325,000 of shipments, we had made, at the same
4 time, payments of ten percent more than that, so three fifty,
5 three seventy-five, thereabouts. And the amounts that were
6 being paid were very much calculated on the amount of the
7 shipment being received at that time because we were not able
8 to get new materials in, without having paid for that current
9 shipment, plus ten percent to be applied to past-due invoices.

10 So, even though the company applied the payments to older
11 invoices, I still believe that it was -- the payments were made
12 to get the materials in the door for that particular week.

13 Q And to the extent they were applied to the materials at
14 that time, is -- and based on your analysis, would there be --
15 or do you believe there would be a valid 503(b)(9) claim?

16 A No, I believe that the company made more payments than the
17 materials received during that period.

18 Q Okay. And then, but if applied to the older invoices, that
19 creates the large preference exposure, correct?

20 A That creates the preference exposure.

21 MR. KLAUDER: Thank you. No more questions, Your
22 Honor.

23 THE COURT: All right. Thank you.

24 Mr. Schepacarter?

25 MR. SCHEPACARTER: Just a couple, Your Honor.

1 THE COURT: Yes. I said Mr. Schepacarter and Mr.
2 Klauder. I'm sorry. Mr. Schepacarter?

3 (Participants confer)

4 MR. SCHEPACARTER: Well, as Your Honor knows, Mr.
5 Klauder and I used to work together, so ...

6 THE COURT: Yes.

7 (Laughter)

8 MR. SCHEPACARTER: At times, we did cover each other
9 cases.

10 THE COURT: Absolutely.

11 MR. SCHEPACARTER: And there could be some overlap
12 there.

13 RECROSS-EXAMINATION

14 BY MR. SCHEPACARTER:

15 Q Mr. Iammartino, Mr. Pacitti asked you about -- I guess it
16 was Item 1.2(c), which is the accounts, correct?

17 A That's correct.

18 Q And then he asked you about -- I guess it's money that LSQ
19 has received, about a million dollars or so?

20 A About new invoices that were being sold.

21 Q Okay. And that million dollars, that was based on the
22 accounts?

23 A The account -- the accounts receivable, correct.

24 Q Okay. All right. But no other assets were involved with
25 the --

1 A No, just receivables.

2 MR. SCHEPACARTER: Okay. That's the only question I
3 had, Your Honor. Thank you.

4 THE COURT: All right.

5 EXAMINATION

6 BY THE COURT:

7 Q Has LSQ received the million dollars or just the accounts
8 receivable, Mr. Iammartino?

9 A As customers pay, they go into a lockbox that is owned by
10 LSQ, and they get applied to the receivables.

11 Q All right. Thank you.

12 THE COURT: All right. Anyone else? Mr. Jung, yes.

13 MR. JUNG: Wojciech Jung, Lowenstein Sandler, for the
14 committee.

15 FURTHER REDIRECT EXAMINATION

16 BY MR. JUNG:

17 Q Mr. Iammartino, I just have one question. Based on your
18 understanding of the current proposed purchase price under the
19 APA, and the amount of debt outstanding to LSQ, is it your
20 understanding that there will be no distribution to unsecured
21 creditors, absent the Court's approval of the current financing
22 package?

23 A That would be correct, sir.

24 Q Thank you.

25 THE COURT: All right. Thank you.

1 Anything prompted by that question?

2 (No verbal response)

3 THE COURT: Hearing no one, you may step down, Mr.

4 Iammartino. Thank you, sir.

5 (Witness excused)

6 THE COURT: Mr. Klauder, I think you're the first up.

7 MR. KLAUDER: Maybe we should close the --

8 THE COURT: Oh, I'm sorry.

9 MR. KLAUDER: We don't have any further evidence.

10 THE COURT: Oh, I'm sorry.

11 MR. KLAUDER: I don't know if anybody else has any
12 evidence to present.

13 THE COURT: All right. The evidence is closed. Thank
14 you.

15 MR. KLAUDER: Okay. Your Honor, I'm going to turn the
16 podium over to Mr. Jung. He's going to principally address the
17 settlement motion -- we're joint movants --

18 THE COURT: All right.

19 MR. KLAUDER: To the extent of anything to add, I will
20 add onto that after he presents.

21 THE COURT: Good.

22 MR. KLAUDER: Thank you.

23 THE COURT: All right. That's fair. Thank you.

24 Mr. Jung?

25 MR. JUNG: Wojciech Jung, Lowenstein Sandler, for the

1 committee.

2 Your Honor, since its appointment, as Your Honor
3 knows, the committee has vigorously opposed the proposed DIP
4 financing package, as well as the sale procedures. We filed
5 multiple objections with respect to financing, as well as an
6 omnibus objection to the bid procedures and the sale.

7 Your Honor, since then, in essence, since the first
8 day of its appointment, the committee has engaged in lengthy,
9 substantive discussions and negotiations with both the debtor,
10 as well as the lenders, with respect to various aspects of
11 principally the financing of the moment. The committee has
12 done so because it believed that the financing package, as
13 originally proposed, was overly burdensome and not appropriate
14 for these cases. Your Honor, these negotiations have resulted
15 in the parties reaching an agreement on a final DIP financing
16 package.

17 For the most part, Your Honor, the changes in the DIP
18 order are memorialized in Paragraphs 18 and 19 of the order.
19 Through that, Your Honor, financing package, the debtors are
20 afforded continued financing to get these debtors through the
21 sale process that is expected to continue, at least until about
22 mid-October.

23 Your Honor, two objections have been filed to the
24 financing: One by the U.S. Trustee, and the second one by a
25 disputed 503(b)(9) holder. Your Honor, it is important to note

1 that both objections disagree with only one aspect of the
2 global resolution, and in essence uphold [sic] the others; that
3 is, the objections raise issue with a part of the proposal in
4 Paragraph 19 that talks about distributions by LSQ of certain
5 funds, should there be funds available to unsecured creditors,
6 Your Honor.

7 We believe that both objections, Your Honor, lack
8 merit because they suffer from a misunderstanding of the facts
9 related to the DIP order as well as a misapplication of
10 applicable law. Your Honor, we believe that both objections
11 assume that the proposed distributions to unsecured creditors
12 are made from property of the debtors. And Your Honor, both
13 objections assume that the lender has agreed to make such
14 distribution in exchange for a release of estate claims. Your
15 Honor, neither of those two things are true, which render the
16 issue of Jevic, and the existence or nonexistence of priority
17 claims to be, in essence, a side issue, rather, in this
18 context.

19 Your Honor, the changes that have been agreed to, in
20 connection with the DIP financing package, are numerous, but I
21 will just summarize a few of them. Your Honor, under the
22 original financing, the lender was getting liens, adequate
23 protection claims, et cetera, on absolutely everything that the
24 debtors have, even when the debtor is no longer in the case.

25 For example, the revised financing package preserves

1 for the estates all claims, including Chapter 5 claims, D&O
2 claims, and proceeds. And as Mr. Iammartino has testified,
3 there's about approximately \$1.2 million in preference claims
4 out there, and that does not, obviously, include any D&O claims
5 and other claims that the estate has.

6 Your Honor, similarly, any and all claims to the
7 unencumbered assets remain with the estate. The lender waives
8 any right to a distribution on account of its deficiency claim,
9 which, Your Honor, obviously, right now, it looks to be very,
10 very substantial. In the same vein, lender's recovery is being
11 limited to the sale proceeds that may be realized as a result
12 of the pending 363 sale process, and the lender will not be
13 asserting any adequate protection or similar claims for its
14 deficiency.

15 Your Honor, the committee's challenge deadline under
16 the original version of the financing was expiring in the
17 beginning of September. Your Honor, that deadline has been
18 extended to the earlier of the closing date or about ten days
19 thereafter, which is closer to the end of October.

20 Your Honor, in support of the compromise, the lender
21 has agreed to an increased amount of the committee carveout for
22 professionals. And as important, or more important, is the
23 lenders agree to distribute some of the sale proceeds that it
24 receives to creditors that have either been scheduled for or
25 filed claims against the estate.

1 Your Honor, under the agreement, all sale proceeds go
2 to the lender, they never come to the estate, because the
3 lender has a first priority lien. And then the lender, Your
4 Honor, has agreed to make distributions to creditors, as it is
5 entitled to do whatever, in essence, it wants to do with its
6 money.

7 Your Honor, it is -- in the two objections that were
8 filed, Your Honor, it is important to know that none of them
9 attack the debtors' business judgment in seeking this
10 financing, which this motion is. Your Honor, the U.S. Trustee
11 does not object to any aspects of the financing under Section
12 364. No party has objected to the original version of the
13 financing, which was obviously much more (indiscernible) that
14 it is now. Your Honor, on that basis alone, the financing
15 remains uncontested under the 364 business judgment standard.

16 Your Honor, the U.S. Trustee argues, as does
17 Diversitex, that the agreement somehow infringes or runs afoul
18 of the recent Supreme Court holding in Jevic. Your Honor, we
19 believe that Jevic has no application to this case.

20 First, what was the issue in Jevic? The Supreme Court
21 has phrased the issue as follows:

22 "-- whether the Bankruptcy Court has the legal power
23 to order this priority-skipping kind of distribution
24 scheme in connection with a Chapter 7" [sic]
25 "dismissal."

1 And the word "dismissal" is italicized. 137 S.Ct., at
2 978.

3 It repeated the question:

4 "The question here concerns the interplay between the
5 Code's priority rules and a Chapter 11 dismissal."

6 At Page 979.

7 Your Honor, what were the facts in Jevic? Jevic
8 involved a distribution of estate assets. The distribution was
9 made, as a result, Your Honor, of the committee's filing
10 complaints against the lender. The committee obtained the,
11 quote, "standing" to prosecute estate claims against the
12 lenders. And Your Honor, the express goal of Jevic was to skip
13 an identified, undisputed members that had priority claims.

14 Your Honor, none of the case -- none of these facts
15 are present in this case. Mr. Iammartino has testified that,
16 in his view, the lender's agreement to make distributions to
17 creditors are clearly gifts from the lender, to resolve
18 objections to the financing and the sale process. Mr.
19 Iammartino has testified that the committee has not released
20 the DIP lender from anything.

21 Your Honor, the original financing order that has been
22 approved over the committee's objection at the first- or
23 second-day hearing here, Your Honor, contained releases and
24 stipulations by the debtor. Your Honor, those releases are
25 stipulations are present there. The committee has not given

1 any additional releases. And frankly, the committee has not
2 blessed any releases.

3 Just as Your Honor highlighted by the fact of the
4 challenge deadline, that the committee has been extended by two
5 months, and the committee is free to assert any claims it may
6 want, and give the lender, if such was appropriate.

7 THE COURT: Yes.

8 MR. JUNG: But Your Honor, even if Jevic was
9 applicable to this situation, it actually supports the Court's
10 approval of this financing package. Your Honor, in Jevic, the
11 Supreme Court made a number of references to situations where
12 priority-skipping is appropriate. One of those -- one of those
13 -- one of those references, Your Honor, is a reference to DIP
14 financing, and I think the Supreme Court specifically talked
15 about the roll-up. Your Honor, this is exactly what Your Honor
16 has. It's an approval of a financing package that involves a
17 payment by the lender from its proceeds to creditors.

18 THE COURT: Well, it's from the sale proceeds, the
19 sale of assets of the debtors' estate.

20 MR. JUNG: Correct, Your Honor. As -- and as Mr.
21 Iammartino has testified, all of the sale proceeds will go to
22 the lender because they have a first priority lien. So, Your
23 Honor, that is only triggered once the lender has the money in
24 its account, as it would be entitled to as a first lien
25 creditor. And then it's up to them whom they wish to make a

1 payment to.

2 Your Honor, the lender and the committee thought it
3 was appropriate to resolve issues with respect to the
4 financing, not issues with respect to any claims that the
5 debtors' estate may or may not have.

6 THE COURT: Didn't the Supreme Court, though, talk
7 about their -- that those payments would go toward confirmation
8 of a plan and the like?

9 MR. JUNG: Your Honor, that is correct. But the
10 crucial distinction, we believe, between that case and this one
11 is that the Jevic payments were made on account or in exchange
12 for a resolution of an estate claim. So, clearly, it was
13 proceeds of the bankruptcy estate. So, only in that instance,
14 the Supreme Court said that it would not be fair if parties
15 could dictate which creditor could or could not receive the
16 funds. Here, Your Honor, we do not have a resolution of any
17 estate claims, which makes this perhaps a someone -- somewhat
18 unique financing package, but that's what we have here.

19 Your Honor, we think this case is more analogous to
20 the ICL Holding case from the Third Circuit, from about two
21 years ago, as well as, frankly, to the recent Delaware District
22 Court decision in Nuverra Environmental Solutions. Your Honor,
23 both cases clearly hold that a settlement that does not
24 involved -- does not involve resolution of estate claims or
25 payment of funds from estate proceeds, that the payments may be

1 made by a lender, in essence, in any way it wishes because,
2 again, those payments do not come from estate money.

3 Your Honor, the concept of gifting has not been
4 addressed specifically by Jevic, but certainly, Jevic has been
5 -- the Jevic decision has been on the record for a number of
6 months before Nuverra, and that Court, as well, did not find
7 Jevic problematic. Your Honor, we would submit that the
8 concept of gifting is entirely appropriate in the Third
9 Circuit, and has not been affected by Jevic.

10 Your Honor, so, in sum, we believe that the objections
11 are not well-founded because of the rather unique nature of
12 these cases, and again, largely because the payments are not
13 being made from estate proceeds, they're not being made as a
14 result of releases that the lenders are receiving. And Your
15 Honor, the payments are made in connection with a financing
16 package, again, not a resolution of estate claims.

17 So, Your Honor, for those reasons, we believe that the
18 debtors' decision to seek the approval of a new, highly
19 improved financing package is very appropriate under the
20 circumstances. And again, we don't believe that Jevic and
21 those arguments are applicable here.

22 THE COURT: Thank you, Mr. Jung.

23 MR. JUNG: Thank you.

24 THE COURT: Mr. Klauder, anything from you?

25 MR. KLAUDER: Your Honor, I'll just get up to support

1 the motion. Obviously, I don't need to get into -- I think
2 it's pretty obvious, from the debtors' perspective, how
3 important it is that financing, in and of itself, be approved.
4 We've talked about that numerous times in this case. I
5 remember, on the first day, being here, telling you how
6 critical even getting an interim order was, in a case where it
7 was in very much in flux --

8 THE COURT: Well, I assume --

9 MR. KLAUDER: -- at that point.

10 THE COURT: -- if I don't approve the settlement,
11 there's no financing.

12 MR. KLAUDER: The -- I think that's correct. I mean,
13 there's certainly no agreement. I mean, the important part of
14 the -- the important part of this deal is that the committee
15 has now signed off on the financing. They clearly made it --
16 clearly made it known, in filings and before this Court, that
17 they had issues --

18 THE COURT: Yes.

19 MR. KLAUDER: -- with the financing and the terms set
20 out, and that they were prepared to litigate those. And this
21 arrangement, this compromise resolves those, and allows us to,
22 essentially, with respect to them, go forward on a consensual
23 basis.

24 THE COURT: And where are we on the financing
25 available to the company today? Do we have a week left of

1 money?

2 MR. KLAUDER: Well -- is it today?

3 (Participants confer)

4 MR. KLAUDER: Yeah, the budget goes through today.

5 THE COURT: Okay.

6 MR. KLAUDER: We, obviously, have a budget before Your
7 Honor that will go through what's projected to be the sale
8 closing date in the middle of October.

9 THE COURT: Yes.

10 MR. KLAUDER: But we are going to need approval today
11 of financing. We're still on an interim order.

12 THE COURT: Right.

13 MR. KLAUDER: And Your Honor, I just want to stress --
14 I'm not going to get into -- Mr. Jung handled the legal
15 aspects. I -- we support the -- we support the arguments
16 there. But from the debtors' perspective, I just want to
17 stress a point made on the proffer. And we dealt with this
18 internally, when the compromise -- before the compromise had
19 been agreed to.

20 There was extreme concern on our end as to the
21 litigation that looked like was on the horizon, with respect to
22 the committee and the financing. And while we had begun to
23 comply with the discovery requests and the other things that
24 were going on, it was going to a major issue for the debtors
25 being able to address those.

1 And to have a compromise that will allow the company
2 to remain in operations, and get us to a sale process that we
3 are on board for next week, Your Honor, and hopeful that it
4 will be at least some sort of auction process, it's still -- we
5 can't definitively determine that because the bid deadline is
6 this Friday, but there is activity. From the debtors'
7 perspective, this agreement is a good one, and it's a good one
8 for the estates, and it's good for the company, and that's why
9 we support it.

10 THE COURT: Okay.

11 MR. KLAUDER: Thank you, Your Honor.

12 THE COURT: Thank you, Mr. Klauder.

13 Mr. Pacitti, yes.

14 MR. PACITTI: Good afternoon, Your Honor. For the
15 record, Domenic Pacitti of Klehr Harrison Harvey Branzburg, on
16 behalf of LSQ Funding Group, LC.

17 Your Honor, I rise just for a couple of points.
18 Number one, obviously, we support the motion and request that
19 Your Honor approve the motion as it currently is structured.

20 Secondly, Your Honor, I think Mr. Jung did point out
21 one issue with respect to Jevic that I sort of want to
22 emphasize. And I think that is important in this context. The
23 Supreme Court, in the Jevic case, went at great lengths to talk
24 about how you end a bankruptcy case. And if you recall, the
25 case was really about a dismissal.

1 THE COURT: Correct.

2 MR. PACITTI: It was -- it focused on how you end a
3 case; you either confirm a plan, you convert the case to a
4 Chapter 7, or you dismiss it. Then it went into great lengths
5 about, well, what can you do in the dismissal context. And
6 what the Supreme Court said was that it was not going to
7 approve, effectively, class-skipping, when there was a case-
8 ending disposition of the case, either a dismissal, a
9 conversion, a plan, something like that.

10 So, when you look at sort of the cases that talk about
11 gifting, talk about class-skipping, they're in the context of
12 those case-ending dispositions. This is not a case-ending
13 disposition, as Mr. Iammartino testified to. This is a
14 financing arrangement that, although we wish we were here
15 months ago, and we didn't have five interim orders,
16 unfortunately, that's what it took to get here, and the process
17 needed notice and the like. So we are where we are, just by
18 happenstance, and by virtue of the fact that this company can't
19 survive a long case.

20 But nevertheless, I think this is a real distinction
21 from what Jevic was trying to prevent, and that was there's
22 only appropriate ways, in their view, of how you end the case.
23 And they -- as Mr. Jung pointed out, there were specific
24 examples that the Supreme Court pointed to that were
25 permissible. Financing was certainly one; first-day motions

1 certainly another. There's a host of other areas in a
2 bankruptcy life that results in payments to creditors that are
3 junior to other creditors. So, as a matter of law, Your Honor,
4 I think it's different.

5 Secondly, I think it's factually different. In all of
6 those cases that talk about whether gifting or class-skipping
7 is permissible, it's clear that junior classes are getting paid
8 ahead of senior classes, and that those senior classes have no
9 other recovery. In this instance, Your Honor, Mr. Iammartino
10 testified it's still yet to be determined whether there are,
11 number one, any senior creditors that won't be paid; and,
12 number two, if there are any, whether there will be sufficient
13 funds to pay those creditors in the form of recoveries for
14 avoidance actions and the like. So, Your Honor, I don't think,
15 either as a matter of law or factually, we're at the point
16 where Jevic actually even applies there.

17 So, as a consequence, Your Honor, I think that the
18 debtors' best business judgment is appropriate, given the
19 context of these cases, and that you should approve this
20 financing with the approval of this arrangement between the
21 debtors and the committee and LSQ.

22 THE COURT: All right, Mr. Pacitti. Thank you.

23 MR. SCHLAUCH: Good morning, Your Honor.

24 THE COURT: Yes.

25 MR. SCHLAUCH: Brendan Schlauch of Richards, Layton &

1 Finger on behalf of our client Jerry Armstrong Consulting.

2 THE COURT: Yes.

3 MR. SCHLAUCH: We just wanted to state on the record
4 that our client is in support of the DIP 9019 motion, for the
5 reasons set forth by the committee, the debtors, and LSQ.

6 We also wanted to take an opportunity to set forth on
7 the record that the committee and Jerry Armstrong, late last
8 week, came to an agreement whereby our client would be removed
9 from the reserved parties list set forth in the DIP order, and
10 will be allowed to participate in the distribution of the GUC
11 fund, subject to our client filing a proof of claim on or prior
12 to the sale hearing next week.

13 THE COURT: All right.

14 MR. SCHLAUCH: Thank you.

15 THE COURT: Thank you.

16 Do we need a break for five minutes or ten minutes?

17 MR. SCHEPACARTER: That's fine, Your Honor.

18 THE COURT: I think we should take one.

19 MR. SCHEPACARTER: I think we -- I think that should -

20 -

21 THE COURT: Let's take a ten-minute break --

22 MR. SCHEPACARTER: That's great.

23 THE COURT: -- and we'll be back here at 25 of.

24 MR. SCHEPACARTER: Thank you.

25 THE COURT: Thank you, all.

1 UNIDENTIFIED: Thank you, Your Honor.

2 (Recess taken at 12:21 p.m.)

3 (Proceedings resume at 12:35 p.m.)

4 (Call to order of the Court)

5 THE COURT: Thank you, everyone. You may be seated.

6 And now we have Mr. Schepacarter.

7 MR. SCHEPACARTER: Good afternoon.

8 THE COURT: Good afternoon.

9 MR. SCHEPACARTER: Good afternoon, Your Honor.

10 Richard Schepacarter for the United States Trustee.

11 I'll try to address some of the points that were made
12 in argument, as well as highlight parts of our objection that
13 were filed --

14 THE COURT: Yes.

15 MR. SCHEPACARTER: -- earlier in this case.

16 THE COURT: It was a very effective objection.

17 MR. SCHEPACARTER: Thank you, Your Honor.

18 THE COURT: It was a good objections.

19 MR. SCHEPACARTER: Thank you, Your Honor. We worked
20 hard on it.

21 THE COURT: Yes.

22 MR. SCHEPACARTER: I can tell you that.

23 THE COURT: I know you did.

24 MR. SCHEPACARTER: If I might, I just want to start
25 with, basically, the preface that the settlement motion should

1 not -- should be denied in this case because it seeks relief
2 not countenanced by the bankruptcy code. Before the sale has
3 been approved in this case, the proceeds from the transaction
4 are to be removed from the estate and the distribution
5 established outside of the plan confirmation process to
6 unsecured creditors, while skipping certain higher-priority
7 creditors.

8 Alternatively, the settlement motion should be denied
9 for six additional separate and distinct reasons that we put
10 into our objection, and I'll just go through those briefly.
11 But they are that:

12 This is a *sub rosa* plan that could not be approved
13 outside of the Chapter 11 plan.

14 It contains terms that would render a Chapter 11
15 patently unconfirmable.

16 It does not provide the mechanism by which the debtors
17 intend to exit Chapter 11.

18 It constitutes a breach of the fiduciary duty of the
19 debtors.

20 It proposes a settlement that is not fair and
21 equitable to all creditors, and violates the due process rights
22 of creditors who had not received notice and a copy of the
23 motion.

24 First, with the lead point, I'd like to state that the
25 settlement motion seeks approval of a settlement that will

1 distribute the proceeds of the sale of assets, estate assets,
2 which are property of the estate, to certain general unsecured
3 creditors, while skipping priority creditors, and potentially
4 skipping other administrative claimants, secured creditors, and
5 other unsecured creditors who have not qualified for treatment
6 under the settlement motion.

7 In the Czyzewski v. Jevic case -- and I'll just call
8 it "Jevic," so I don't have to keep saying "Czyzewski" --

9 THE COURT: Right.

10 MR. SCHEPACARTER: Although my grandmother would be
11 proud that I could say "Czyzewski."

12 (Laughter)

13 MR. SCHEPACARTER: The Supreme Court rejected a non-
14 plan, priority-skipping distribution of estate assets in a
15 Chapter 11 case that the three lower courts had approved.

16 Although Jevic presented the Supreme Court with an
17 end-of-case structured dismissal scenario, the Supreme Court's
18 reasoning is not limited to either structured dismissals or
19 case-ending distributions. Rather, the Jevic reasoning applies
20 whenever a Bankruptcy Court is presented with distributions of
21 estate assets in a Chapter 11 case that would be flatly
22 impermissible, even if they were proposed in a plan, because
23 they violate priority without the impaired creditor's consent.

24 The Supreme Court premised its Jevic decision upon the
25 bedrock principle that the Code's priority system constitutes a

1 basic underpinning of business bankruptcy law, which is
2 fundamental to the Bankruptcy Code's operation. The statutory
3 priority is established by Section 507, and when analyzing a
4 request to make non-plan, priority-skipping distributions in a
5 Chapter 11 case, this Court must examine the Bankruptcy Code
6 for some affirmative indication of intent that Congress
7 actually meant to make this proposed disbursement a back-door
8 means to circumvent the statutory priority system established
9 by the Bankruptcy Code. As I said, the Bankruptcy Code's
10 priority system is fundamental to its operation, and it's not
11 based on -- the priority system is not based on either inside
12 influence or economic leverage.

13 Here, we have no Bankruptcy Code provision that
14 provides for the priority-skipping distributions, as proposed
15 in this settlement. As a result, it should not be allowed.
16 Although the Supreme Court acknowledged in Jevic that some
17 courts have approved interim, as opposed to final,
18 distributions outside of the usual priority, such as first-day
19 wage orders, critical vendor orders, roll-ups, it noted that
20 these courts have usually found that the distributions at issue
21 would enable a successful reorganization, and even make the
22 favored creditors better off.

23 Such is not the case here. Once these proceeds are
24 distributed, there is no indication that the -- anything will
25 be going forward with respect to any other assets that have

1 been reserved, and that the skipped creditors will be made
2 better off, at some point in time.

3 Indeed, Section 105 does not authorize the approval of
4 non-plan, priority-skipping distribution, as this Court cannot
5 alter the balance struck by the statute. The Supreme Court, in
6 Jevic, also rejected the idea that Bankruptcy Courts can
7 disregard the statutory priority system in rare cases in which
8 they find sufficient reason. The Supreme Court determined
9 that, because it is difficult to give precise content to the
10 concept "sufficient reasons" -- and I use sufficient reasons in
11 quotes -- the exception would likely swallow the rule, and
12 every case would be presented to the Bankruptcy Court as the
13 rare case exception to be -- as the rare case.

14 The Supreme Court further found that the consequences
15 of accepting a rare case exception to be potentially serious,
16 including departure from the protections Congress granted
17 particular classes of creditors; changes in bargaining power of
18 the different classes of creditors, even in bankruptcies that
19 do not end in structured dismissals; and the risk of collusion,
20 for example, senior creditors and general unsecured creditors
21 teaming up to squeeze out priority unsecured creditors.

22 In this case, the settlement motion departs from the
23 Bankruptcy Code's creditor protections. It changes the
24 bargaining power of creditors, such as administrative priority
25 creditors, non-favored creditors left out of the money, even if

1 this case does not end in a structured dismissal. And it
2 evinces that teaming up between LSQ and the committee to
3 squeeze out priority unsecured creditors.

4 As the Supreme Court feared in Jevic, here, a few
5 powerful players, the debtors, LSQ, and the creditors'
6 committee, have agreed to divvy up estate assets at the expose
7 of those with little to no leverage in the bankruptcy process.
8 The committee took their Section 103(c) power, the duty to
9 investigate, and monetized it. The Code nowhere authorizes
10 parties to take money in return for withdrawing objections
11 about a motion's validity.

12 Yet, rather than let the Bankruptcy Court determine
13 whether its objections to the asset sale or post-petition
14 financing had merit, the committee withdrew its objections in
15 exchange for a greater payday for counsel and the diversion of
16 estate assets that should be distributed, as Congress has
17 directed.

18 At best, the Supreme Court, perhaps, left room for
19 early-in-the-case distributions outside of the priority scheme,
20 under the doctrine of necessity. But the debtors and the
21 committee do not and cannot argue that the distributions
22 proposed in this settlement motion can satisfy such a test.

23 The proposed payments are not to critical vendors,
24 taxing authorities, or rank-and-file employees. In fact, the
25 taxing authorities and some of the governmental entities, as

1 well as the employees, who have not been paid fully yet, are
2 among the priority creditors being skipped by the proposed
3 payment. Simply put, there is no doctrine or code section that
4 permits advanced payment of ordinary, general unsecured
5 creditors.

6 In light of the foregoing, even if the creditor --
7 even if the settlement motion is not viewed as proposing an
8 end-of-case distribution, under the Jevic reasoning, the
9 settlement motion must be denied because it proposes a non-
10 plan, priority-skipping distribution in circumvention of the
11 Bankruptcy Code's priority system and procedural safeguards,
12 without any offsetting bankruptcy-related justification.

13 However, notwithstanding the settlement motion
14 argument and the parties' arguments to the contrary, the
15 proposed distribution of the sale proceeds of substantially all
16 of the debtors' assets to select general unsecured creditors
17 means, for all intent and purposes, the end of these Chapter 11
18 cases. Once the debtors' assets have been sold and the
19 proceeds disbursed, there will be little left to do with
20 respect to this case, and then you'll have the case-ending
21 situation, where the case will either have to be converted or
22 dismissed.

23 THE COURT: Isn't that the case now, though, Mr.
24 Schepacarter, if I don't approve the settlement?

25 MR. SCHEPACARTER: That's what the parties would

1 posture.

2 THE COURT: Yes.

3 MR. SCHEPACARTER: But the payment to the unsecured
4 creditors does not necessarily lead to the fact that the DIP
5 financing should not be approved. That's -- those proceeds,
6 for example, could go into the estate and be distributed
7 according to the rules of the -- of absolute priority.

8 THE COURT: But then we've got -- if I don't approve
9 the settlement, then we have the committee objections to the
10 financing.

11 MR. SCHEPACARTER: Well, as I'll get to in a few
12 seconds --

13 THE COURT: Okay.

14 MR. SCHEPACARTER: -- there are still -- some of those
15 objections have not, frankly, been resolved as of yet.

16 THE COURT: Okay.

17 MR. SCHEPACARTER: Some have, but the -- what the --
18 but what's been resolved are, basically, only the objections to
19 the DIP financing, such as all of the -- I can tell you in a
20 second what it is -- basically, whether the unencumbered assets
21 can be used to secure the DIP loan, the 506(c) waiver, and the
22 Section 552(b) issue, the right to default interest, whether
23 the estates are administratively solvent, and the pay -- and
24 the fees for proceeding in that fashion, with respect to a
25 challenge. So those are the issues that have been resolved.

1 But there's other issues that have not been resolved,
2 some of which I hit on; the issue with respect to my cross-
3 examination of Mr. Iammartino, such as the roll-up has not been
4 -- the setting of the prepetition claim, basically what -- how
5 much LSQ's prepetition claim is. And even the challenges, as
6 counsel has indicated, the challenges are still active up until
7 the sale closes, so ...

8 THE COURT: Right.

9 MR. SCHEPACARTER: In Jevic, the Supreme Court ruled
10 that:

11 "A distribution scheme order, in connection with the
12 dismissal of a Chapter 11 case, cannot, without the
13 consent of the affected parties, deviate from the
14 basic priority rules that apply under the primary
15 mechanisms the Code has established for final
16 distributions of estate value in business
17 bankruptcies."

18 The Supreme Court also recognized in Jevic that:

19 "A non-consensual deviation from the statutory
20 priority scheme is prohibited under Chapter 7
21 liquidations and the Chapter 11 process."

22 And that's the Supreme Court at 979; also, at 983.

23 As a result, the Supreme Court held in Jevic that:

24 "Under each of the three avenues for leaving Chapter
25 11, conversion, dismissal, or confirmation of a plan,

1 Bankruptcy Courts cannot approve distributions that
2 would violate the priority distribution system
3 established by Congress without the consent of the
4 affects parties."

5 Nevertheless, the debtors and the committee propose a
6 Chapter 11 regime in which, prior to the point of the case at
7 which assets are normally distributed, and seemingly before,
8 but preparatory to one of the three case-exiting events, a
9 Bankruptcy Court is somehow empowered to alter the statutory
10 priorities. This result would fly directly in the face of
11 Jevic, and finds no support elsewhere in the Code. As the
12 Supreme Court held in Jevic, more than simple statutory silence
13 is required before the distribution proposed in the settlement
14 motion can be approved.

15 By moving the payment of creditors' claims, which
16 usually occurs at the end of the case, up to the time when the
17 sale is closed, and seeking such approval of such
18 distributions, even before the sale occurs, the settlement
19 motion seeks to avoid very important protections built into the
20 structure of the Chapter 11 case. These proposed distributions
21 avoid the claims process proscribed by the Code and the Rules;
22 do not give holders of contingent, unliquidated claims the
23 right to have their claims determined by the Court; appear to
24 permit creditors to file proofs of claim without any stated or
25 meaningful review of those proofs of claim or any challenge to

1 their claims; and fails to follow the plan solicitation
2 process.

3 Here, the sale proceeds of the debtors' assets will be
4 disbursed to unsecured creditors on their prepetition claims.
5 No matter what the parties call them in this case, these are
6 final distributions, in effect, and do not provide any benefit
7 to the debtors' estate. They will not promote the debtors'
8 ongoing business, will not fund the litigation, will not assist
9 the debtors' reorganization efforts. Simply put, there is no
10 doctrine or code section that permits early payment of general
11 unsecured creditors from the proceeds of a sale of
12 substantially all of the debtors' assets, in violation of the
13 Code's priority system.

14 The debtors and committee have argued that this is not
15 an end-of-the-case distribution, but rather, a permissible
16 early case distribution that enables the debtors to obtain DIP
17 financing, save jobs, and allow the debtors to sell their
18 assets as a going concern. They further argue that the
19 proposed disbursements are permissible because the *quid pro quo*
20 here is that it is not the settlement of estate causes of
21 action, but the reduction of litigation costs and the ability
22 to move the case forward; however, a closer look at the
23 proposed settlement points out its delusive nature.

24 The committee is agreeing not to object to the
25 stalking horse, the APA, subject to input from -- with respect

1 to certain terms. The committee is further agreeing not to
2 object to related bid protections. And the committee retains
3 its rights to object to a sales procedure motion. It has not
4 disclosed what -- and what certain terms remain open to
5 negotiation and potential litigation; thus, there appears to be
6 potential litigation that would continue in this case.

7 The committee has not agreed to the amount of the
8 prepetition obligations owed to LSQ, but has, rather, agreed to
9 an expedited schedule for the determination of the amount of
10 LSQ's claim. And if the parties do not subsequently agree,
11 there would be additional fees in negotiating and litigating
12 that issue. In addition, the committee continues to have the
13 right to pursue challenges and seek standing to pursue
14 challenges until the sale closes.

15 While the settlement motion indicates that the
16 settlement resolves a litany of issues, as I indicated before,
17 only a few of those are resolved with finality. The amount of
18 the roll-up, the amount of -- the ability to credit bid, I
19 think, are still open issues. The releases are only being
20 provided once the sale closes.

21 As I indicated before, the issues that have been
22 resolved have been the DIP -- necessary DIP-type issues. And
23 the Court should not elevate those DIP-type issues into the
24 sort of doctrine of necessity type of payments that maybe get
25 paid on the first day, such as wages or critical vendors, so

1 that the debtors' business can get, usually, a two-week or ten-
2 day period from Point A to Point B.

3 There's been some mention of the ICL case --

4 THE COURT: Yes.

5 MR. SCHEPACARTER: -- and I'll sort of address that
6 now, Your Honor. The debtors and the committee contend that
7 the proposed settlement does not run afoul of Jevic because the
8 disbursements are being made from LSQ, from proceeds received
9 by LSQ from the sale of its collateral. As a result, the
10 debtors and the committee argue that the Third Circuit's
11 decision in ICL Holding governs this situation and supports
12 granting the settlement motion.

13 However, that argument fails because, unlike the sale
14 proceeds to be disbursed here, the secured creditor's
15 contribution in ICL Holding was not the -- was not the proceeds
16 of the sale of its collateral. In ICL Holding, a secured
17 creditor seeking to purchase the assets of a number of debtors,
18 including LifeCare Holdings, agreed to place cash in trust for
19 the benefit of general, unsecured, non-priority creditors. In
20 exchange, the creditors' committee withdrew its objection to
21 the sale, and the Third Circuit found that the settlement
22 between the creditors' committee and the secured creditor did
23 not need to comply with the priority scheme, but it did so upon
24 a very narrow factual ground.

25 As the Court explained, it allowed the transaction

1 because:

2 "-- the funds contributed by a secured creditor were
3 not estate property, since they were not proceeds from
4 its liens, not" -- "and did not, at any time, belong
5 to LifeCare's estate, and will not become part of its
6 estate, even as a pass-through."

7 And that's ICL at 555 and 556.

8 Indeed, the Third Circuit, in ICL Holding stated that,
9 quote:

10 "We are not dealing with collateral. If we were, this
11 would suggest it was LifeCare's property."

12 That's at 557, in ICL.

13 The Third Circuit expressly distinguished the facts
14 before it from an ordinary carveout under which secured
15 creditors permit the use of a portion of their collateral that
16 is estate property to pay administrative costs. Here, unlike
17 in ICL Holding, the disbursements will be made from money
18 derived from the sale of the debtors' property. The proceeds
19 of the sale of estate property are, themselves, estate property
20 under Section 541.

21 And as the Third Circuit recognized in ICL Holding:

22 "Even proceeds of the sale of estate property that
23 serves as collateral for a secured creditor's lien is,
24 nevertheless, estate property."

25 In this case, the settlement consideration in this

1 case also differs from that in ICL in two additional, critical
2 ways. First, the debtors are parties to this settlement
3 motion, and are themselves providing consideration to
4 counterparties. Unlike ICL Holding, where the debtors were not
5 parties to the settlement or the motion to approve it, the
6 debtors here are parties to the settlement, and are providing
7 full, mutual releases and exculpations on a final basis to the
8 secured lenders, as well as the lender's past and current
9 respective directors, officers, employees, and other parties.

10 Because those causes of action are estate property
11 under Section 541(a)(1), the consideration paid by the secured
12 lenders for the release of those claims are proceeds from
13 estate property, and are, themselves, estate property under
14 Section 541. By contrast, the Third Circuit, in ICL Holding,
15 did not confront the release of any debtor claims, and its
16 decision did not require the ICL Holding debtors to do
17 anything.

18 Secondly, this settlement motion effectively releases
19 the committee's ability to challenge the validity, perfection,
20 priority, extent, and enforceability of LSU's claim [sic]. The
21 committee could only mount such a challenge if it obtained
22 derivative standing under Cybergenics. Consequently, any
23 consideration that the committee receives for settlement of
24 such claims belong to the estate. By contrast, the settlement
25 in ICL Holding only covered objections relating to an asset

1 sale, and did not implicate a derivative claim analysis.

2 In any event, it is not clear from ICL -- that ICL may
3 still be good law because, after Jevic, there is no longer any
4 reason to draw a distinction between estate and non-estate
5 property with regard to non-plan, priority-skipping
6 distributions in Chapter 11 cases.

7 To be sure, the Supreme Court, in Jevic, did not
8 expressly consider whether the Code's priority rules apply to
9 gifts of purportedly non-estate property. But in rejecting the
10 Jevic settlement, the Supreme Court demanded strict adherence
11 to the rules established by Congress, and laid bare the true
12 harms of so-called "gifting."

13 As I previously stated, courts cannot approve
14 distributions that deviate from the statutory priority system
15 simply because the Code does not contain an express prohibition
16 because the Supreme Court, in Jevic, held that the priority
17 system is fundamental to the Code's operation, any departure
18 from the priority system, whether in a structured dismissal, a
19 sale, a settlement, or other court-approved agreement must come
20 from Congress no authorization exists for Bankruptcy Courts to
21 approve priority-skipping gifts of non-estate property.

22 The integrity of the comprehensive bankruptcy system,
23 including the painstakingly detailed priority rules governing
24 distribution to creditors, cannot be cast aside in favor of
25 creditor side deals. The Bankruptcy Code is meant to be a

1 comprehensive federal scheme to govern the bankruptcy process.
2 And although flexibility is necessary the federal scheme cannot
3 remain comprehensive if interested parties and the Bankruptcy
4 Courts, in each case, are free to tweak the law to fit their
5 preferences. Simply put, the parties should not reap the
6 benefits from the comprehensive bankruptcy process, without
7 also accepting its obligations, including the obligation to
8 follow statutory priorities.

9 In addition, the Third Circuit, in ICL Holding, failed
10 to consider the full consequences of priority-skipping
11 distributions. However, by contrast, in Jevic, the Supreme
12 Court exposed the harms that priority-skipping settlements
13 inflict upon disfavored creditors, and observed that departures
14 from the Code's priority rules, even in supposedly,
15 quote/unquote, "rare cases," run counter to the protections
16 Congress granted particular classes of creditors. Those
17 statutory protections take precedence over even well-
18 intentioned payments to junior creditors, and departing from
19 them invites collusion, as I've indicated earlier.

20 The failure to follow the statutory priorities
21 increases uncertainty in the bankruptcy process, and also makes
22 such settlements more, not less, difficult to achieve. In
23 Jevic, the Supreme Court recognized that priority-circumventing
24 theories, such as gifting, undermine the rights of creditors
25 by, among other harms, depriving them of a prospect of a

1 settlement that respects their priority.

2 Here, accepting the argument that disbursements will
3 be funded by money gifted by LSQ, rather than from estate
4 funds, created from the sale of substantially all of the
5 debtors assets, would unleash the very harms that the Supreme
6 Court in Jevic sought to avoid; namely, the increased
7 difficulty in reaching global settlements and the seeming
8 collusion between and among debtors' favorite creditors, to
9 squeeze out other disfavored creditors. For all of the
10 reasons, and even if ICL Holding remains good law and -- after
11 Jevic, it does not apply here. And as a result, no support for
12 this settlement motion can be found in ICL.

13 Now, Your Honor, just to address some of the other
14 arguments that we've made in our brief.

15 THE COURT: Yes.

16 MR. SCHEPACARTER: The settlement motion also seeks
17 authorization for a Chapter 11 distribution of the sort that
18 one would find in an impermissible *sub rosa* plan. The Third
19 Circuit requires that settlements not short-circuit the
20 requirements of Chapter 11 by establishing the terms of the
21 plans *sub rosa*, in connection with the sale of its assets.

22 Moreover, in rejecting the Third Circuits rare
23 exception approach, the Supreme Court in Jevic noted that
24 distributions at issue there more closely resembled proposed
25 transactions that lower courts have refused to allow on the

1 ground that they circumvent the Code's procedural safeguards,
2 and they cited to the Fifth Circuit's Braniff decision.

3 In Braniff, the Fifth Circuit reversed the District
4 Court's approval of an agreement and a memorandum of
5 understanding between the debtor and various creditors, under
6 Section 363 of the Bankruptcy Code. In particular, the Court
7 held that certain parts of the transaction were clearly outside
8 of the scope of Section 363(b) because the settlement had the
9 effect of dictating any future reorganization plan,
10 disenfranchising creditors from the right to vote on the
11 reorganization plan, and releasing claims against the debtor.
12 In Energy Future, the Third Circuit quoted Braniff's analysis
13 in reviewing a settlement, thereby making it clear that
14 settlements cannot dictate the terms of any future
15 reorganization plans.

16 Other courts have applied the Fifth Circuit's Braniff
17 decision to conclude that transactions involving DIP lenders
18 may also constitute *sub rosa* plans. And there, we cited the
19 Belt Properties case for the premise that disapproving proposed
20 DIP financing with terms that constitute a *sub rosa* plan, in
21 favor of the debtor's proposed lender.

22 Paving the way for the final DIP order and the
23 transfer of the GUC funds, the settlement motion provides non-
24 priority, unsecured creditors with what most likely will be a
25 final recovery, and is not done out -- and it is done outside

1 of a court-approved Chapter 11 plan. The detailed distribution
2 obligations of related claims allowance process imposed on LSQ
3 and the committee and the non-priority, unsecured creditors
4 further illustrates that the payments are not gifts, but
5 instead, the restructuring of creditors' rights, culminating in
6 payments on account of non-priority bankruptcy claims. In
7 turn, the settlement motion determines the recoveries of non-
8 priority, unsecured creditors, in exchange for the committee's
9 support in favor of the ultimate case distribution, which is
10 the settlement proceeds being paid.

11 These are precisely the things that should occur in a
12 Chapter 11 plan, where all parties can assert their rights and
13 find protection in the Code's confirmation safeguards.
14 Accordingly, and for all practical purposes, the settlement
15 motion is a *sub rosa* plan that substitutes for a confirmable
16 Chapter 11 plan, and should not be denied.

17 As we've also argued, as well, the settlement motion
18 could not be considered outside of a Chapter 11 plan, and this
19 Court should, nonetheless, examine whether the terms are
20 consistent with confirmation rules established by Congress in
21 Section 1129. In other words, this Court should not approve
22 relief through the settlement motion that it could not approve
23 through the plan confirmation process.

24 The Supreme Court reinforced this principle in Jevic,
25 when it rejected a structured dismissal, but served as a back-

1 door means to achieve the exact kind of non-consensual,
2 priority-violating, final distributions that the Code prohibits
3 in Chapter 11 liquidations -- Chapter 7 liquidations and
4 Chapter 11 plans.

5 Under Section 1129(a)(3), the plan must be proposed in
6 good faith, and not any means forbidden by law. Although the
7 Code does not define "good faith," it is generally interpreted
8 to mean that there exists a reasonable likelihood that the plan
9 will achieve a result consistent with the objectives and
10 purposes of the Bankruptcy Code. In doing so, the Court should
11 consider whether the plan fosters a result consistent with the
12 Code's objectives; has been proposed with honesty and good
13 intentions, with a basis for expecting that a reorganization
14 can be effective; and most importantly, whether the plan
15 exhibits a fundamental fairness in dealing with the creditors.
16 When evaluating good faith, courts must examine, not only the
17 contents of the plan before it, but also the entire process by
18 which the plan was negotiated.

19 When a non-debtor makes payments to a creditor in
20 exchange for its agreement to vote in favor of the plan, that
21 plan violates Section 1129(a)(3), and the vote cast by that
22 creditor who received payment would be deemed to be procured in
23 bad faith, in violation of 1126(e).

24 Under the settlement motion, LSQ will pay the GUC
25 funds to non-priority creditors, in exchange for an agreement

1 to support entry of a final DIP order. If these payments were
2 made at a plan stage, the recipients' votes would be subject to
3 designation because they were not solicited or procured in good
4 faith. However, in particular, these payments would enrich
5 favored creditors and provide them with greater recoveries than
6 those with equal, or even superior statutory rights, and such
7 is not the result -- and such a result is not only inconsistent
8 with the Code's objection, but actually undermines them.

9 In Jevic, the Supreme Court reiterated that settling
10 parties cannot provide an exclusive benefit to specific
11 creditors if those creditors do not have a greater right to
12 such benefit, as compared to others. Because the GUC funds
13 are, by definition, an exclusive benefit for particular
14 creditors, the creditor recipients' support would not have been
15 procured in good faith. The settlement motion terms,
16 therefore, could not have been approved as part of a Chapter 11
17 plan because they would have violated 1129(a)(3), and subject
18 those recipients' votes to designation.

19 As we also stated in our objection, the proposed
20 settlement does not disclose the mechanisms of an exit strategy
21 from the bankruptcy cases. The motion itself is vague, as to
22 the criteria for determining which claims will be entitled to
23 distribution under the proposed settlement. The settlement
24 motion party -- in the settlement motion, the parties assert
25 that LSQ will be provided with a list of unsecured creditors

1 who have either filed a claim or who have been listed on the
2 schedules filed by the debtors as having claims not otherwise
3 identified as disputed, contingent, or unliquidated.

4 After initial screening by the committee for disputed,
5 amended, superseded, or insider claims, including those reserve
6 parties, distributions will be made on the requested amounts.
7 However, there are no standards or procedures identified as to
8 how LSQ, the committee, or both will critically review filed
9 proofs of claim, whether such proofs of claim will be verified,
10 who will be responsible for claims objections, and whether
11 claim objections will be resolved at all.

12 In addition, the settlement motion also fails to
13 disclose what happens post-distribution, and only states that
14 LSQ, the debtors, and the committee agree to work cooperatively
15 on all case-related matters to minimize estate expenses and
16 speed up the wind-down of these cases. As a result, it is not
17 apparent from the settlement motion how the debtors plan to
18 exit these bankruptcy cases. Yet, while the ultimate
19 distribution of the cases is left unanswered, the debtors and
20 the committee request that some general unsecured creditors be
21 paid along with estate professionals.

22 While the lower court in Jevic approved a class-
23 skipping settlement that resulted in a structured dismissal, it
24 was at least provided with sufficient information to enable the
25 Court to determine whether the settlement and subsequent

1 dismissal was in the best interest of creditors -- or the
2 estates. As the settlement motion lacks such information, a
3 meaningful determination of the merits of the settlement cannot
4 be made, and the motion should be denied.

5 Even had the Supreme Court not issued its decision in
6 Jevic, the proposed settlement would have met the standard
7 required for -- would not have met the standard required for
8 approval. To be approved by the Bankruptcy Court, a settlement
9 must be fair and equitable. Under that standard, the Court
10 must consider whether the settlement is fair to all creditors,
11 regardless of whether anyone objections.

12 In the Nutraquest case, which is a Third Circuit case
13 --

14 THE COURT: Uh-huh.

15 MR. KLAUDER: -- a creditor alleged that the
16 settlement could not be approved because it prevented the
17 creditor from asserting claims for contribution against the
18 debtor. In affirming that settlement, the Court was careful to
19 explain that the disparate treatment alleged by the complaining
20 creditor was not due to the terms of the settlement.

21 Here, however, the disparate treatment of creditors is
22 an inherent part of a settlement. The debtors' Schedules E and
23 F listed priority claims for the Broward County Tax Collector;
24 the CRIM claim, which we've already talked about; the Delaware
25 Division of Corporations; and the IRS, as well; and the -- that

1 municipal claim --

2 THE COURT: Yes.

3 MR. SCHEPACARTER: -- as well as various employees,
4 who have not been paid yet. I mean, there's the indication
5 that they will be paid, but they haven't been paid, as of yet,
6 at least not for their accrued vacation time, all of which are
7 priority claims.

8 The settlement motion does not explain how this
9 priority-skipping settlement is fair and equitable to the
10 skipped priority creditors, and as the creditors and the debtor
11 -- the debtors and the committee have not shown that the
12 settlement is fair and equitable to the parties.

13 Also, that ties into the -- another argument, which is
14 that the settlement motion violates the due process of certain
15 creditors. As I indicated on the examination of Mr.
16 Iammartino, the creditor list that was filed with the case did
17 not list the employees on that creditor matrix, so they didn't
18 get notice from the Court of any sort, as well as the fact that
19 there was no employees having been served with the motion.

20 So the employees in this case -- and we've already had
21 testimony, either through the first-day affidavit, or even
22 today, that there's 500 plus employees. None of them have
23 gotten, or have been able to prove that they've been able to
24 get notice of this case, of this motion, and of this
25 settlement. There rules require them to get at least 21 days'

1 notice. In this case, there was an order shortening time, so
2 there was a little bit of trimming of that -- the deadline or
3 those dates. But all parties whose rights are affected by the
4 motion are required to receive notices, under the rules. As I
5 indicated before, those creditors have not been given copies of
6 the motion, and their due process rights have been affected.

7 And lastly, as we stated in our motion, there's a --
8 sort of a breach of the debtors' fiduciary rights, only from
9 the standpoint from that debtors-in-possession have the duty to
10 object to certain things. And they -- and in this case, as
11 part of the settlement, they've agreed not to object to certain
12 of the retention applications, and I think some of the fee
13 applications in this case.

14 So I think that that's an issue there, with respect to
15 the settlement. They really can't bargain away some of their
16 fiduciary rights. They still have the right -- actually, the
17 duty to review fee applications and make sure that fees are not
18 out of control, or that claims are not being made that are --
19 that would be bothersome to the estate.

20 So, for all of that, all of that argument, we submit
21 that the motion, the settlement motion, should not be approved,
22 and should be denied.

23 THE COURT: All right.

24 MR. SCHEPACARTER: Thank you, Your Honor.

25 THE COURT: Mr. Schepacarter --

1 MR. SCHEPACARTER: Sure.

2 THE COURT: -- this is a difficult case. If I don't
3 approve the settlement, 500 people are out of work --

4 MR. SCHEPACARTER: Well --

5 THE COURT: -- because there's nothing in place to
6 continue the financing.

7 MR. SCHEPACARTER: Right. And I think that ties into
8 the rare case exception that the Supreme Court said we can't
9 allow for.

10 THE COURT: Yes.

11 MR. SCHEPACARTER: And that's part of the problem.
12 And I think there's -- part of the problem is that the
13 settlement is now tied in with a DIP financing order, and I
14 think that's really sort of the crux of the issue and the
15 problem here because you really can't tie a settlement in with
16 DIP financing.

17 So the DIP financing should go forward. The
18 settlement could be something that could be resolved in another
19 way. Perhaps those proceeds that are gotten don't need to be
20 paid to certain general unsecured creditors, but could be put
21 into the estate to pay all of the -- all of the creditors, in
22 accordance with the rules of absolute priority, and in
23 accordance with the rules set forth by the Court in the
24 Bankruptcy Code.

25 And that's part of the problem in this case, is that

1 the debtors will say that, no, we need this -- or not the
2 debtors; I shouldn't say the debtors, but the committee,
3 basically, and we need this settlement, we need to put these
4 monies -- you know, resolve these claims that we have.

5 THE COURT: yes.

6 MR. SCHEPACARTER: But the problem is that they're
7 resolving them, and not following the statute, not following
8 the priority scheme that the Bankruptcy Code has set up, and
9 that Jevic has basically said that is, to a large extent,
10 sacrosanct, and that it needs to be followed, whether it be a
11 structured dismissal, whether it be a settlement of this
12 nature.

13 THE COURT: All right. All right. Thank you, Mr.
14 Schepacarter.

15 MR. SCHEPACARTER: Thank you. Thank you, Your Honor.

16 THE COURT: Yes. Mr. Cole.

17 MR. COLE: Thank you, Your Honor.

18 THE COURT: Yes, sir.

19 MR. COLE: Andrew Cole of LeClairRyan on behalf of
20 Diversitex again.

21 I don't want to repeat all of Mr. Schepacarter's
22 arguments, they were well-made. We appreciate the U.S.
23 Trustee's Office's efforts in, effectively, making all of our
24 arguments for us, in some sense. I just want to make a couple
25 of points.

1 The first is this is a court of equity. And I know,
2 you know, that gets bandied about a lot. But in this
3 particular case, this is not a fair result under the Code. You
4 have a group of constituencies, each of whom have rights under
5 the Code, bandying together to squeeze out a -- you know, in
6 this case, it appears a single party, who has higher rights
7 under the Code, but no representation and no standing in the
8 same way that a committee would have.

9 There is no administrative claimants' committee under
10 the Code. There's a reason for that. The reason is because
11 administrative claimants are protected under the Code. What
12 you have here, though, is you have a situation where the
13 unsecured creditors, who perhaps are not as well-protected
14 under the Code, are given a voice and certain rights and
15 certain standing, with the idea that that will, as a result of
16 some sort of a chain reaction, protect the priority and the
17 administrative claimants.

18 In this particular case, that has failed. And what is
19 happening here is that the standing given to the committee and
20 the rights given to the committee have resulted in a situation
21 where the committee has been able to jump over the intervening
22 creditors and obtain rights for itself.

23 There are mentions here that the things that are being
24 done are not -- or the proceeds that are being paid are not in
25 exchange for property of the estate. Well, that sort of asks

1 the question, which is: If these are not distributions, if
2 these are not -- if it's not consideration being given on
3 account of some property of the estate, then what is it?

4 The committee only has -- the committee doesn't have
5 anything independent. Nobody on the committee has ponied up
6 any individual claims to release here. Nobody on the committee
7 has ponied up any sort of cash here. The only thing that is
8 being exchanged for value from LSQ, it has to be property of
9 the estate because there simply isn't anything else here. The
10 --

11 THE COURT: Well, the agreement of sale provides for
12 that, doesn't it? That it's property of the estate, I believe,
13 if we look at exhibit -- U.S. Trustee's Exhibit 1, one point --
14 what is it, 1.3, Mr. Schepacarter?

15 MR. SCHEPACARTER: It's 1.1; 1.1 in Section 3.3 --

16 THE COURT: Right.

17 MR. SCHEPACARTER: -- that makes it clear that what's
18 being sold is estate property.

19 THE COURT: Yes. Thank you.

20 MR. COLE: Well, and I think that there's arguably two
21 different things that are being sold here: One is, obviously,
22 the estate property. But the thing which is also being sold --
23 and I'm going to use that word fairly loosely -- is there are
24 some objecting rights, whether it's a right to assert claims or
25 a right to object to some process or a right to do something,

1 but there are some -- as the U.S. Trustee has put it, there's a
2 right being monetized which only exists in the context of the
3 bankruptcy. It is a -- as far as we are concerned, it is
4 property of the estate, and whatever benefits accrue to the
5 parties that asserts those rights are property of the estate,
6 which should be distributed in accordance with the code.

7 Turning briefly to Diversitex's --

8 THE COURT: Let me ask you this, though, real quickly.

9 MR. COLE: Sure.

10 THE COURT: If the parties have not reached a
11 settlement here, it's unlikely that Diversitex would have
12 received anything from this estate. Isn't that true?

13 MR. COLE: I don't know that that's necessarily true,
14 Your Honor. We don't know what claims might have been
15 asserted, which are not going to be asserted as a result of
16 this settlement.

17 THE COURT: Okay.

18 MR. COLE: You know, I don't mean to disparage any
19 party here because I don't have enough facts to be able to
20 suggest that there are or are not claims. We -- it's simply
21 not our role in the case to investigate claims at this point.

22 This case came into bankruptcy with the debtor
23 asserting that its secured creditor had done all sorts of ills.
24 You know, as a young bankruptcy lawyer, you look at the
25 prototypical lender liability case, and this ticked every

1 single box on, you know, what you would expect for a
2 prototypical lender liability case, ostensibly on the
3 declaration of the debtor. I'm not saying that those things
4 actually happened; I don't know.

5 But as it stands today, we still don't know,
6 Diversitex doesn't know. But Diversitex doesn't, necessarily,
7 have standing to pursue claims of that ilk. These are things
8 which are generally assigned, either to the debtor at this
9 stage, or possibly to the committee, or perhaps to a Chapter 7
10 Trustee, all of these claims. But none of that, as far as we
11 can tell, is being dealt with. This is simply a way of trying
12 to close this case out, make the unsecured creditors happy
13 enough to go away and not cause problems. And if they can all
14 do it while squeezing out Diversitex, without having to make
15 any provision for us, that's, effectively, what they're trying
16 to do in the case.

17 Just very briefly, with respect to the 503(b)(9) and
18 the preference claims. It's been suggested here that perhaps
19 Diversitex doesn't have any valid claim because of the analysis
20 done by the debtor. You know, we filed our claim; they filed
21 their claim. There's a whole bunch of due process that's got
22 to go on between now and figuring out what the, you know, bona
23 fides of those claims are. And it's, I don't think,
24 appropriate to consider the debtors' testimony that there's no
25 valid claim --

1 THE COURT: Right.

2 MR. COLE: -- because I think, certainly, the evidence
3 that we put on today demonstrates that there is at least an
4 arguable claim, if not a pretty solid claim for positive
5 recovery on behalf of Diversitex.

6 THE COURT: Yes, sir. Yes.

7 MR. COLE: As with the U.S. Trustee, we don't object
8 to the financing terms. We don't necessarily object to the
9 amount of money which is being paid in what we consider to be a
10 settlement of certain claims, even though it's not framed that
11 way, but we do object to the way it's being distributed. We
12 object, for the same reasons as the U.S. Trustee, to the
13 distribution of these proceeds and of these monies outside of
14 the provisions of the Code. And we feel that it falls under
15 Jevic.

16 And in some sense, when rereading Jevic this morning,
17 it just reminded me of how closely this fact pattern is
18 following that in Jevic, in terms of the interests that are
19 being squeezed out and the abilities of parties with officially
20 recognized standing to do things to squeeze out an intervening
21 class of creditors when it's convenient for them.

22 And with that, we would ask that the Court deny the
23 financing motion, at least to the extent that the settlement is
24 part of it.

25 THE COURT: Thank you, Mr. Cole.

1 MR. COLE: Thank you, Your Honor.

2 THE COURT: Any response? Mr. Jung.

3 MR. JUNG: Your Honor, I will be brief. There has
4 been a lot of -- there has been a lot of mention between,
5 potentially, the Court approving the DIP financing and maybe
6 adjourn the settlement package to a different date. But Your
7 Honor, there is only one set of relief proposed today, which is
8 the financing. There is no separate components, financing
9 versus 9019.

10 Your Honor, we -- a second part of the supplemental
11 DIP motion does talk about 9019, but that's only out abundance
12 of caution, not -- and that's primarily because, again, we
13 don't believe that we have settled any estate claims, so there
14 is no need for a 9019. So Your Honor has a financing package
15 before Your Honor.

16 Your Honor, with respect to the arguments that the
17 distributions that LSQ would be making are from estate
18 property, Your Honor, once the -- once the lender receives cash
19 from the (indiscernible) it's not on the proceeds of the
20 estate, Your Honor. At that time, the lender can do whatever
21 it wishes with that money. Mr. Pacitti, he, I'm sure, receives
22 some of the money on accounts of his services provided to his
23 client, and the client uses the money in any way it wishes.
24 Your Honor, this is really not much different than that.

25 With respect to *sub rosa*, Your Honor, this argument is

1 also interesting because we are not talking about a global case
2 settlement, which opens nothing -- which leaves nothing for the
3 estate to do. Your Honor, claims remain in the estate.
4 Whether or not this is converted is -- remains to be seen.
5 Largely, it will probably depend on the outcome of the sale
6 process.

7 But as of today, we are talking about only a minuscule
8 portion of what I would call a "claim resolution," which is it
9 resolves the committee's objection to the financing package,
10 and it substantially improves it.

11 THE COURT: If I deny this settlement, what happens
12 with the financing, we go forward with your objections?

13 MR. JUNG: That's correct.

14 THE COURT: Okay.

15 MR. JUNG: Your Honor, with respect to allegations of
16 breaches of fiduciary duties, which we found it quite
17 surprising, is that there were no such allegations where the
18 original financing provided for complete releases and no chance
19 of distribution to unsecured creditors, but such allegations
20 have been raised with respect to a situation where the
21 financing has been significantly improved, and there is a
22 potential for distributions. Your Honor, we don't believe that
23 that's necessarily a well-taken objection.

24 With respect to Diversitex, they may or may not have a
25 503(b)(9) claim. As of today, that remains to be seen. If

1 they have a claim, it may very well be offset against a
2 substantial preference exposure, Your Honor. So I'm not sure
3 that's determinative. But again, that's -- whether or not the
4 financing skips any class of creditors, Your Honor, I think, in
5 this context, is really besides the point.

6 Your Honor, and also, Diversitex is not really being
7 squeezed out here, to the extent they have a claim. Most of
8 the claim will be participating here because it is unsecured,
9 which is also interesting because, absent this agreement, they,
10 in essence, guarantee themselves no distribution, versus
11 sharing in our distribution.

12 So, Your Honor, again, we don't think Jevic has any
13 application here. This is a clear financing arrangement that
14 now is consensual, at least on the side of the committee, the
15 objections. So I will -- what I would call (indiscernible)
16 this has been noticed to everybody, and at least according to
17 the debtors, there are no claims, in any event, that would be
18 skipped here. So, Your Honor, again, we would request that
19 this financing package be approved. Thank you.

20 THE COURT: All right. Thank you, Mr. Jung.

21 MR. KLAUDER: Your Honor, briefly.

22 THE COURT: Yes.

23 MR. KLAUDER: Again, David Klauder for the debtors. I
24 just wanted to hit on two issues that were brought up by the
25 objectors.

1 One of the reasons we went through the creditor
2 breakdown is because of our belief that, at least on the
3 priority end, both priority and admin, that those obligations
4 are either disputed or will be paid.

5 As it relates to the employees, I don't think it's --
6 it's uncontroverted that they either have been paid because
7 there's an order to pay wages --

8 THE COURT: Or they --

9 MR. KLAUDER: -- or we wouldn't --

10 THE COURT: -- will be paid.

11 MR. KLAUDER: -- be operating right now because
12 there's no way those people would have been continuing in
13 operations without getting that paid. And we have a budget set
14 out to pay the remaining obligations. So there's no issue
15 there.

16 Secondly, with respect to Diversitex, I want to
17 address a point, which I think -- frankly, I think they're
18 being a bit disingenuous by saying that they're this creditor
19 here, out on their own, and that the big, bad committee has all
20 this information, and that they're able to determine what other
21 claims there might be and so forth.

22 It should be noted that Diversitex was on the
23 committee; they were on the committee for a few weeks. They
24 resigned from the committee. We don't know why they resigned,
25 by we have our suspicions that they believe that they could

1 assert some other rights that they felt would conflict with
2 their duties on the committee, but they were on the committee.
3 So, to the extent that they say, we have no information, we
4 don't know anything, frankly, we think is disingenuous, and I
5 want to make that point, Your Honor. Thank you.

6 THE COURT: Thank you, Mr. Klauder.

7 Anyone else?

8 (No verbal response)

9 THE COURT: Well, I'd like to have about 15 minutes,
10 just to put together my thoughts a little differently, and come
11 out and rule. I can come back in an hour, if parties would
12 prefer to have lunch, or I can come back in about 15 minutes,
13 if that's acceptable to everyone.

14 MR. PACITTI: I think whatever Your Honor's pleasure
15 is. Either way, it's fine.

16 (Participants confer)

17 THE COURT: Mr. Schepacarter, any preference? Because
18 we're beyond lunch time now, and I don't want to forestall --

19 MR. SCHEPACARTER: Well, I am hungry.

20 THE COURT: Yes.

21 (Laughter)

22 THE COURT: I'm sure you are. You've worked hard
23 today.

24 MR. SCHEPACARTER: And I usually eat my lunch before
25 1. So it's up to Your Honor's preference.

1 THE COURT: Let's come back at 2:30.

2 MR. SCHEPACARTER: 2:30? That's fine.

3 THE COURT: 2:30, and I'll issue my ruling then.

4 MR. SCHEPACARTER: Thank you.

5 THE COURT: Thank you, everyone. It was a very
6 interesting argument, and a tough decision, so --

7 MR. SCHEPACARTER: May we leave our papers and stuff
8 here?

9 THE COURT: Yes, you may, you sure may. Thank you.

10 COUNSEL: Thank you. Thank you, Your Honor.

11 (Luncheon recess taken at 1:27 p.m.)

12 AFTERNOON SESSION

13 (Proceedings resume at 2:32 p.m.)

14 (Call to order of the Court)

15 THE COURT: Good afternoon, everyone. You may be
16 seated. And I hope you had time to get some lunch and relax
17 for a few minutes because it certainly was an active morning.

18 And I'll begin my ruling with the observation that, as
19 some say, a bad settlement is better than a good lawsuit. And
20 settlements bring certainty, and the Court recognizes that the
21 debtors, LSQ Funding, and the committee, by the proposed
22 settlement, are attempting to provide unsecured creditors with
23 some recovery.

24 And let me tell you right up front, so that people
25 aren't guessing, that I'm going to approve the settlement, and

1 with it, the financing motion. I am rendering a decision which
2 I believe is in the best interest of the debtors, and it is a
3 very difficult decision to make.

4 And incidentally, the Court is considering, for
5 purposes of this ruling, that the Diversitex claim, the
6 administrative claim is a valid claim, and the preference
7 analysis is for another day.

8 The Court started its thinking in terms of rejecting
9 the settlement. Both Diversitex and the Office of the United
10 States Trustee filed very strong objections and made strong
11 arguments today, and the Court found itself playing mental
12 tennis, back and forth on the issues.

13 At first, the Court viewed Jevic as commanding it to
14 reject the settlement. The priority scheme in the Code is
15 mandatory, was the Court's thinking. But then the Court reread
16 Jevic and came to a different conclusion, and here is why. The
17 Supreme Court stated, in Jevic, that, quote:

18 "The question here concerns the interplay between the
19 Code's priority rules and a Chapter 11 dismissal."

20 That was the issue in Jevic; it was all about a
21 structured dismissal. And the Supreme Court stated that,
22 quote:

23 "Nothing else in the Code authorizes a court ordering
24 a dismissal to make general, end-of-the-case
25 distributions of estate assets to creditors of the

1 kind that normally take place in a Chapter 7
2 liquidation or Chapter 11 plan, let alone final
3 distributions that would be flatly impermissible in a
4 Chapter 7 liquidation or a Chapter 11 plan because
5 they violate priority, without the impaired creditor's
6 consent."

7 Then the Supreme Court cited In Re Iridium Operating,
8 LLC, a decision of the Second Circuit Court of Appeals in 2007,
9 found at 478 F.3d 452. And the Iridium Court ruled that,
10 quote:

11 "It is difficult to employ the rule of priorities"
12 because "the nature and extent of the estate and the
13 claims against it are not yet fully resolved."

14 And that is what we have here: The extent of the
15 estate, and the claims against it are not yet fully resolved.
16 Ultimately, the Supreme Court rejected the Jevic settlement
17 because the priority-violating distribution did not meet any
18 significant, offsetting, bankruptcy-related justification.
19 Here, the settlement enables the debtors to continue with their
20 businesses -- with their business and the employment of 500
21 plus people, while preserving the committee's rights to bring
22 actions against insiders.

23 The failure to serve employees is not fatal because
24 they will be paid in full under the budget. And the case is
25 not a *sub rosa* plan because the parties to the settlement are

1 not settling all claims. Similarly, the debtor has exercised
2 its judgment, apropos of its fiduciary duty, that the
3 settlement is in its best interest.

4 Is the settlement fair and equitable, as required? It
5 does, potentially, but not certainly, impact Diversitex as an
6 administrative claimant. But Diversitex can participate in the
7 settlement to a small degree, and there is little, if any,
8 assurance that Diversitex would receive any distribution, were
9 the settlement to be denied.

10 The settlement does preserve the debtors and their
11 business with some, but not great offense to administrative
12 claimants. And the Court finds that the settlement is fair and
13 equitable, and I will approve it.

14 And it was a difficult decision to make, as I said.
15 And I wrote what I just read during the hour that I took. And
16 I appreciate counsel's arguments and presentations.

17 MR. KLAUDER: Thank you, Your Honor.

18 THE COURT: Yes.

19 MR. KLAUDER: I guess I need to give you an order.

20 THE COURT: Yes, because I marked up the one you sent
21 in.

22 MR. KLAUDER: Yeah, I do have -- I do have a -- one
23 moment, please.

24 THE COURT: Sure. If not, I'll be here.

25 (Participants confer)

1 THE COURT: I think I have the budget, still, that you
2 gave me before, that I can attach.

3 (Participants confer)

4 MR. KLAUDER: I did find it, Your Honor. And there's
5 one change that was made --

6 THE COURT: Yes.

7 MR. KLAUDER: -- which was discussed on the record.
8 One of the reserved parties -- and I -- I'll hand up a page.
9 In Paragraph 19, you may recall, Jerry --

10 THE COURT: Yes.

11 MR. KLAUDER: -- Jerry Armstrong Consulting, as part
12 of their resolution, was stricken, or agreed -- it was agreed
13 that they would be stricken from Paragraph 19(a).

14 THE COURT: All right.

15 MR. KLAUDER: And so we've just crossed that out in
16 this --

17 THE COURT: Understood.

18 MR. KLAUDER: -- copy for Your Honor.

19 THE COURT: All right.

20 MR. KLAUDER: Otherwise, there is no changes. I do
21 have a budget that will go with this.

22 THE COURT: Yes.

23 MR. KLAUDER: And if I may approach.

24 THE COURT: You may. Thank you, Mr. Klauder. That's
25 the whole animal.

1 MR. KLAUDER: That's it.

2 THE COURT: Do I need to do anything with Paragraph
3 19?

4 MR. KLAUDER: No, it's already been --

5 THE COURT: It's been stricken?

6 MR. KLAUDER: It's been stricken.

7 THE COURT: All right. All right. I'm going to sign
8 the order, and we will have it docketed today.

9 (Pause in proceedings)

10 THE COURT: All right, Counsel. I've signed.

11 MR. KLAUDER: Thank you.

12 THE COURT: Anything further today?

13 MR. KLAUDER: That is all we have for today. We'll
14 see you next week.

15 THE COURT: For the sale.

16 MR. KLAUDER: We'll see you next week at the sale
17 hearing.

18 THE COURT: Right. All right. Thank you, everyone.
19 With that, we'll stand in recess.

20 COUNSEL: Thank you, Your Honor. Thank you. Thank
21 you, Your Honor.

22 THE COURT: Good day to everyone.

23 UNIDENTIFIED: Thank you.

24 (Proceedings concluded at 2:40 p.m.)

25 *****

1 CERTIFICATION

2 I certify that the foregoing is a correct transcript
3 from the electronic sound recording of the proceedings in the
4 above-entitled matter to the best of my knowledge and ability.

5

6

7 /s/ Coleen Rand September 12, 2017

8 Coleen Rand

9 Certified Court Transcriptionists

10 For Reliable

Deathtraps

- A deathtrap provision seeks to encourage claimants in a class to vote in favor of a plan by providing for more favorable treatment if the class votes to accept the plan than if the class votes to reject the plan.
 - Importantly, a deathtrap is based on a class's vote. It is likely impermissible to provide an individual claimant in a class different treatment depending on whether it votes to accept the plan.
 - Recently, there have been variations in the use of death traps that do not change recovery based on votes on the plan, but rather, based on whether certain parties object to the plan.
- If successful in convincing the class to vote to accept the plan, the deathtrap can avoid a cramdown fight.
- Across various jurisdictions, deathtraps have been found to be valid, although not universally accepted.
- Often times, objections to death traps culminate in a settlement between the objecting parties and the debtors.
- Third Circuit: *In re Zenith Elecs. Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999) the Court held that there is no prohibition in the Bankruptcy Code against a plan proponent offering different treatment to a class depending on whether the class votes to accept or reject the plan.
 - The Court stated: "One justification for such disparate treatment is that, if the class accepts, the plan proponent is saved the expense and uncertainty of a cramdown fight. This is in keeping with the Bankruptcy Code's overall policy of fostering consensual plans of reorganization and does not violate the fair and equitable requirement of section 1129(b)."
- Third Circuit: *In re Molycorp, Inc.*, 15-11357 (CSS) (Bankr. D. Del. 2015) the Court held that a death trap provision, which provided that a class would receive a recovery if it did not object to the third party releases in the plan and did not object to the plan, was "unacceptable" and "ridiculous."
 - At the disclosure statement hearing, Judge Sontchi admonished the lawyers, stating that "I'd rather you not give them anything than you squash the rights of fiduciaries."

Weil, Gotshal & Manges LLP

1

Courts outside of Third Circuit

- Fifth Circuit: At the disclosure statement hearing for *Midstates Petroleum, et.al.*, No. 16-32237 (DRJ) (Bankr. S.D. Tex. June, 2016), Judge Jones stated on the record that death-trap provisions may be approved and rejected the argument that a death-trap provision is per se bad faith.
 - A provision in the plan stated that if an unsecured creditor objects to the disclosure statement or plan, it will terminate the agreement of the second and third lienholders to waive their deficiency claims in order to provide a higher recovery to the unsecured claimants. In response to the unsecured committee's objection at the disclosure statement, Judge Jones noted "But the concept doesn't bother me. I do think that it makes – the committee has to be very strategic in what it does, but... it doesn't result in a per se finding of bad faith."
 - This is not a "traditional" death trap as it is not linked to how a class votes but instead is a means to ensure that certain parties-in-interest do not object to the debtor's plan or settlements.
 - The Committee ultimately decided to object to the confirmation of the plan arguing, among other things, unfair discrimination. The parties subsequently settled prior to confirmation.
- Second Circuit: Courts in the Second Circuit have held that death traps are valid.
 - The Court in *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 714, 715-16 (Bankr. S.D.N.Y. 1992), *aff'd*, 140 B.R. 347 (S.D.N.Y. 1992) and *In re Adelpia Commun. Corp.*, 368 B.R. 140, 275-76 (Bankr. S.D.N.Y. 2007) held that a death trap is not a violation of the absolute priority rule.

Weil, Gotshal & Manges LLP

2

Double Deathtraps

- A double deathtrap, on the other hand, links the recovery of one class of claimants to how another class of claimants vote.
- Third Circuit: The Bankruptcy Court found a double death trap violated unfair discrimination in *In re Allegheny, Int'l, Inc.* 118 B.R. 282 (Bankr. W.D. Pa. 1990).
 - The plan of adjustment provided that “if any class of equity holders reject the plan, then that class and any junior class would not receive any distribution.”
 - The Court did not provide a rationale for finding the double death trap unfair, but rather, relegated the issue to a brief footnote. This case has since rarely been cited as authority on double death traps in the Third Circuit.
- Fifth Circuit: In *In re MCorp Financial*, 137 B.R. 219, 236 (Bankr. S.D. Tex. 1992) the bankruptcy court held that a death trap can be invalidated if rejection of the death trap affects classes other than the rejecting class itself.
 - The death trap in MCorp Financial provided a possible payout to three equity classes if one equity class (Class 15) voted to accept the plan and nothing to the three equity classes if that same equity class voted to reject the plan; the bankruptcy court held that this death trap was invalid because Class 15's rejection of the plan essentially stripped the two remaining equity classes of the right to vote effectively, because they could not know until after class 15 had cast its vote what their own status would be.
 - It is not clear whether MCorp Financial has been used as an authority on double death traps in the Fifth Circuit.

**Prepackaged and Prearranged Chapter 11 Cases:
Compilation of 2018 and 2019 Cases**

Prepackaged and prearranged chapter 11 cases have long been the preference of chapter 11 practitioners advising clients in need of debt restructurings. They are often faster, cheaper and less volatile than traditional “free-fall” chapter 11 cases, and also permit a debtor to reorganize debt without the need to achieve unanimity among affected debtholders as would otherwise be required outside of a bankruptcy proceeding. The principal hallmark of a prepackaged or prearranged proceeding is a pre-bankruptcy agreement between the debtor and one or more of its principal stakeholders concerning the terms of a consensual plan of reorganization for the debtor. Whether the case is considered a “prepackaged” or “prearranged” bankruptcy usually turns upon the degree to which the plan of reorganization was actually solicited pre-bankruptcy. In circumstances where the plan was solicited prior to the bankruptcy case, even if solicitation was not completed on the petition date, the case is typically viewed as a prepackaged chapter 11 proceeding. In contrast, where the debtor has reached agreement with key stakeholders but has not actually begun solicitation, the case is typically viewed as a prearranged or prenegotiated chapter 11 proceeding.

As with other recent years, calendar year 2018 and the first eight (8) months of 2019 saw their fair share of prepackaged and prearranged chapter 11 cases. We surveyed forty-five (45) prepackaged and prearranged chapter 11 cases.¹ Part I of this article provides a summary of key datapoints in the cases. Part II of this article summarizes the surveyed cases. Part III of this article identifies cases that were filed but were unresolved as of the date of this article.

I. Trends in Prepackaged and Prearranged Cases.

With respect to the forty-five (45) cases surveyed, we reviewed five categories of information: (1) whether the case was prepackaged or prearranged; (2) length of the proceeding from the petition date to the confirmation date; (3) filing venue; (4) whether the debtor entered into a restructuring support agreement with key creditors; and (5) the industry in which the debtor operates.

A. Number of Prepackaged and Prearranged Cases Surveyed.

<u>Prepackaged</u>	<u>Prearranged</u>
35	10

B. Length of Proceeding from Petition Date to Confirmation Date (in days).

<u>1-9</u>	<u>20-29</u>	<u>30-39</u>	<u>40-49</u>
3	3	5	4
<u>50-59</u>	<u>60-69</u>	<u>70-79</u>	<u>80-89</u>
3	2	2	3

¹ This article does not contain an exhaustive list of all prepackaged or prearranged chapter 11 cases that were filed or confirmed in 2018 and the first eight (8) months of 2019. Rather, the list provides the reader with a resource of representative cases during this time period.

2019 DELAWARE VIEWS FROM THE BENCH

<u>90-99</u>	<u>100-99</u>	<u>110-19</u>	<u>140-49</u>
2	2	1	2
<u>150-59</u>	<u>180-89</u>	<u>200-09</u>	<u>310-19</u>
1	1	1	1

C. Filing Venue.

<u>Delaware</u>	<u>S.D. Tex.</u>	<u>S.D.N.Y.</u>	<u>N.D. Tex.</u>	<u>W.D. Wash.</u>
29	9	5	1	1

D. Restructuring Support Agreement.

<u>Restructuring Support Agreement</u>	<u>NO Restructuring Support Agreement</u>
40	5

E. Industry.

<u>Energy</u>	<u>Retail</u>	<u>Manufacturing</u>	<u>Health Care</u>	<u>Media</u>
14	7	5	4	4
<u>Financial Services</u>	<u>Technology</u>	<u>Food Services</u>	<u>Maritime/Shipping</u>	<u>Automotive</u>
3	3	3	2	1

II. Summary of Surveyed Prepackaged and Prearranged Chapter 11 Cases.

A. *In re Sungard Availability Services Capital, Inc.*, Case No. 19-22915 (RDD) (Bankr. S.D.N.Y. 2019); 1 Day.

Sungard Availability Services Capital, Inc. and its affiliated debtors (“Sungard”) filed for chapter 11 relief in the U.S. Bankruptcy Court for the Southern District of New York on May 1, 2019, and filed its prepackaged joint chapter 11 plan of reorganization contemporaneously therewith. Sungard is a leading provider of disaster recovery services, managed information technology services, and information availability consulting solutions for companies in a wide variety of private industries and government sectors across North America, Europe, and India. Sungard experienced financial distress due to shifting market conditions and a decline its legacy, infrastructure-focused products.

Sungard entered into a restructuring support agreement with its secured lenders, unsecured noteholders, and equity sponsors, pursuant to which Sungard’s obligations under its secured credit agreement would be converted into a new \$300 million term loan as well as 89% of the new equity in reorganized Sungard, and the conversion of the unsecured notes into 11% of the new equity in reorganized Sungard, plus 2% of the reorganized Sungard equity otherwise distributable to the holders of certain 2022 Term Loan Claims. Solicitation of the plan commenced on April 5, 2019 with a voting deadline of April 26, 2019, and the plan was unanimously accepted by both classes entitled to vote thereon. The U.S. Trustee objected to the plan based primarily on the expedited

nature of the relief sought and related notice concerns; however the court overruled this objection and found that Sungard's prepetition notice and the time provided to potential objectors prepetition to respond was sufficient, and the plan was confirmed on May 2, 2019.

B. *Fullbeauty Brands Holdings Corp.*, Case No. 19-22185 (RDD) (Bankr. S.D.N.Y 2019); 4 Days.

Fullbeauty Brands Holdings, Inc. and its affiliated debtors (collectively, "Fullbeauty") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on February 3, 2019 in the United States Bankruptcy Court for the Southern District of New York. Fullbeauty filed a prepackaged plan of reorganization and restructuring support agreement on the petition date. Fullbeauty is a leading direct-to-consumer retailer in the U.S. plus-size apparel market, and had over \$825.3 million in direct plus-size sales in 2018. Fullbeauty experienced financial distress due to substantial prepetition debt service obligations, a generally depressed retail apparel market, and merchandising issues including untested changes to product strategy, challenged inventory and sales processes implementation, and inventory pricing controls.

Fullbeauty, and its First Lien Lenders, Second Lien Lenders, Equity Sponsors, and "first-in, last-out term loan claims," entered into a restructuring support agreement on December 18, 2018. Pursuant to the restructuring agreement: (a) the First Lien Lenders received a pro rata share of \$175 million of the New First Lien Term Loan and 87.5% of the equity in the new company, (b) the Second Lien Lenders received a pro rata share of \$15 million of the New Junior Loan and 10% of the equity of the new company (c) the "first-in, last-out term loan claims" received a pro rata share \$75 million of the New First Lien Term Loan. Solicitation commenced prepetition on January 6, 2019, and the voting deadline was January 24, 2019. All voting classes accepted the plan, and the plan was confirmed on February 7, 2019.

C. *In re Arsenal Energy Holdings LLC*, Case No. 19-10226 (BLS) (Bankr. D. Del. 2019); 9 Days.

Arsenal Energy Holdings LLC ("Arsenal") filed for chapter 11 relief on February 4, 2019 in the U.S. Bankruptcy Court for the District of Delaware, and filed a prepackaged plan of reorganization contemporaneously therewith. Arsenal is a holding company in a corporate enterprise that is engaged in the acquisition and development of natural gas resources in the Appalachian Basin. Arsenal was forced to file for chapter 11 protection after it failed to achieve unanimous consent from holders of its Subordinated Notes to an exchange agreement as part of an out-of-court recapitalization of its non-debtor subsidiaries.

Arsenal did not enter into a restructuring support agreement, but did enter into a "Subordinated Notes Transaction Support Letter with consenting debtholders and equityholders pursuant to which the parties thereto agreed to support Arsenal's restructuring under which the subordinated noteholders would receive shares of class A new common stock in the reorganized entity and equityholders would receive 100% of class b new common stock. Solicitation on the plan began on January 9, 2019, with a voting deadline of January 31, 2019. All classes entitled to vote voted to accept the plan, and the plan was confirmed on February 13, 2019

D. *In re Seattle Proton Center LLC*, Case No. 18-14380 (TWD) (Bankr. W.D. Wash. 2018); 20 Days.

Seattle Proton Center LLC and its affiliated debtors (collectively, “Seattle Proton”) filed for chapter 11 protection on November 14, 2018. Seattle Proton filed a prepackaged plan of reorganization the next day. Seattle Proton operates a cancer treatment center in Seattle that specializes in outpatient proton radiation treatment. Seattle Proton experienced financial distress as a result of financial performances below projections caused by high start-up costs and insurers’ reluctance to provide coverage for new cancer treatments.

Seattle Proton, its senior secured lenders, the Seattle Cancer Care Alliance, and IBA Proton Therapy Inc. (Seattle Proton’s primary medical equipment vendor) entered into a restructuring support agreement prior to the petition date. Solicitation commenced on November 12, 2018. All voting classes voted to accept the plan, and the plan was confirmed on December 4, 2018.

E. *Jones Energy, Inc.*, Case No. 19-32112 (DRJ) (Bankr. S.D. Tex. 2019); 22 Days.

Jones Energy, Inc. and its affiliated debtors (collectively, “JEI”) filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on April 14, 2019 in the Southern District of Texas. JEI filed a restructuring support agreement on the day of filing and a prepackaged plan of reorganization the next day. JEI is an oil and gas company that experienced financial distress due to the volatile oil and gas market in recent years.

JEI, certain of its First Lien Noteholders and certain of its Unsecured Noteholders, entered into a restructuring support agreement on April 2, 2019. Pursuant to the restructuring support agreement, the First Lien Noteholders exchanged \$450 million in claims for 96% of the equity in the reorganized debtors and the Unsecured Noteholders exchanged \$559 million in claims for 4% of the equity. Solicitation commenced prepetition on April 3, 2019 and the voting deadline was on May 1, 2019. All voting classes accepted the plan, and the plan was confirmed on May 6, 2019.

F. *In re Rand Logistics, Inc.*, Case No. 18-10175 (BLS) (Bankr. D. Del. 2018); 29 Days.

Rand Logistics, Inc. and related debtors (collectively, “Rand”) filed a voluntary petition for chapter 11 relief on January 30, 2018 in the Bankruptcy Court for the District of Delaware. The chapter 11 bankruptcy filing included a prepackaged plan of reorganization. Rand is one of the largest providers of bulk freight shipping services in the Great Lakes region. Several factors, including, the volatility in the valuation of the U.S. dollar relative to the Canadian dollar and the increased costs of repairing, maintaining and certifying vessels combined to make the Rand’s capital structure unsustainable. In order to address the issues with its capital structure, Rand engaged in negotiations with its second lien lender regarding a consensual deleveraging restructuring transaction while simultaneously pursuing a third party sales process.

Prior to the petition date, Rand entered into a restructuring support agreement with its second lien lender in which the parties agreed to pursue a consensual reorganization. Pursuant to the restructuring support agreement, the parties agreed to support a plan of reorganization that would, among other things, convert the second lien claims to new common stock of the

reorganized Rand and pay in full in cash all other claims. As a result, Rand only solicited votes from the second lien lender in connection with the plan. Other creditors were deemed unimpaired, while Rand's equity was extinguished and deemed to reject. Rand's plan was confirmed on February 28, 2018.

G. *Joerns WoundCo Holdings, Inc.*, Case No. 19-11401 (JTD) (Bankr. D. Del. 2019); 31 Days.

Joerns Woundco Holdings, Inc. and its affiliated debtors (collectively, "Woundco") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on June 24, 2019 in the United States Bankruptcy Court for the District of Delaware. Woundco filed a prepackaged plan of reorganization and restructuring support agreement on June 25, 2019. Woundco is a leading manufacturer, distributor, and service provider of medical bed frames, therapeutic support surfaces, patient lifts and repositioning devices, among other types of durable medical equipment. Woundco experienced financial distress due to challenges faced by the post-acute sector, including multi-year occupancy rate declines and increased costs of providing patient care.

Woundco, certain of its First Lien Lenders and certain Second Lien Lenders, entered into a restructuring support agreement on June 21, 2019. Pursuant to the restructuring support agreement, the First Lien Lenders received 90% of the equity in the reorganized debtors in exchange for \$270 million in secured claims and the Second Lien Lenders received 5% of the equity in exchange for \$126 million in claims. Solicitation commenced prepetition on June 21, 2019 and the voting deadline was on July 15, 2019. All voting classes accepted the plan, and the plan was confirmed on July 25, 2019.

H. *In re Orchard Acquisition Company, LLC*, Case No. 17-12914 (KG) (Bankr. D. Del 2017); 36 Days.

Orchard Acquisition Company, LLC and related debtors (collectively, "Orchard") filed a voluntary petition for chapter 11 relief on December 12, 2017. On that date, Orchard also filed a prepackaged plan of reorganization. Orchard is a provider of direct-to-consumer access to financing through a variety of avenues including mortgage lending, structured settlements, annuity and lottery payment purchasing, prepaid cards, and conduits to personal loan providers. Leading up to its filing, Orchard faced increasing competition to its home-lending line of business as well as increased scrutiny from federal, state, and local regulators. As a result of these challenges, Orchard decided to reach out to certain of its lenders in order to proactively deleverage its balance sheet.

Prior to its bankruptcy filing, Orchard entered into a restructuring support agreement with certain of its lenders. The restructuring support agreement provided for a consensual restructuring of the lenders debt pursuant to a prepackaged plan of reorganization. Prior to filing, Orchard commenced solicitation of votes on the plan from those classes and interest holders entitled to vote on the plan. The established voting deadline, however, straddled the petition date—falling on December 29, 2017, approximately two and a half weeks after Orchard commenced the chapter 11 cases. The Orchard prepackaged plan was confirmed on January 17, 2018, a mere thirty-six (36) days after the petition date.

I. *In re Triangle Petroleum Corporation*, Case No. 19-11025 (MFW) (Bankr. D. Del. 2019); 37 Days.

Triangle Petroleum Corporation (“TPC”) filed for chapter 11 relief on May 8, 2019 in the U.S. Bankruptcy Court for the District of Delaware, and filed its prepackaged plan of reorganization contemporaneously therewith. TPC is an independent energy holding company with operations conducted through wholly-owned non-debtor subsidiaries and other affiliated non-debtor entities that provides crude oil and natural gas gathering and processing, water transportation and disposal, and freshwater sourcing, and transportation services to third parties in the Williston Basin of North Dakota, as well as leases certain commercial and residential buildings in North Dakota. TPC filed for chapter 11 after a breakdown in negotiations for a consensual out-of-court restructuring.

There was no restructuring support agreement, however, TPC did agree with the one holder of a secured notes claim entitled to vote on the plan to the planned restructuring, pursuant to which the secured noteholder would receive 100% of the new common stock of the reorganized debtor. Solicitation on the plan began on May 7, 2019, with a voting deadline that same day at 10:00 pm. The secured noteholder voted to accept the plan, and the plan was confirmed on June 14, 2019.

J. *In re CTI Foods, LLC*, Case No. 19-10497 (CSS) (Bankr. D. Del. 2019); 38 Days.

CTI Foods and its affiliated debtors (“CTI”) filed for chapter 11 relief on March 11, 2019 in the U.S. Bankruptcy Court for the District of Delaware, and filed a prepackaged plan of reorganization contemporaneously therewith. CTI is a leading independent provider of custom food solutions to major chain restaurants in North America. CTI experienced financial distress as a result of an increase in the number of protein processors in competitive segments of the food manufacturing and foodservice industries, increased operational and food safety costs, a capital expenditure reimbursement issue with one of its customers, and a large interest payment coming due on its term loan debt.

CTI entered into a restructuring support agreement with (1) an ad hoc group of holders of approximately 78.70% of the outstanding principal amount of its first lien term loans and 52.31% of the outstanding principal amount of its second lien term loans; and (2) the prepetition equity sponsors which own or control approximately 94.31% of the outstanding equity interests in Chef Holdings, Inc., CTI’s ultimate parent, pursuant to which the company would equitize a substantial portion of its first and second lien term loans. Solicitation on the plan commenced on March 8, 2019, with a voting deadline of April 1, 2019. The plan was unanimously accepted by both classes entitled to vote, and the plan was confirmed on April 18, 2019.

K. *Monitronics International, Inc.*, Case No. 19-33650 (DRJ) (Bankr. S.D. Tex. 2019); 38 Days.

Monitronics International, Inc. and its affiliated debtors (collectively, “Monitronics”) filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on June 30, 2019 in the United States Bankruptcy Court for the Southern District of Texas. Monitronics filed a prepackaged plan of reorganization and a restructuring support agreement on July 1, 2019.

Monitronics primarily engaged in the business of providing residential customers and commercial client accounts with monitored home and business security systems and interactive and home automation services. Monitronics experienced financial distress as a result of rapidly changing market conditions and increased competition that caused the company to become highly leveraged in an attempt to grow and maintain their customer base.

Monitronics, certain of its Term Lenders, certain of its Unsecured Noteholders, and its ultimate non-debtor parent company entered into a restructuring support agreement on May 20, 2019. Pursuant to the restructuring support agreement: (a) \$585 million in principal amount of Prepetition Notes was eliminated in exchange for either equity in the reorganized Debtors or a discounted cash payout; (b) \$100 million of term loans under the Debtors' Prepetition Term Loan Facility was equitized; and (c) \$200 million of secured loan was reduced, funded through a rights offering. Solicitation occurred prior to and after the bankruptcy filing. Prepetition solicitation commenced on May 31, 2019, with a voting deadline of June 24, 2019. Postpetition solicitation commenced on July 2, 2019, with a voting deadline of July 31, 2019. All voting classes accepted the plan, and the plan was confirmed on August 7, 2019.

L. In Remington Outdoor Co., Inc., Case No. 18-10684 (BLS) (Bankr. D. Del. 2018); 40 Days.

Remington Outdoor Co., Inc. and certain of its affiliated debtors (collectively, "Remington") filed voluntary petitions for chapter 11 relief on March 25, 2018 in the United States Bankruptcy Court of the District of Delaware. Remington filed a prepackaged joint plan of reorganization that same day. Remington is one of the country's largest manufacturers of firearms, ammunition and related products for commercial, military, and law enforcement customers throughout the world. Remington experienced financial distress as a result of a significant decline in sales coupled with an increase in costs.

Remington, certain of its Term Lenders, and certain of its Third Lien Noteholders entered into a restructuring support agreement that allowed Remington Outdoor Company to borrow an additional \$45 million to satisfy certain obligations of its subsidiaries and provide postpetition financing, as well as an additional \$100 million in postpetition financing through a Term DIP Facility in exchange for, among other things, a distribution of 17.5% of the equity in the reorganized parent entity to the Third Lien Noteholders, and 82.5% of the equity in the reorganized parent entity to the Term Lenders. Solicitation commenced on March 22, 2018, with a voting deadline of April 26, 2018. All voting classes voted to accept the plan, and the plan was confirmed on May 4, 2018.

M. In re Dixie Electric, LLC, Case No. 18-12477 (KG) (Bankr. D. Del. 2018); 41 Days.

Dixie Electric, LLC and its affiliated debtors (collectively, "Dixie") filed for chapter 11 relief on November 2, 2018 in the U.S. Bankruptcy Court for the District of Delaware. Dixie filed its joint pre-packaged plan of reorganization on the same date. Dixie is a privately held provider of oilfield electrical infrastructure and automation services to upstream and midstream customers in the Permian and Bakken basins through its 16 branches in located in Montana, New Mexico, North Dakota, Oklahoma, and Texas. Dixie experienced financial distress as a result of decreased

drilling and well completion activity, tightness in the skilled labor market, and unprofitable lump-sum contracts.

Prior to the filing, Dixie entered into a restructuring support agreement with (i) holders of over 67% in outstanding principal amount of claims under its prepetition secured credit agreement; (ii) Wilmington Trust, National Association, as successor administrative agent under the prepetition secured credit agreement; (iii) the lender under Dixie's unsecured loan agreement; the sole holder of the equity interests in FR Dixie Holdings Corp.; and (iv) the consenting prepetition secured lenders in their capacity as DIP Lenders, pursuant to which holders of secured loan claims will receive 98.25% of the equity in the reorganized Dixie, with holders of unsecured loan claims receiving the remaining 1.75%. Solicitation of the plan commenced prepetition on October 31, 2018, with a voting deadline of November 20, 2018, and all voting classes voted to accept the plan. The plan was confirmed on December 13, 2018.

N. In re Angel Medical Systems Inc., Case No. 18-12903 (KG) (Bankr. D. Del. 2018); 42 Days.

Angel Medical Systems, Inc. ("AMS") filed for chapter 11 relief on December 31, 2018 in the U.S. Bankruptcy Court for the District of Delaware, and filed its prepackaged plan of reorganization contemporaneously therewith. AMS was a privately held pre-commercial medical device company that, as of the petition date, owned approximately 50 U.S. patents and, among other things, had developed and received FDA approval for an implantable cardiac monitoring and alerting system designed to warn patients of certain acute coronary syndromes. AMS filed for bankruptcy due to delays in obtaining FDA approval that prevented commercialization of the cardiac monitoring and alerting system after AMS was unable to obtain consent from a majority of its noteholders to extend the maturity date of the notes and to allow AMS to obtain bridge financing.

AMS did not enter into a restructuring support agreement, but did negotiate with an existing 2016 Noteholder to provide DIP financing and a preferred stock offering for current stakeholders and new investors, with the DIP obligations converting to preferred stock on the effective date. Solicitation for the plan began on December 17, 2018, with a voting deadline of January 14, 2019. The two classes of 2014 noteholders voted to reject the plan, but the class of 2016 noteholders voted to accept the plan. The plan was confirmed on February 11, 2019.

O. In re Global Brokerage, Inc., Case No. 17-13532 (MEW) (Bankr. S.D.N.Y. 2017); 42 Days.

Global Brokerage filed a voluntary petition for chapter 11 relief on December 11, 2017. Global Brokerage also filed a prepackaged plan of reorganization and restructuring support agreement at the time of its chapter 11 filing. Global Brokerage was a holding company with limited business operations. It derived all of its revenue from distributions and payments made by its subsidiaries, which provide online foreign exchange trading and related services to retail and institutional customers worldwide.

Global Brokerage had issued \$172.5 million aggregate principal amount of 2.25% Convertible Senior Notes due in 2018. In November 2017, the price of Global Brokerage's

Class A common stock fell to a point where the stock was delisted by NASDAQ. The delisting triggered the right of each note holder to require Global Brokerage to purchase for cash all of the holder's notes for the price of the principal amount. Global Brokerage was unable to repurchase the notes, which constituted an event of default under the indenture. In addition, Global Brokerage was unable to make an interest payment on the notes that was due in December 2017 and was confronting an impending maturity of the notes in June 2018. In light of these circumstances, Global Brokerage engaged in negotiations with an ad hoc group of the noteholders around the terms of a consensual restructuring that was embodied in a restructuring support agreement and a prepackaged plan of reorganization.

Global Brokerage commenced and completed solicitation of votes on the prepackaged plan in December 2017, before the petition date. Holders of more than 78.5% in dollar amount of the notes claims voted to accept the plan, and no holder voted to reject the plan. Pursuant to the plan, the noteholders received new notes with an extended maturity and increased interest rate as well as additional governance rights in the reorganized company. Global Brokerage's other creditors were left unimpaired under the plan, and shareholders retained their equity. The Global Brokerage plan was confirmed on January 22, 2018.

P. *In re Mattress Firm, Inc.*, Case No. 18-12241 (CSS) (Bankr. D. Del. 2018); 42 Days.

Mattress Firm and its affiliated debtors (collectively, "Mattress Firm") were the largest specialty mattress retailer in the United States, with over 3,230 stores across 49 states. Mattress Firm filed for chapter 11 as a result of liquidity constraints caused by two significant structural challenges: (1) a complicated capital structure that restricted Mattress Firm from securing additional funding, including a total of more than \$3.2 billion in funded debt and debt restrictions in existing debt facilities; and (2) an overly aggressive expansion of the company's retail footprint through organic growth and major store acquisitions that more than doubled its store count between 2006 and 2016 and resulted in an inefficient geographic distribution of Mattress Firm stores.

Mattress Firm filed chapter 11 petitions on October 5, 2018, and filed their Joint Prepackaged Chapter 11 Plan of Reorganization (the "Plan") that same day. Prior to the petition date, the Mattress Firm's primary stakeholders agreed to support the Plan pursuant to a restructuring support agreement dated October 4, 2018. Only the intercompany class of claims was entitled to vote on the Plan. Solicitation packages were distributed on October 4, 2018, with a voting deadline of October 5, 2018.

The Plan was confirmed on November 16, 2018. Among other things, the Plan provided for payment in full of the Mattress Firm's prepetition secured debt and all general unsecured claims, including allowed lease rejection claims. The Plan became effective on November 21, 2018. Currently, the case is still open as Mattress Firm resolves certain disputes with respect to cure amounts and lease rejection claims.

Q. *In re New MACH Gen LLC*, Case No. 18-11368 (MFW) (Bankr. D. Del. 2018); 42 Days.

New MACH Gen, LLC and certain of its affiliated debtors (collectively, “New MACH Gen”) filed voluntary petitions under chapter 11 on June 11, 2018 in the United States Bankruptcy Court for the District of Delaware. New MACH Gen filed a prepackaged plan of reorganization that same day, with an amended plan filed on July 18, 2018. New MACH Gen owns and manages a portfolio of three natural gas-fired electric generating facilities in the U.S., and generates revenue through the sale of energy, capacity, and ancillary services from its electricity facilities into certain power markets pursuant to energy management agreements. In 2016, New MACH Gen significantly underperformed and suffered a net loss of approximately \$589.8 million, with liquidity issues continuing as a result of certain regulatory obstacles affecting pipeline construction in the New York market, lower than expected market prices, higher than expected service agreement costs, and hedging restrictions in its First Lien Credit Agreement.

New MACH Gen, its First Lien Lenders, and certain non-debtor affiliates entered into a restructuring support agreement on June 4, 2018, pursuant to which one of the electric generating facilities would be transferred to the First Lien Lenders in exchange for a reduction of the indebtedness under the First Lien Credit Agreement, a refinancing of the remaining indebtedness under the First Lien Credit Agreement, and an new financing from the non-debtor affiliates on a second lien basis. Solicitation commenced on June 4, 2018, a week before the petition date, with a voting deadline of June 5, 2018. The plan was unanimously approved by the classes entitled to vote on the plan, and the amended plan was confirmed on July 23, 2018.

R. *In re Taco Bueno Restaurants, Inc.*, 2018 WL 6820774 (SGJ) (Bankr. N.D. Tex. 2018); 44 Days.

Taco Bueno Restaurants, Inc. and its related debtors (collectively, “Taco Bueno”) filed voluntary petitions for chapter 11 relief on November 6, 2018, which included a prepackaged plan of reorganization, in the Northern District of Texas Bankruptcy Court. Prior to the petition date, Taco Bueno had entered into a restructuring support agreement with a new investor by which the new investor agreed to acquire all senior debt in the company and then convert such debt into equity pursuant to a plan of reorganization. All general unsecured claims in the company were deemed to reject the plan and were not entitled to a recovery.

The bankruptcy court confirmed the plan, finding that: i) prior to filing, Taco Bueno commenced solicitation of votes on the plan from those classes and interest holders entitled to vote on the plan; ii) the only eligible holder of a claim in the voting class approved the claim; iii) Taco Bueno then filed a plan supplement, and later modified the plan; iv) although there was a single dispute regarding a store lease, it was resolved and affirmed by the court; v) Taco Bueno had complied with the applicable provisions of the Bankruptcy Code. Taco Bueno’s plan was confirmed on December 20, 2018.

S. *In re Ascent Resources Marcellus Holdings, LLC*, Case No. 18-10265 (LSS) (Bankr. D. Del. 2018); 45 Days.

Ascent Resources Marcellus Holdings, LLC and related debtors (collectively, “Ascent Resources”) filed voluntary petitions for chapter 11 relief on February 6, 2018. Concurrently therewith, Ascent Resources filed a joint prepackaged plan of reorganization. Ascent Resources

acquired, explored for, developed, produced and operated natural gas and oil properties in the Marcellus Shale basin in the U.S. These activities are capital intensive, and declining prices in the natural gas and oil market significantly decreased the Ascent Resources' revenues and amount of internally generated cash available for operating expenses. Due to the unfavorable market conditions, Ascent Resources left unable to cover its expenses and satisfy its contractual commitments.

In light of the continuing adverse conditions, Ascent Resources began negotiating with certain first and second lien lenders, and eventually entered into a restructuring support agreement with these lenders, which established a timeline for Ascent Resources and supporting creditors to pursue a marketing process for the sale of all or substantially all of Ascent Resources' assets. The parties also agreed to pursue a consensual reorganization under which the first and second lien lenders would convert their debt to equity, all general unsecured creditors would be unimpaired, and the existing management team would continue to manage the business in exchange for equity in the reorganized Ascent Resources.

Ascent Resources commenced solicitation of votes on the plan from holders of first and second lien claims prior to filing, with the deadline for submitting votes one month later. Both classes of claims unanimously voted to approve the plan. The plan was confirmed shortly after the petition date on March 23, 2018.

T. *In re EV Energy Partners LP*, Case No. 18-10814 (CSS) (Bankr. D. Del. 2018); 45 Days.

EV Energy Partners, L.P. and certain of its affiliate debtors (collectively, "EV Energy Partners") filed voluntary petitions for chapter 11 bankruptcy on April 2, 2018 in the United States Bankruptcy Court for the District of Delaware. EV Energy Partners filed a prepackaged plan of reorganization on the same date. EV Energy Partners' are upstream oil and natural gas producers whose primary assets are its producing and non-producing oil, natural gas, and NGL reserves, which are interests that provide EV Energy Partners with the right to drill, produce, and maintain wells in specific geographic regions. EV Energy Partners experienced financial distress as a result of low natural gas and oil prices and sought to comprehensively restructure their balance sheet rather than wait for improved market conditions.

EV Energy Partners, certain noteholders representing approximately 70% of the value of senior notes claims, the secured lenders, and certain non-debtor affiliates entered into a restructuring support agreement in which, among other things, the noteholders would receive 95% of the equity in the reorganized debtors' parent entity and secured lenders would receive new revolving loans under an amended credit agreement and cash equal to accrued by unpaid interest and letter of credit fees payable to such lenders. Solicitation commenced on March 14, 2018, with a voting deadline of March 30, 2018, and all voting classes voted to accept the plan. The plan was confirmed on May 17, 2018.

U. *In re David's Bridal, Inc.*, Case No. 18-12635 (LSS) (Bankr. D. Del. 2018); 46 Days.

David's Bridal, Inc. and its affiliated debtors (collectively, "David's Bridal") filed a voluntary petition for chapter 11, which included a prepackaged plan of reorganization. David's

Bridal is an international bridal retailer deriving their revenue from online merchandise and brick-and-mortar locations, alterations services, franchising arrangements, partnership programs, and wedding services programs. Despite maintaining steady operating cash flows over the years, David's Bridal was burdened by a substantial amount of borrowed-money debt, as well as the pressures of the changing market affecting retailers generally, and decided to seek bankruptcy protection.

David's Bridal engaged in extensive negotiations with their principal stakeholders, resulting in a consensual restructuring support agreement with holders of approximately 85% of the \$481.2 million in outstanding principal amount of term loans, holders of 97% of the \$270 million in outstanding principal amount of unsecured notes, and David's Bridal principal equity holders. The RSA outlines the material terms of the prepackaged plan, contemplating a substantial deleveraging that will reduce the David's Bridal funded indebtedness from \$777 million to \$343 million.

Under the prepackaged plan, the Term Lenders agreed to receive their pro rata share of \$240-260 million in junior secured takeback term loans, 76.25% of common equity of reorganized David' and common equity and warrants to be issued to holders of unsecured notes, and the right to participate in the Priority Exit Facility. Lenders who participate in the Priority Exit Facility will receive their pro rata share of an additional 15% of the new common equity. The Term Lenders also agreed to waive any deficiency claims. Unsecured noteholders will receive their pro rata share of 8.75% of the new common equity, and the warrants, which will be exercisable within 5 years of the effective date for 20% of the new common equity. The prepackaged plan also provides that general unsecured trade creditors will receive 100% recovery on their claims.

V. *In re Fieldwood Energy LLC*, Case No. 18-30648 (DRJ) (Bankr. S.D. Tex. 2018); 46 Days.

Fieldwood Energy LLC and its affiliated debtors (collectively, "Fieldwood Energy") filed for chapter 11 on February 15, 2018 in the U.S. Bankruptcy Court for the Southern District of Texas. On the petition date, Fieldwood Energy also filed a prepackaged plan of reorganization and a restructuring support agreement.

Fieldwood Energy operates an energy business focused on the acquisition, development, exploitation, and production of oil and natural gas properties. Fieldwood Energy experienced financial distress due to the distressed market conditions in the oil and gas industry, largely due to the volatility of the commodity markets and the depressed prices of oil and natural gas for a prolonged period of time.

The restructuring support agreement was between Fieldwood Energy and prepetition equity sponsor and single largest lender holding second lien claims, an ad hoc group of lenders holding several kinds of first lien and second lien claims, and an ad hoc group of lenders holding first lien claims. The only classes entitled to vote on the plan were the holders of the first lien claims and second lien claims (Classes 4, 5, and 6), and each class voted to accept the plan. The prepackaged plan was confirmed on April 2, 2018.

W. In re Southeastern Grocers, LLC, Case No. 18-10700 (MFW) (Bankr. D. Del. 2018); 48 Days.

Southeastern Grocers, LLC and several affiliated debtors (collectively, “Southeastern Grocers”) filed voluntary petitions under chapter 11 after negotiating and voting on a plan of reorganization. The plan provided for restructuring Southeastern Grocers’ balance sheet to reduce their funded debt by about \$500 million and annual debt service obligations by about \$40 million. As of the petition date, 68% of the unsecured noteholders and 99% of the existing equity had voted in support of the prepackaged plan.

The prepackaged plan contemplated the sale or rejection of unprofitable store locations and assumption of other stores. A property manager for two of the store locations objected to confirmation, claiming that those leases had been terminated or were in default pre-petition because Southeastern Grocers failed to accurately report gross sales and pay the percentage of rent due thereon. Southeastern Grocers filed an amended plan providing that leases subject to a dispute would not be assumed until the dispute was resolved. At the confirmation hearing, the Bankruptcy Court directed the parties to agree to a scheduling order to brief the issues.

At the heart of the dispute was the issue of whether the gross sales included the total amounts paid by customers for ancillary services offered in the stores (such as ATMs, sale of gift cards, and check cashing services) or only the amount of fees Southeastern Grocers actually received for allowing these services at their store locations. After examining the lease provisions, the Bankruptcy Court found the leases unambiguous and concluded that the term “gross sales” encompassed the total revenues from the store services, including the ancillary services. The Bankruptcy Court ordered a status hearing to consider any additional issues relative to the leases at the next omnibus hearing.

X. In re Walter Investment Management Corp., Case No. 17-13446 (JLG) (Bankr. S.D.N.Y. 2017); 49 Days.

Walter Investment Management Corp. and related debtors (collectively, “Walter Investment”) filed a voluntary petition for chapter 11, which included a joint prepackaged plan of reorganization. Walter Investment’s businesses are comprised of three primary segments: (i) forward mortgage originations; (ii) forward mortgage servicing; and (iii) reverse mortgage servicing. During the years prior to filing, Walter Investment grew its business through a number of acquisitions. As a result of those acquisitions, Walter Investment incurred debt and became highly leveraged. On top of that, Walter Investment recorded significant net losses for the three years leading up to the filing.

Walter Investment entered into a restructuring support agreement with its lenders and noteholders, in which the parties agreed to pursue a consensual reorganization. Prior to filing, Walter Investment commenced solicitation of votes on the plan from those classes and interest holders entitled to vote on the Plan. The prepackaged plan received the overwhelming support of all voting classes. Walter Investment’s plan was confirmed on January 18, 2018.

Y. In re Gastar Exploration, Inc., Case No. 18-36057 (MI) (Bankr. S.D. Tex. 2018); 50 Days.

Gastar Exploration, Inc. and its affiliated debtors (collectively, “Gastar”) filed for chapter 11 protection on October 31, 2018. Gastar filed a prepackaged plan of reorganization that same day. Gastar is primarily involved in the identification, acquisition, exploration, and development of oil and natural gas properties on unconventional reserves, such as shale resource plays. After a 2017 refinancing, Gastar experienced financial distress due to low market prices for oil and gas, as well as operational challenges stemming from a failure of a DrillCo Venture to develop up to 60 wells in Oklahoma.

Gastar entered into a restructuring support agreement with certain of its Term Lenders, second lien noteholders, and its shareholder. Solicitation commenced on October 26, 2018, with a voting deadline of October 30, 2018 (the day prior to the petition date). All voting classes unanimously voted to approve the plan, and the plan was confirmed on December 20, 2018.

Z. In re Fuse, LLC, Case No. 19-10872 (KG) (Bankr. D. Del. 2019); 57 Days.

Fuse, LLC and its affiliated debtors (“Fuse”) filed for chapter 11 relief on April 22, 2019 in the U.S. Bankruptcy Court for the District of Delaware. The next day, on April 23, 2019, Fuse filed its prepackaged joint plan of reorganization. Fuse is a leading multicultural medial company, comprised principally of two cable networks, “Fuse” and “FM”. Fuse experienced financial distress as a result of material declines in the pay-tv industry and increased competition from digital media.

Fuse entered into a restructuring support agreement with their senior secured noteholders centered around a debt-to-equity to be implemented through the plan. Solicitation on the plan began on April 18, 2019 with a voting deadline of May 9, 2019. The plan was accepted by the only class entitled to vote thereon. The plan was amended on June 4, 2019 and confirmed on June 18, 2019.

AA. In re PES Holdings, LLC, Case No. 18-10122 (KG) (Bankr. D. Del. 2018); 64 Days.

PES Holdings, LLC and its affiliated debtors (collectively, “PES”) filed for chapter 11 on January 21, 2018 in the U.S. Bankruptcy Court for the District of Delaware. PES also filed a prepackaged plan of reorganization with a restructuring support agreement on that date.

PES operations primarily consist of two business segments—oil refining and logistics. PES experienced financial distress due to increased environmental regulatory burdens, changes in crude oil prices, and the imbalanced supply/demand in the refining market leading to compressed refining margins.

Prior to filing for chapter 11, PES negotiated a prepackaged plan of reorganization and entered into a restructuring support agreement with their parent parties, 100% of the holders of their Term Loan A Debt, the Term Loan A Agent, holders of 91% of Term Loan B Debt, and Sunoco Logistics Partners Operations LP (as an additional financing lender). In January 2018, prior to the petition date, PES commenced solicitation, with the holders of Term Loan A Claims and Term Loan B Claims (Classes 7 and 8) eligible to vote. Both classes voted to accept the plan. The plan was confirmed on March 26, 2018.

BB. *In re ATD Corporation*, Case No. 18-12221 (KJC) (Bankr. D. Del. 2018); 66 Days.

ATD Corporation and certain of its affiliated debtors (collectively, “ATD”) filed voluntary petitions under chapter 11 on October 4, 2018 in the United States Bankruptcy Court for the District of Delaware. Shortly after the petition date, on October 15, 2018, ATD filed a prenegotiated plan of reorganization and a restructuring support agreement. ATD operates the largest distribution network of replacement tires across North America. ATD filed for bankruptcy relief in order to deleverage their balance sheet and obtain additional liquidity.

ATD, an ad hoc group of Senior Subordinated Noteholders, and ATD’s equity sponsors were parties to the restructuring support agreement, pursuant to which the Senior Subordinated Notes would be exchanged for 95% of the equity in reorganized ATD. The solicitation package and disclosure statement were approved by the Bankruptcy Court on November 14, 2018, and solicitation of the plan commenced on November 16, 2018 with a voting deadline of December 14, 2018. Each class entitled to vote approved the plan, and the plan was confirmed on December 19, 2018.

CC. *Blackhawk Mining LLC*, Case No. 19-11595 (LSS) (Bankr. D. Del. 2019); 71 Days.

Blackhawk Mining LLC and its affiliated debtors (collectively, “Blackhawk”) filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on July 19, 2019 in the United States Bankruptcy Court for the District of Delaware. Blackhawk filed a prepackaged plan of reorganization and restructuring support agreement at the time of filing. Blackhawk is a coal mining company that operates 19 active underground and 6 active surface mines. Blackhawk experienced financial distress as a result of its strategic growth plan that caused it to take on debt along with unanticipated increases in costs in the coal markets.

Blackhawk, its founder, and certain of its First Lien Term Lenders and Second Lien Term Lenders entered into a restructuring support agreement on July 15, 2019. Pursuant to the restructuring support agreement: (a) First Lien Lenders exchanged \$528 million in secured claims in exchange for 71% of the equity in the reorganized debtors and \$225 million of a new first lien loan; and (b) Second Lien Term Lenders exchanged \$318 million in claims for 29% of the equity in the reorganized debtors. Solicitation commenced on July 15, 2019 and the voting deadline was on July 26, 2019. Five of the six classes eligible to vote on the plan voted in favor and the Debtors satisfied the cram down requirements of section 1129(b). A group of landlords owning property where the debtor operates mines had objected the plan but their rejection was overruled after the Debtors added a paragraph making explicit that those landlords’ rights would be unimpaired by the plan. The plan was confirmed on August 29, 2019.

DD. *In re HGIM Holdings LLC*, Case No. 18-31080 (DRJ) (Bankr. S.D. Tex. 2018); 77 Days.

HGIM Holdings, LLC and its affiliated debtors (collectively, “HGIM”) filed for chapter 11 protection on March 7, 2018 in the U.S. Bankruptcy Court for the Southern District of Texas.

A couple days after filing its petition, HGIM filed a pre-packaged plan of reorganization together with a restructuring support agreement.

HGIM is a maritime transportation company owning and operating a fleet of offshore supply and multi-purpose support vessels. HGIM experienced financial distress due to depressed oil prices, which caused oil production and rig companies (an important source of HGIM's revenue) to cut back on the number of projects for which they utilized the debtors' services.

ATD entered into the restructuring support agreement with HGIM's equity sponsor and a broad base of lenders under its credit agreement. HGIM's completed solicitation of votes on the plan before filing chapter 11, where only holders of allowed claims on account of the credit agreement were entitled to vote on the plan. Holders of approximately 94% in number and 75.5% in dollar amount voted to accept the plan, excluding the votes of insiders. The plan was confirmed on May 23, 2018.

EE. *Parker Drilling Co., Case No. 18-36958 (MI) (Bankr. S.D. Tex. 2018); 85 Days.*

Parker Drilling Co., and its affiliated debtors (collectively, "Parker") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on December 12, 2018 in the United States Bankruptcy Court for the Southern District of Texas. Parker filed a prepackaged plan of reorganization and restructuring support agreement on the petition date. Parker is a leading provider of contract drilling and drilling-related services, as well as rental tools and equipment for exploration, production, and service companies in the Gulf of Mexico. Parker experienced financial distress due to a downturn in commodity prices.

Parker, and its Noteholders, Preferred Shareholders, and Common Shareholders entered into a restructuring support agreement on December 12, 2018. Pursuant to the restructuring agreement: (a) the Noteholders received a pro rata share of \$210 million of the New Second Lien Term Loan and 53.2% of the equity in the new company, (b) the Preferred Shareholders received 6% of the equity of the new company, and (c) the Common Shareholders received 9% of the equity in the new company. Solicitation commenced on January 23, 2019, and the voting deadline was February 22, 2019. All voting classes accepted the plan, and the plan was confirmed on March 7, 2019.

FF. *PetroQuest Energy Inc., Case No. 18-36322 (DRJ) (Bankr. S.D. Tex. 2018); 85 Days.*

PetroQuest Energy Inc., and its affiliated debtors (collectively, "PetroQuest") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on November 6, 2018 in the United States Bankruptcy Court for the Southern District of Texas. PetroQuest filed a prepackaged plan of reorganization and restructuring support agreement on the November 7, 2018. PetroQuest is a leading provider of contract drilling and drilling-related services, as well as rental tools and equipment for exploration, production, and service companies in the Gulf of Mexico. PetroQuest experienced financial distress due to a downturn in commodity prices.

PetroQuest, and its First Lien Lenders and Second Lien Lenders entered into a restructuring support agreement on December 6, 2018. Pursuant to the restructuring agreement, the First Lien

Lenders received payment of their claims in full, and the Second Lien Lenders received 100% equity in the new company and \$80 million of New Second Lien PIK Notes. Solicitation commenced on November 20, 2018, and the voting deadline was January 23, 2019. All voting classes accepted the plan, and the plan was confirmed on January 31, 2019.

GG. *In re Hexion Holdings LLC, Case No. 19-10684 (KG) (Bankr. D. Del. 2019); 85 Days.*

Hexion Holdings LLC and its affiliated debtors (“Hexion”) filed for chapter 11 relief on April 1, 2019 in the U.S. Bankruptcy Court for the District of Delaware. Hexion filed a pre-arranged plan of reorganization several weeks later, on April 24, 2019. Hexion, together with its non-debtor affiliates, are leaders in the field of thermoset resins which are used in a wide variety of industries, including forest products, architectural and industrial paints, packaging, consumer products, composites and automotive coatings. Hexion experienced financial distress due to liquidity constraints and impending maturities of approximately \$2.5 billion of secured debt.

Hexion entered into a restructuring support agreement with ad hoc groups of its first lien and 1.5 lien noteholders as well as an ad hoc crossover group of claimants with holdings across its capital structure representing approximately 70% of the debt to be restructured and which was centered on a rights offering of common shares in the reorganized debtor to deleverage its balance sheet. Solicitation commenced on May 24, 2019, with a voting deadline of June 19, 2019. The plan was accepted by both classes entitled to vote. The plan was amended twice, and was ultimately confirmed on June 25, 2019.

HH. *In re Patriot National, Inc., Case No. 18-10189 (KG) (Bankr. D. Del. 2018); 94 Days.*

Patriot National, Inc. and its affiliated debtors (collectively, “Patriot National”) filed for chapter 11 on January 30, 2018 in the U.S. Bankruptcy Court for the District of Delaware. Patriot National filed a pre-negotiated plan of reorganization with a restructuring support agreement on that date.

Patriot National (through its subsidiaries) provides comprehensive technology-enabled outsourcing solutions to insurance carriers, primarily in the workers’ compensation sector, to mitigate risk, comply with complex regulations, and save time and money. In November 2017, one of Patriot National’s most significant customers was placed into receivership in Florida, causing its cash payments to Patriot National to sharply fall off, depleting the Patriot National’s cash balances and operating capital.

Patriot National entered into the restructuring support agreement with the agents for its lenders, certain of the lenders themselves, and TCW Asset Management Co. LLC, which agreed to acquire Patriot National. After filing its initial plan of reorganization, Patriot National filed three amended plans in response to concerns raised by various parties in interest and echoed by the court. The fourth amended plan was confirmed on May 4, 2018.

II. *In re The Walking Co. Holdings Inc, Case No. 18-10474 (LSS) (Bankr. D. Del. 2018); 99 Days.*

The Walking Company Holdings, Inc. and its affiliated debtors (collectively, “Walking Company”) filed for chapter 11 on March 6, 2018 in the U.S. Bankruptcy Court for the District of Delaware. Walking Company filed a pre-negotiated plan of reorganization on that date, having already obtained support from key equity and creditor constituencies.

Walking Company is engaged in the design, manufacture, and sale of comfort footwear, graphic T-shirts, and casual sportswear and accessories. Walking Company underwent a restructuring in 2009 due to the general downturn in the 2008 recession. While Walking Company’s business improved significantly after the first reorganization, allowing it to expand and develop its business and brands, by 2017, Walking Company began to experience financial distress again due to the increasing power of internet retailers.

One of the key obstacles to the plan of reorganization was securing new equity commitments from current shareholders and financing from the Walking Company’s primary lender, Wells Fargo. The commitments were contingent on Walking Company conforming its lease portfolio to market rents, which required extensive negotiations with landlords. Walking Company’s management and advisers negotiated with the landlords postpetition and were eventually able to obtain required concessions. The First Amended Plan of Reorganization was confirmed on June 13, 2018.

**JJ. *In re Fallbrook Technologies Inc.*, Case No. 18-10384 (MFW) (Bankr. D. Del. 2018);
105 Days.**

Fallbrook Technologies Inc. and its affiliated debtors (collectively, “Fallbrook”) filed for chapter 11 protection on February 26, 2018 in the U.S. Bankruptcy Court for the District of Delaware. Fallbrook had entered a restructuring support agreement prior to the petition date, with the stated intention to file a pre-negotiated plan of reorganization shortly thereafter.

Fallbrook invented and patented mechanical technology that enhanced performance and improved efficiency in machinery, vehicles, and equipment. Fallbrook’s revenue streams were insufficient to satisfy their debt and operating expense obligations.

The prepetition restructuring support agreement was between Fallbrook and its most significant creditors (the holders of existing notes, the holders of claims against and other interests in the Fallbrook parties, and additional supporting creditors). Despite the significant support for the plan, the plan received two objections – a shareholder holding approximately 3.5% of Fallbrook’s prepetition equity challenged the value of Fallbrook’s interest in one of its non-debtor subsidiaries as well as the feasibility of the plan, and the IRS objected because Fallbrook did not yet file its 2017 tax returns. Fallbrook viewed the first objection as non-meritorious, and worked with the IRS to resolve the second objection. The First Amended Plan was confirmed on June 11, 2018.

**KK. *In re HCR ManorCare, Inc.*, Case No. 18-10467 (KG) (Bankr. D. Del. 2018);
109 Days.**

HCR ManorCare and its affiliated debtors (collectively, “HCR”) is a leading national healthcare provider that, through certain non-debtor providers, operates a network of more than

450 locations across the United States for long-term patient care at skilled nursing, inpatient rehabilitation and assisted living facilities, hospice care agencies, and outpatient rehabilitation clinics. HCR itself is a holding company with no material assets other than its ownership interests in its operating subsidiaries. HCR filed for chapter 11 on March 4, 2018 after facing liquidity constraints caused by an overall decline in the market for skilled nursing facility operators that left the company unable to meet rent obligations incurred as part of a 2011 sale-leaseback transaction with a publicly traded real estate investment trust.

HCR had initially filed a prepackaged plan (the “Original Plan”), pursuant to which 100% of the Reorganized HCR’s stock was to be transferred to Quality Care Products (“QCP”), the owner and lessor of approximately 98% of the company’s skilled nursing and assisted living facilities. Solicitation packages were distributed on March 3, 2018, with a voting deadline on the same day. The Original Plan was unanimously approved, and was confirmed at an uncontested hearing on April 13, 2018. The effective date of the Original Plan was conditioned on the closing of the Plan Sponsor Agreement between HCR and QCP, dated as of March 2, 2018.

Before any distributions were made under the Original Plan, HCR, QCP, and other parties entered into various agreements to effect an alternative transaction, pursuant to which Welltower, Inc. would acquire all outstanding stock of QCP under a merger agreement, and the Reorganized HCR would transfer 100% of its New Common Stock to an indirect subsidiary of non-profit ProMedica Health System, Inc. The alternative transaction would result in an 80-20 joint venture between Welltower and ProMedica to own and operate HCR’s business, with the joint venture owning the real estate, and ProMedica leasing the real estate from the joint venture. To support the alternative transaction, the parties executed an alternative plan support agreement, alternative restructuring support agreement, and an amendment to the original plan support agreement. Pursuant to the merger agreement between Welltower and QCP, QCP solicited proposals for higher bids, with one bidder offering a potentially superior offer.

To reflect the alternative transaction, HCR filed its amended plan (the “Amended Plan”). The Amended Plan created three voting classes, which were solicited on May 23, 2018, with a voting deadline of June 15, 2018. All three voting classes voted unanimously to approve the Amended Plan, and the Amended Plan was confirmed after an uncontested hearing on June 21, 2018. After the Amended Plan was confirmed, the additional bidder for QCP withdrew its offer to acquire the company.

On July 25, 2018, QCP’s shareholders voted to approve the merger, and the Amended Plan became effective on July 26, 2018. The bankruptcy case was closed on October 19, 2018.

**LL. *Westmoreland Coal Co., Case No. 18-35672 (DRJ) (Bankr. S.D. Tex. 2018);*
144 Days.**

Westmoreland Coal Co., and its affiliated debtors (collectively, “Westmoreland”) filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on October 9, 2018 in the United States Bankruptcy Court for the Southern District of Texas. Westmoreland filed a prepackaged plan of reorganization and restructuring support agreement on the petition date. Westmoreland is the sixth largest North American coal producer, and sells thermal coal to investment grade power plants, industrial customers, and barbeque charcoal manufacturers.

Westmoreland experienced financial distress due to a downturn in commodity demand and an increasing regulatory burden.

Westmoreland, and certain term loan lenders, certain holders of Senior Secured Notes, and three third-party lenders, entered into a restructuring support agreement on October 9, 2018. Pursuant to the restructuring agreement, a 363 sale of certain assets and mining operations would be made with the Senior Secured Notes and lenders as the stalking horse bidder, and all other assets would be marketed and sold. The auction took place on January 22, 2019. Solicitation commenced on December 23, 2018, and the voting deadline was January 25, 2019. All voting classes accepted the plan, and the plan was confirmed on December 18, 2018.

MM. *In re LBI Media Inc.*, Case No. 18-12655 (CSS) (Bankr. D. Del. 2018); 146 Days.

LBI Media Inc. and its affiliated debtors (“LBI”) filed for chapter 11 relief on November 21, 2018 in the U.S. Bankruptcy Court for the District of Delaware, and filed a joint pre-negotiated plan two days later on November 23, 2018. LBI is a national television and radio broadcasting company that runs primarily Spanish-speaking programs across its television and radio operations. Although LBI’s core businesses remained strong, it experienced financial distress due to substantial debt service obligations, changing consumer habits, and increased competition from the digital advertising industry.

Immediately prior to filing for bankruptcy, LBI entered into a restructuring support agreement with one of its secured lenders and its DIP lender, HPS Investment Partners, LLC (“HPS”), pursuant to which \$223 million of LBI’s first lien debt could be swapped for 95% of the reorganized equity. Solicitation on the plan began on February 4, 2019 with a voting deadline of March 4, 2019. The plan was rejected by the second lien notes claims and, with respect to certain debtors, ongoing trade claims and general unsecured claims, but was accepted by the first lien notes claims and, with respect to other debtors, ongoing trade claims, general unsecured claims. LBI’s plan was amended three times, with the third amended plan filed on April 12, 2019. LBI’s plan, which had the support of the creditors committee, drew a number of objections, including from certain second lien noteholders, challenging the plan as, among other things, impermissibly sanctioning a fraudulent transfer of value to HPS. The objections were withdrawn or overruled and the third amended plan was confirmed on April 17, 2019.

NN. *In re Maremont Corp.*, Case No. 19-10118 (LSS) (Bankr. D. Del. 2019); 114 Days.

Maremont Corporation and its debtor subsidiaries (“Maremont”) filed for chapter 11 relief on January 22, 2019 in the U.S. Bankruptcy Court for the District of Delaware, and filed a joint prepackaged plan of reorganization contemporaneously therewith. Maremont formerly manufactured, distributed, and sold aftermarket friction products, including aftermarket brake linings, disc pads, and clutch facings, as well as aftermarket muffler, aftermarket shock absorbers and strut assemblies, and original equipment vacuum actuators for automotive climate controls systems, supercharges and turbochargers, and gas springs, some of which contained asbestos. As a result of multiple sale transactions, as of the petition date, Maremont’s only ongoing operations consisted of their management of certain legal environmental and asbestos liabilities, as well as

owning and collecting rent on certain commercial property. Maremont filed for bankruptcy due to thousands of claims against it by personal injury plaintiffs alleging that Maremont is liable for damages caused by products containing asbestos.

Maremont did not enter into a restructuring support agreement, but did enter into a prepetition settlement with the Asbestos Claimants Committee and the Future Claimants' Representative that was embodied in the prepackaged plan. Solicitation began on December 4, 2018, with a voting deadline of January 18, 2019. The plan was unanimously approved by holders of Asbestos Personal Injury Claims, which comprised the only class of claims entitled to vote on the plan. The U.S. Trustee objected to the plan, primarily challenging the trust distribution procedures as not sufficiently transparent and likely to facilitate fraud. The trust distribution procedures were amended to require claimants to provide certain additional information to the trust, and the plan, with these modifications, was confirmed on May 17, 2019.

OO. *In re Gibson Brands Inc.*, Case No. 18-11025 (CSS) (Bankr. D. Del. 2018); 155 Days.

Gibson Brands, Inc. and certain of its subsidiary debtors (collectively, "Gibson") filed voluntary petitions under chapter 11 on May 1, 2018 in the United States Bankruptcy Court for the District of Delaware. Gibson filed as a prenegotiated case with a restructuring support agreement, and filed its initial plan on June 20, 2018. Gibson is one of the world's leading designers and manufacturers of guitars, guitar products, other fretted instruments, and accessories. Gibson began experiencing financial distress after a significant decline in its consumer electronics businesses, caused by credit restrictions and loss of credit insurance overseas along with unsustainable overhead costs of its consumer electronics business. After defaulting on its International Term Loan Agreement, the foreign non-debtor subsidiaries comprising the consumer electronics business entered liquidation proceedings, which themselves triggered cross-defaults on other debt facilities.

Gibson, an ad hoc group of noteholders owning approximately 69% of the principal amount of notes, and Gibson's majority shareholders entered into a restructuring support agreement that would result in a change of control of the musical instrument business. A number of objections to the initial plan were filed, including by the creditors committee, challenging, among other things, the proposed treatment of unsecured creditors (who were to receive a 0.2% recovery) and Gibson's lack of a prepetition marketing process. After months of negotiations, discovery, and the filing of an amended plan, Gibson eventually reached a global settlement with the plan objectors that raised recoveries for general unsecured creditors to between 5.1% to 10.8%, and provided a certain objecting creditor an allowed guaranty claim under the International Term Loan Agreement. Amended solicitation packages were distributed to classes impacted by the global settlement on September 14, 2018, with a voting deadline of September 27, 2018, with all voting classes voting to accept the amended plan. Gibson's Fifth Amended Joint Chapter 11 Plan of Reorganization was confirmed on October 3, 2018.

PP. *In re Claire's Stores Inc.*, Case No. 18-10584 (MFW) (Bankr. D. Del 2018); 186 Days.

Claire's Stores, Inc. and its affiliated debtors (collectively, "Claire's") filed for chapter 11 relief on March 19, 2018 in the U.S. Bankruptcy Court for the District of Delaware.

Concurrently with the filing, Claire's filed a restructuring support agreement with an ad hoc group of Claire's first lien lenders and its equity sponsor, Apollo Global Management, LLC.

Claire's was a girls' accessories and jewelry retailer, which experienced financial distress due to the highly competitive retail market and changing retail landscape. Claire's filed for chapter 11 bankruptcy protection to eliminate a substantial portion of debt. After the bankruptcy filing, Claire's majority second lien creditor, Oaktree Capital Management, challenged its plan, specifically taking aim at the propriety of corporate decision-making by claiming that Claire's restructuring was wrongly structured to benefit its equity sponsor, thus hurting its more senior stakeholders. Various other creditors, including BOK Finance NA, lodged challenges to various aspects of Claire's plan, claiming the plan discouraged alternative offers and restructuring proposals and improperly favored Claire's plan sponsor and first lien lender.

The objections to Claire's plan were ultimately resolved, and the plan was confirmed approximately six months after the case was filed on September 21, 2018.

QQ. *In re Cenveo Inc.*, Case No. 18-22178 (RDD) (Bankr. S.D.N.Y. 2018); 200 Days.

Cenveo, Inc. and its affiliated debtors (collectively, "Cenveo") filed for chapter 11 protection on February 2, 2018 in the U.S. Bankruptcy Court for the Southern District of New York. Cenveo entered into a restructuring support agreement prior to the petition date, but did not file a plan until two months later.

Cenveo is one of the largest North American printing and envelope companies, operating a streamlined "one-stop" shop for all envelop, label, and print-related services. Cenveo filed for chapter 11 relief due to persistent negative industry trends, an unsustainable capital structure, vendors' contraction of trade terms causing rapidly deteriorating liquidity, and customer reduction in exposure to Cenveo.

The restructuring support agreement was between Cenveo and an ad hoc first lien noteholder group holding more than half of their first lien debt. Despite this support, the Cenveo faced immediate opposition from Brigade Capital Management, its largest second lien holder who also held equity and a cross-over first lien positions. Brigade raised concerns about improper prepetition insider transactions, among other deficiencies.

After filing its initial plan on April 2, 2018, Cenveo submitted three amended plans of reorganization. The official committee of unsecured creditors objected to the first plan, claiming it was patently unconfirmable. The plan was eventually amended to address the objections and was ultimately confirmed on August 21, 2018.

RR. *In re iHeartMedia, Inc.*, Case No. 18-31274 (MI) (Bankr. S.D. Tex. 2018); 314 Days.

iHeartMedia, Inc. and its affiliated debtors (collectively, "iHeart") filed for chapter 11 protection on March 14, 2018 in the U.S. Bankruptcy Court for the Southern District of Texas. At the time of filing, iHeart had an "agreement in principle" on a restructuring transaction with

the support of a group of holders of more than \$10 billion of outstanding debt obligations and iHeart's equity sponsors. iHeart did not have a restructuring support agreement finalized as of the petition date.

iHeart is a diversified media, entertainment, and data company, owning and operating radio stations and other advertising-supported and consumer-focused platforms. The global downturn in 2008 resulted in a decline in advertising and marketing spending by iHeart's customers, leading to a decline in advertising revenues. After the economy recovered, iHeart's industry faced new competition from the internet and digital advertising industry and on-demand streaming services. As a result, iHeart needed to undergo a restructuring to right-size its balance sheet.

On March 16, 2018, shortly after the bankruptcy case was filed, iHeart entered into a restructuring support agreement with a group of creditors holding Term Loan Credit Facility Claims, PGN Claims, Legacy Notes Claims, and 2021 Notes Claims, and equity holders. iHeart proposed its initial plan of reorganization on April 28, 2018, and went through five amendments. The Official Committee of Unsecured Creditors, who tried to assert standing to bring causes of action relating to some \$13 billion in claims against the lenders asserting various causes of action, requested more information concerning the restructuring negotiations, and suggested the general unsecured creditors should be entitled to more than the projected recovery under the plan. These concerns were eventually resolved by Creditors Committee, Senior Creditors, and sponsors and resulted in improved recoveries for unsecured creditors under the plan. The Fifth Amended Plan of Reorganization was eventually confirmed on January 22, 2019.

III. 2019 Prepackaged and Prenegotiated Chapter 11 Cases to Watch

The following cases are prepackaged and renegotiated chapter 11 cases that had not yet confirmed plans of reorganization as of the date of this article.

1. *In Ditech Holding Corp.*, Case No. 19-10412 (JLG) (Bankr. S.D.N.Y 2019); confirmation pending.

Ditech Holding Corp, and its affiliated debtors (collectively, "Ditech") filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on February 11, 2019 in the United States Bankruptcy Court for the Southern District of New York. Ditech filed a prepackaged plan of reorganization and restructuring support agreement on the March 5, 2019. Ditech is an independent servicer and originator of mortgage loans and servicer of reverse mortgage loans for government-sponsored agencies, government agencies, third-party securitization trusts, and other credit owners. Ditech experienced financial distress due to liquidity and performance challenges, an overall decrease in total mortgage originations, an increase in interest rates, and increased regulatory burden.

Prepetition, Ditech had entered into a marketing process to explore value-enhancing transactions, including a sale of some or substantially all assets, a merger, or continuation as a standalone company. After the marketing process had begun, Ditech and an ad hoc group of term lenders entered into a restructuring support agreement on February 8, 2019. Pursuant to the restructuring agreement, the prepetition marketing process would continue, and any and all bids

would be evaluated as a precursor to confirmation of a plan. Under the RSA, at the end of the marketing process term loan lenders could elect to pursue a sale transaction, a reorganization transaction, or a hybrid of those transaction. After the marketing process ended, Ditech proposed to sell its forward mortgage business to stalking-horse bidder New Residential Investment Corp. for \$1 billion, and its reverse mortgage business to Mortgage Assets Management LLC for \$762 million, both “free and clear” of all legal claims. A mortgage customer committee objected on the bases that the “free and clear” provision would prevent homeowners from recovering mortgage overpayments from the buyers. Ditech, supported by term lenders and the UCC, argued that holders could still assert legal claims as defenses in mortgage suits under the plan and that a sale would be impossible if the “free and clear” provisions were struck. On August 28, 2019, the court denied the second plan of reorganization, on the basis that the plan was not in the best interest of the customers. This case is still ongoing.

2. *In re ONE Aviation Corp.*, Case No. 18-12309 (CSS) (Bankr. D. Del. 2018): (filed prepackaged chapter 11 case on October 9, 2018; subsequently filed a modified amended plan on March 1, 2019 and confirmation is still pending).
3. *Maxcom USA Telecom, Inc.*, Case No. 19-23489 (RDD) (Bankr. S.D.N.Y. 2019) (filed bankruptcy petition and prepackaged plan of reorganization on August 19, 2019; approval of disclosure statement and confirmation of plan of reorganization scheduled to be heard on September 17, 2019).
4. *Halcón Resources Corp.*, Case No. 19-34446 (DRJ) (Bankr. S.D. Tex. 2019) (filed bankruptcy petition and prepackaged plan of reorganization on August 7, 2019; approval of disclosure statement and confirmation of plan of reorganization to be heard on September 24, 2019).
5. *Stearns Holdings, LLC*, Case No. 19-12226 (SCC) (Bankr. S.D.N.Y. 2019) (filed bankruptcy petition and prepackaged plan of reorganization on July 9, 2019; disclosure statement was approved on August 22, 2019; confirmation of plan of reorganization to be heard on October 3, 2019).
6. *Weatherford International PLC*, Case No. 19-33694 (DRJ) (Bankr. S.D. Tex. 2019) (filed bankruptcy petition on July 1, 2019, and the prepackaged plan of reorganization was filed on July 2, 2019; approval of disclosure statement and confirmation of plan of reorganization scheduled to be heard on September 11, 2019).
7. *Aegerion Pharmaceuticals Inc.*, Case No. 19-11632 (MG) (Bankr. S.D.N.Y. 2019) (filed bankruptcy petition on May 20, 2019 and plan of reorganization on May 21, 2019; court approved disclosure statement on July 9, 2019; confirmation hearing will be held on September 5, 2019).
8. *Hollander Sleep Products, LLC*, Case No. 19-11608 (MEW) (Bankr. S.D.N.Y. 2019) (filed bankruptcy petition and plan of reorganization on May 19, 2019; subsequently filed an amended plan of reorganization on July 21, 2019; court approved debtors’ disclosure statement on July 25, 2019 and scheduled confirmation hearing for September 4, 2019).

9. *Elk Petroleum, Inc.*, Case No. 19-11157 (LSS) (Bankr. D. Del. 2019) (filed bankruptcy petition and plan of reorganization on May 22, 2019; approval of disclosure statement and confirmation of plan of reorganization scheduled to be heard on September 20, 2019).