AMERICAN BANKRUPTCY INSTITUTE

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Litigation Roundup

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"Litigation Roundup": Panel Overview & Materials

Overview

This panel will explore key bankruptcy litigation issues that are currently the subject of significant interest and debate, including (i) how bankruptcy courts address gerrymandering in the classification context and how such concerns may arise in connection with liability management transactions, (ii) how debtors may attempt to effect "backdoor" estate releases through a sale transaction, whereby the buyer of the assets acquire estate claims and causes of action, and whether such attempts invoke concerns of a sub rosa plan, and (iii) how the standard of adequate protection should be interpreted where a debtor is using cash collateral to maintain operations as a going concern, where the alternative is a potentially value-destructive Chapter 7. If there is sufficiently time, we will also address (iv) the jurisdictional split regarding whether the confirmation requirement of an impaired accepting class requires a "per plan" or a "per debtor" approach for a multi-debtor plan.

[Intro for speakers]

Classification and Gerrymandering

A foundational objective of Chapter 11 bankruptcy is to ensure an equitable distribution of the debtor's estate, such that creditors with equal priority are treated equally and receive pro rata recoveries. To confirm a Chapter 11 plan, the debtor must demonstrate compliance with Section 1123(a) of the Bankruptcy Code, which mandates that the plan must classify all claims and interests, and provide specific treatment for each impaired class. Section 1123(a)(4), in particular, requires that all claims within a single class receive the same treatment unless a claimant agrees to less favorable terms.

Classification rules are governed by Section 1122(a), which requires that only "substantially similar" claims may be placed in the same class. Courts have interpreted this to mean claims must be similar in legal nature or effect. Both the type of claim and the identity and interests of the creditor are relevant when determining whether claims are substantially similar. If creditors are motivated by different considerations or have divergent legal interests, courts often find their claims should not be placed in the same class. *See In re LightSquared Inc.*, 513 B.R. 56, 84–90 (Bankr. S.D.N.Y. 2014) (finding separate classification of certain claims "necessary and appropriate" where the claimants have disparate interests). Proper classification safeguards the integrity of the voting process and prevents manipulation by debtors attempting to gerrymander a consenting impaired class to achieve cramdown. *See In re U.S. Truck Co., Inc.*, 800 F.2d 581, 587 (6th Cir. 1986) (because one creditor has a "virtually unique interest" in the debtor's Chapter 11 cases, which "differ[s] substantially from those of the other impaired creditors," putting that creditor in the same class as the other impaired creditors "would be to allow it to prevent a court from considering confirmation of a plan that a significant group of creditors with similar interests have accepted").

Improper classification may become a concern when a debtor places an undersecured creditor's unsecured deficiency claim in the same class as general unsecured claims. Though both are technically unsecured, courts have debated whether they are substantially similar because the secured creditor's interests often diverge from those of general unsecured creditors. *Compare In re Waterways Barge P'ship*, 104 B.R. 776, 785–86 (Bankr. N.D. Miss. 1989) (denying separate classification of a secured creditor's unsecured claim in the amount of $5,000,000 and the claims of the two other unsecured creditors totaling only $13,000 and noting that "[t]o permit these two creditors to enjoy the same voting powers as [the secured creditor] defies the concepts of fairness and equity") *with In re Bos. Post Rd. Ltd. P'ship*, 21 F.3d 477, 483 (2d Cir. 1994) (the debtor's argument that its "future viability as a business depends on treating its trade creditors more favorably than [the secured creditor]" is not "a legitimate business reason for the separate classification").

Secured creditors may support a suboptimal recovery on their deficiency claims to protect favorable treatment on the secured portion of their claims. Because of these differing incentives, courts may require that deficiency claims be separately classified to avoid unfairly influencing the vote of general unsecured creditors. *See, e.g.*, *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213, 223 (Bankr. D.N.J. 2000) (finding that the debtors' separate classification of the unsecured deficiency portions of the noteholder's claims from an unsecured class is permissible where the classification "is offered in good faith, does not foster an abuse of the classification system, and promotes the rehabilitative goals of Chapter 11"). However, where the debtor improperly seeks to create separate classes of unsecured claims to manufacture an impaired consenting class, courts have found that separate classification is not warranted for a deficiency claim and other general unsecured claims. *See, e.g.*, *In re Lumber Exch. Bldg. Ltd. P'ship*, 968 F.2d 647, 650 (8th Cir. 1992) (finding that undersecured mortgagee's deficiency claim may not be classified separately from other unsecured claims, because "[c]lassifying [mortgagee's] unsecured claim separately is the only means by which [the debtor] could obtain the acceptance of one impaired class, because [mortgagee] would dominate the vote in any class in which it was placed.").

At the same time, however, when a secured creditor's deficiency claim is not separately classified, and that class votes to accept the plan, general unsecured creditors may be left without a meaningful opportunity to influence the outcome—particularly in cases where the unsecured class is impaired but receives little or no recovery. In such scenarios, the general unsecured class is effectively disenfranchised from raising objections about the absolute priority rule. Under Section 1129(b)(2)(B) of the Bankruptcy Code, the absolute priority rule bars a plan from being confirmed over the objection of an impaired class of unsecured creditors if junior classes—such as equity holders—are receiving or retaining any property under the plan. However, this rule only applies in the context of a non-consensual plan confirmation, *i.e.*, cramdown. If the deficiency claim class is deemed the accepting impaired class under Section 1129(a)(10), the debtor can avoid cramdown altogether, thereby sidestepping the absolute priority rule and confirming a plan that allocates all residual value to the secured class. This can result in a distribution scheme that leaves general unsecured creditors with no recovery, no priority-based objection, and only the "best interests" test under Section 1129(a)(7) as a procedural safeguard, which requires that any dissenting creditor in an impaired class must receive no less under the proposed Chapter 11 plan than it would have received in a hypothetical Chapter 7 liquidation. While separate classification of deficiency claims may be justified where secured creditors have divergent interests from other unsecured creditors, it can also be used strategically to neutralize general unsecured creditors and deny them the protections that Chapter 11 is designed to afford.

In the plan voting process, secured creditors can seek to benefit themselves at the expense of general unsecured creditors. The goal of general unsecured creditors is to maximize recoveries on account of their unsecured claims, but secured creditors may vote their deficiency claims to accept subpar recoveries to create an accepting unsecured class in order to protect expected recoveries on account of their secured claims. Moreover, prior to the plan confirmation process, secured creditors may have entered into a restructuring support agreement or similar arrangement with the debtor, which could entitle them to the reimbursement of advisor fees or an opportunity to provide additional financing under favorable terms, both of which are voting incentives that are unavailable to general unsecured creditors. Secured creditors may also agree to certain releases or be promised certain releases as a part of the restructuring support agreement or similar arrangement. In these instances, separate classification of a secured creditor's deficiency claim may be necessary to ensure the integrity of the plan voting process and prevent an attempt to gerrymander a consenting class.

Rule 3013 of the Bankruptcy Rules allows courts to determine claim classifications and is frequently cited as a mechanism to challenge improper gerrymandering. Although underutilized in recent years, Rule 3013 motions have been effective tools for creditors' committees, especially in cases where debtors reach agreements with secured lenders and classify deficiency claims in the same class as general unsecured claims, such as trade debt. Rule 3013 motions help ensure a fair vote and prevent estate resources from being wasted on plans that cannot be confirmed. *See In re Gulfport Energy Corp., et al.*, Case No. 20-35562 (DRJ) (Bankr. S.D. Tex. Feb. 16, 2021), ECF No. 770; *In re Seadrill Ltd., et al.*, Case No. 17-60079 (DRJ) (Bankr. S.D. Tex. Dec. 21, 2017), ECF No. 843.

Concerns about voting manipulation arise not only in traditional classification disputes, but also in restructuring strategies involving liability management transactions. Gerrymandering is often a concern for uptier transactions, such as *in In re Wesco Aircraft Holdings, Inc.* ("Wesco"), No. 23-90611 (Bankr. S.D. Tex.). In an uptier transaction, a borrower, typically with the support of majority lenders, amends financing agreements to permit the issuance of new senior debt, which the majority then funds and exchanges for their existing debt. This move effectively subordinates the non-participating minority lenders. These transactions often exploit amendment provisions that allow changes that benefit the majority over the minority. However, minority creditors have recently challenged such deals in court, asserting breach of contract and breach of the implied covenant of good faith and fair dealing.

In 2022, Wesco amended the terms of its 2026 notes indenture to authorize the issuance of $250 million in new, super-priority debt. The transaction was structured such that participating noteholders exchanged their existing debt for newly issued first-lien debt, effectively priming the collateral interests of the non-participating noteholders. The transaction was approved by a simple majority of existing noteholders pursuant to an amendment mechanism in the notes indenture, and was executed without notice to or consent from the minority noteholders.

In a significant bench ruling issued in July 2024, Judge Isgur held that the transaction violated the indenture's collateral protection provisions, which required consent from two-thirds of the holders before liens could be released or modified. He rejected the debtor's argument that the transaction complied with the indenture's technical amendment procedures, reasoning instead that the maneuver constituted an indirect stripping of liens without proper authorization. He described the transaction as a "domino" sequence: the initial amendments merely appeared to authorize the transaction, but in substance, they enabled the participating creditors to reach their intended objective, leaving the non-participants with subordinated claims and diluted lien rights. Judge Isgur found that this structure breached both the express terms of the indenture and the implied covenant of good faith and fair dealing. He ordered that the priming liens granted to the super-senior facility be avoided and that the liens of noteholders who did not participate in the exchange be restored. The decision emphasized that formal adherence to amendment mechanisms cannot be used to override fundamental creditor protections built into debt instruments.

Judge Isgur's ruling bears on classification concerns in the Chapter 11 context. Much like the priming transaction in Wesco, improper classification of creditors—such as grouping a secured creditor's deficiency claim with general unsecured creditors—can result in the same form of structural subordination and inequitable treatment. When a debtor places a secured creditor's deficiency claim into a general unsecured class, it can distort the voting process, allowing the debtor to confirm a plan that disproportionately favors the secured creditor—particularly if that creditor has struck side deals or is receiving other forms of value outside the plan. This risks disenfranchising the remaining general unsecured creditors, much like minority lenders in an uptier transaction, and underscores why separate classification may be warranted to protect the integrity of the plan voting process.

Wesco reaffirms that bankruptcy courts will scrutinize transactional structures—whether through prepetition exchanges or in-plan classifications—that have the effect of redistributing estate value to select creditors at the expense of others, especially where such strategies rely on procedural technicalities rather than substantive fairness. In the Chapter 11 proceedings of Revlon, Inc. ("Revlon"), (Case No. 22-10760, Bankr. S.D.N.Y.), creditors contested a dropdown transaction executed by Revlon, in which the company transferred valuable intellectual property (IP) assets to unrestricted subsidiaries, thereby enabling it to secure new financing backed by these assets, effectively placing them beyond the reach of existing lenders under its term loan agreement. In the beginning, when Revlon first sought to amend its term loan agreement to transfer valuable IP collateral to unrestricted subsidiaries, it had lacked the required majority lender support. To gain approval, Revlon issued millions in new revolving loans to friendly lenders who had supported the transfer, and those lenders then purportedly became the new majority by voting the revolving loans in the same class as the term loans. With their support, Revlon completed the IP transfer and entered into new credit facilities secured by the IP. At the same time, Revlon exchanged the supporting lenders' debt into the new credit facilities and used loan proceeds to repay the revolver. After Revlon filed for bankruptcy in 2022, the non-participating lenders contested this transaction, alleging it violated their rights under the original term loan agreement.

Claims that arise from these majority-controlled transactions are not a new phenomenon and often parallel the reasoning in *Hackettstown Nat'l Bank v. D.G. Yuengling Brewing Co.*, 74 F. 110 (2d Cir. 1896), an early Second Circuit case addressing the duties of majority security holders to minority holders. In *Hackettstown*, minority bondholders sued to overturn an amendment that extended the maturity date of corporate bonds. Although the amendment was approved by a 75% majority, as permitted by the bond terms, the court found troubling facts: the majority position was amassed by the owner's brother-in-law, the owner privately guaranteed full repayment to him under the new terms, and the two allegedly conspired to drive down the bonds' value for minority holders. While the district court upheld the amendment based on the contractual language, the Second Circuit reversed, emphasizing that majority bondholders owe a duty of good faith to minority holders and remanded for a factual inquiry into whether the amendment was made in bad faith. The court underscored that in joint financial arrangements, all parties have mutual obligations rooted in good faith.

These cases illustrate that classification disputes and liability management transactions often raise similar concerns: the risk that debtors and majority lenders may use procedural mechanisms to redistribute estate value at the expense of disfavored creditors. Whether through the grouping of economically dissimilar claims to influence plan voting or through prepetition restructurings like uptier and dropdown transactions, the underlying issue is the erosion of equitable treatment among creditors of the same priority. Courts have increasingly looked beyond formal compliance with technical provisions to assess whether such strategies undermine the fundamental protections and goals of Chapter 11.

"Backdoor" Releases/Sub Rosa Plan

Section 363 of the Bankruptcy Code allows a debtor, after notice and a hearing, to use, sell, or lease property of the estate outside the ordinary course of business. However, courts have consistently held that a sale under Section 363 cannot be used to implement or dictate the terms of a reorganization plan without undergoing the formal plan confirmation process. For a plan to be confirmed, the debtor, as the plan proponent, must show that its proposed plan has satisfied each of the requirements under Section 1129(a) of the Bankruptcy Code, including Section 1129(a)(1), which requires the plan's compliance with all "applicable Sections" of the Bankruptcy Code. A proposed sale transaction that attempts to bypass the requirements of Section 1129(a) is considered an impermissible sub rosa plan—a de facto plan of reorganization disguised as a simple asset sale.

The concern with sub rosa plans is that they circumvent the procedural safeguards built into the Chapter 11 plan confirmation process as required by Section 1129(a). These safeguards include full disclosure, the right of creditors to vote on the plan, and a formal confirmation hearing with notice to all parties in interest. Although a Section 363 sale requires court approval and allows for creditor objections, it does not include these heightened protections. Therefore, if a proposed Section 363(b) sale would effectively lock in or dictate the terms of a future plan of reorganization, it should not be approved.

A Section 363 sale that transfers unencumbered litigation claims—such as potential causes of action belonging to the estate that are not subject to any secured creditor's lien—to a purchaser can raise serious concerns under the sub rosa plan doctrine. These claims, which would otherwise represent potential value for unsecured creditors, effectively become part of the purchase consideration without any direct recovery or allocation to those creditors. By including such unencumbered assets in the sale without compensating the estate or channeling proceeds to the unsecured class, the debtor may be effectuating an improper release of estate claims. This amounts to implementing a material term of a Chapter 11 plan—namely, the resolution of estate claims—without complying with the plan confirmation process. In doing so, the sale deprives unsecured creditors of their right to share in that value, and sidesteps the disclosure, voting, and approval requirements that are meant to protect their interests. Such a structure risks converting a sale into an impermissible sub rosa plan.

In the 2024 Chapter 11 case of Big Lots, Inc. ("Big Lots"), Case No. 24-11967 (Bankr. D. Del.), the debtors sought approval of a Section 363 sale of substantially all assets to an affiliate of Nexus Capital Management ("Nexus"). Included in the negotiated Stalking Horse Asset Purchase Agreement ("Big Lots APA") was a provision that purported to transfer "all rights, claims, accounts, and causes of action" of the debtors and their subsidiaries against any third parties—including former directors, officers, shareholders, affiliates, vendors, and secured lenders. This sweeping provision, which became known as the "backdoor release" provision by parties who objected to the proposed sale, effectively operated as a non-consensual release of estate claims outside the plan process, without the procedural protections afforded by Section 1129 of the Bankruptcy Code.

The Official Committee of Unsecured Creditors and Blue Owl Real Estate Capital LLC each filed objections, arguing that the Big Lots APA's broad transfer of estate claims violated limitations on the use of Section 363. *See In re Big Lots, Inc.*, Case No. 24-11967, ECF Nos. 981, 992. The objecting parties argued that courts have long held that a sale under Section 363(b) must serve a sound business purpose and not be used to restructure the rights of stakeholders outside of the plan confirmation process. *See In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 149–50 (3d Cir. 1986). Where a proposed transaction has the effect of releasing or extinguishing claims against insiders or creditors without creditor consent or plan confirmation, it constitutes an impermissible sub rosa plan. *See In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983) ("The debtor and the bankruptcy court should not be able 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").

The objecting parties emphasized that the backdoor release provision extended far beyond the sale of operational assets or contract-based rights. It included blanket transfers of claims that had no relevance to the go-forward business and were not tied to any assumed liabilities or customer relationships. Critically, the Big Lots APA did not assign value to these litigation assets, and discovery confirmed that Nexus had not negotiated for the claims and had no intention of pursuing them. The absence of a business justification or any associated consideration rendered the proposed transfer of claims improper under Section 363. As the court in *In re Delaware & Hudson Ry. Co.*, 124 B.R. 169, 176 (D. Del. 1991) observed, even if a sale includes intangible assets like claims, the debtor must still demonstrate that the transfer is supported by a sound business purpose and that fair value is being provided to the estate.

Further, the objecting parties argued that the proposed sale order authorized the immediate distribution of virtually all cash proceeds from the sale to the debtor's prepetition and debtor-in-possession (DIP) financing lenders. This was in direct tension with the final DIP order, which had established a challenge period allowing the creditors' committee and other parties-in-interest to investigate and, if warranted, contest the validity, priority, or extent of the lenders' claims. The objecting parties asserted that, at the time of the filing of the objections, they were actively conducting investigations into potential estate claims against the secured parties. Authorizing a full paydown of the lenders—who were potential litigation targets—before the challenge period expired would effectively moot any successful challenge and require complex post-closing recovery efforts, undermining the purpose of the challenge period and the protections it was designed to provide.

In response to these objections and the factual revelations obtained through discovery, the debtors amended the Big Lots APA shortly before the sale hearing to carve out claims against former directors, officers, and employees who would not be retained by Nexus. The bankruptcy court approved the revised sale, concluding that there was no sound business reason for transferring claims against non-retained insiders and that such a transfer would not be appropriate under the standards of Section 363. The court's ruling aligns with decisions that emphasize the importance of maintaining the integrity of the plan confirmation process and preventing debtors from using sales to confer improper releases. *See In re Cont'l Airlines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986) (sub rosa plans are "per se invalid because they bypass Chapter 11's plan confirmation requirements").

The Big Lots case highlights the legal risks associated with overbroad claim transfers in 363 sales and serves as an example of how debtors may attempt to embed substantive plan terms—such as third-party releases—into sale documents. When such transfers occur without valuation, business justification, or creditor consent, they circumvent the protections of disclosure, voting, and confirmation, and violate the fundamental purpose of Chapter 11 to preserve estate value for the benefit of all stakeholders in accordance with the Bankruptcy Code.

While the issue of backdoor releases most commonly arises in the context of Section 363 asset sales, courts have recognized that DIP financing arrangements can also operate as plans of reorganization when they dictate the outcome of the case. For example, when DIP loans are conditioned on granting liens over unencumbered estate assets or include terms that preordain the structure of a subsequent sale or plan, they can have the effect of locking in a particular result without creditor consent or judicial findings under Section 1129 of the Bankruptcy Code.

In the Chapter 11 case of Mondee Holdings, Inc. ("Mondee"), Case No. 25-10047 (Bankr. D. Del.), the debtors proposed a DIP financing and credit bid structure that would transfer substantially all estate assets—including valuable, unencumbered litigation claims against insiders—to a stalking horse buyer backed by the debtors' prepetition secured lenders and their former CEO, Prasad Gundumogula. The proposed structure included a $191 million credit bid that would sweep estate assets, including claims against insiders, in exchange for debt forgiveness rather than new value. Notably, the claims against insiders were not subject to the lenders' prepetition liens and could not be foreclosed upon outside bankruptcy. Yet, through the DIP financing and the proposed Stalking Horse Asset Purchase Agreement ("Mondee APA"), the debtors sought to grant liens on those claims and ultimately transfer them via sale—an arrangement that objecting creditors characterized as a backdoor release scheme and an impermissible sub rosa plan.

Tuesday Investor LP ("Tuesday"), preferred equity holder of the debtors, filed an objection to the DIP motion and attacked the improper inclusion of claims against insiders within both the DIP collateral and the assets to be sold, which would include potential litigation against Gundumogula, who was under SEC investigation for insider trading and market manipulation. *See In re Mondee Holdings, Inc.*, Case No. 25-10047, ECF No. 104. Tuesday argued, as an initial matter, that as of the petition date of the debtors' bankruptcy cases, these claims were not part of the secured lenders' collateral package, and under Section 363(k) of the Bankruptcy Code, a credit bid may only apply to assets subject to a valid and perfected lien. Citing *In re The Free Lance-Star Publ'g Co. of Fredericksburg, VA*, 512 B.R. 798, 806 (Bankr. E.D. Va. 2014), Tuesday argued that permitting a credit bid on unencumbered claims against insiders would effectuate a de facto release of litigation rights without the proper plan confirmation and creditor voting requirements.

Tuesday further argued that granting liens on these unencumbered claims would artificially enhance the secured lenders' position in bankruptcy—an outcome contrary to the principle that bankruptcy should not improve a creditor's position relative to state law. *See White v. Stump*, 266 U.S. 310 (1924); *Everett v. Judson*, 228 U.S. 474 (1913). Tuesday's objection emphasized that avoidance actions and commercial tort claims, including Chapter 5 avoidance actions, are statutorily reserved for the benefit of the estate and its creditors and cannot be pledged as collateral for DIP financing without clear statutory authority. *See In re Cybergenics Corp.*, 226 F.3d 237, 243–44 (3d Cir. 2000); *In re Integrated Testing Prod. Corp.*, 69 B.R. 901 (D.N.J. 1987).

Because the claims against insiders were also included in the definition of "Purchased Assets" under the Mondee APA, Tuesday asserted that the sale process would culminate in an impermissible release of valuable litigation rights without independent valuation or disclosure. This risk was particularly acute given the proposed purchaser's ownership structure—75% equity would be held by Gundumogula himself, despite his status as a potential litigation target. Tuesday noted that the Mondee debtors had already filed a plan that assumed consummation of the stalking horse sale transaction and left nothing for unsecured creditors or preferred shareholders, underscoring the argument that the proposed sale was effectively a sub rosa plan. *See In re Energy Future Holdings Corp.*, 648 F. App'x 277, 284–85 (3d Cir. 2016); *In re Capmark Fin. Grp., Inc.*, 438 B.R. 471, 513 (Bankr. D. Del. 2010).

In light of these concerns, Tuesday requested that the court deny approval of the DIP motion and bid procedures to the extent they sought to encumber or sell insider claims. Alternatively, it proposed modifying the DIP order to ensure that any DIP liens on insider claims would be limited to the portion of DIP financing actually provided postpetition (*i.e.*, new money only) and subject to equitable marshalling principles. Tuesday also argued that the entire sale was ultra vires, as it violated the debtor's certificate of designation by proceeding without the consent of the preferred majority holders, whose approval was contractually required for actions such as the sale of substantially all assets or any transaction involving Gundumogula. As with Big Lots, the Mondee case illustrates the risks of embedding plan-like terms—especially claim releases—in the sale and financing context, bypassing the safeguards of Chapter 11's confirmation process.

Use of Cash Collateral and Adequate Protection

In a Chapter 11 bankruptcy, a debtor is generally allowed to continue using a secured creditor's collateral, including physical assets like equipment or real estate, even if the loan is in default. When the collateral is "cash collateral"—such as bank deposits or receivables—the debtor must obtain the creditor's consent or bankruptcy court approval, which often occurs through an emergency "first day" motion. If the creditor and debtor can't reach an agreement, the court will hold a contested hearing where the debtor must demonstrate that the creditor will receive "adequate protection" for any potential loss in value resulting from the use of its collateral, as required by Section 361 of the Bankruptcy Code.

Adequate protection can take several forms under Section 361, such as periodic payments, post-petition interest, or replacement liens on new assets. For instance, secured creditor would often be granted a replacement lien on postpetition receivables when prepetition receivables are used. If a lender is significantly oversecured (*i.e.*, the value of the collateral greatly exceeds the debt), that the existence of equity cushion may itself constitute adequate protection. Courts have almost uniformly held that (i) an equity cushion of 20% or more constitutes adequate protection and (ii) an equity cushion under 11% is insufficient to constitute adequate protection. Courts are divided on whether an equity cushion of 12% to 20% constitutes adequate protection. *See In re James River Assocs.*, 148 B.R. 790, 796 (E.D. Va. 1992).

It is generally recognized that collateral may decline in value during the bankruptcy cases for reasons such as market volatility or wear and tear from continued use. Since creditors are usually barred from foreclosing during the case due to the automatic stay, they can request court intervention under Section 363(e) or Section 362(d)(1) to obtain adequate protection or relief from the automatic stay. The creditor must prove actual postpetition value loss, and mere delay or inconvenience caused by the automatic stay does not justify compensation. Courts have typically found that lenders are adequately protected where the creditor remains substantially oversecured, though as the collateral value approaches the debt amount, a claim for protection becomes more viable.

In the 2024 Chapter 11 cases of Fisker, Inc. ("Fisker"), Case No. 24-11390 (Bankr. D. Del.), an electric vehicle manufacturer, and its affiliated debtors, the concept of what constitutes adequate protection was debated in the context of a contested Chapter 7 conversion. The debtors' secured lender filed a motion to convert the cases to Chapter 7, arguing that main reason for the conversion was the substantial incremental administrative expenses of the Chapter 11 case, which were depleting the estate. *See In re Fisker, Inc.*, Case No. 24-11390, ECF No. 238. The lender argued that the debtors had no access to cash without the lender's consent to the use of its cash collateral and therefore were unable to remain in Chapter 11 without its support, because the debtors had no conceivable ability to adequately protect the lender if they sought to use the cash non-consensually. Specifically, the lender pointed to the fact that the debtors were liquidating and generating cash solely from the sale of its remaining assets, and not from ongoing business operations.

In response, the Fisker debtors contended that the lender was indeed adequately protected under Section 363(e) of the Bankruptcy Code, which mandates protection of a secured party's interest from any decline in value resulting from the debtor's use of collateral. *See In re Fisker, Inc.*, Case No. 24-11390, ECF No. 304. The Fisker debtors argued that adequate protection was meant to preserve the creditor's position as of the bankruptcy filing, not to not to confer an affirmative benefit. *See In re Swedeland Dev. Grp., Inc.*, 16 F.3d 552, 564 (3d Cir. 1994). In other words, stable collateral value negates the need for further protection. *See In re Phila. Consumer Disc. Co.*, 37 B.R. 946, 949 (E.D. Pa. 1984). Thus, if the collateral's value is not projected to decline, courts generally find no justification for imposing new protections.

The debtors argued there is no evidence of diminution in the value of the lender's collateral here, which mainly consisted of electric vehicles that were subject to a sale whose value was fixed at the highest and best price pursuant to the sales agreement. Further, the debtors argued that the debtors' cash balance had increased post-petition, and that there was no indication that other key assets—such as intellectual property, tooling, or receivables—had declined in value. Agreeing that the debtors were no longer operating and were using cash collateral solely to implement the sales agreement and monetize remaining assets, the debtors argued that their efforts are expected to incur lower costs than a Chapter 7 liquidation and aim to maximize value for all stakeholders, especially the lender. To support its point, the debtors argued that the lenders' interest in the collateral, consisting of the sale vehicles, has actually improved post-petition due to the debtors' ability to realize sale proceeds through the sales agreement, and these actions should provide adequate protection against any potential decline in the vehicles' collateral value.

Moreover, the Fisker debtors cited multiple cases for the position that not every use of cash collateral constitutes a per se diminution in the value of the collateral. In *In re Megan-Racine Associates, Inc.*, the court emphasized that the critical factor in evaluating adequate protection is the anticipated stability of the collateral's future value. 202 B.R. 660, 663 (Bankr. N.D.N.Y. 1996). This analysis focuses on whether the asset is likely to deteriorate during the bankruptcy process, rather than whether it is merely being used by the debtor. Additionally, courts have clarified that the use of cash collateral does not automatically equate to a reduction in the value of a secured party's interest. In *In re Residential Capital, LLC*, the court noted that certain administrative expenses, such as those incurred to maintain operations or conduct an orderly liquidation, do not amount to a diminution in collateral value. 497 B.R. 403, 420 (Bankr. S.D.N.Y. 2013). These expenses can help preserve or increase the overall value of the estate. This reasoning was further affirmed in *In re Sears Holdings Corp.*, where the court held that liquidation-related costs should not be considered a loss to secured creditors because those costs were necessary to preserve and realize the value of the collateral in an orderly manner. 621 B.R. 563, 575 (S.D.N.Y. 2020). Accordingly, courts distinguish between expenditures that deplete collateral and those that support the estate's value, concluding that the latter do not trigger a need for additional protection.

To the extent the lender's collateral did decline in value, the Fisker debtors argued that they had proposed comprehensive adequate protection measures in their cash collateral motion, including replacement liens, superpriority administrative claims, and the accrual of postpetition interest and fees, which mirror those agreed to by the lender in earlier interim cash collateral orders. As supported by *In re Beker Indus. Corp.*, 58 B.R. 725, 741 (Bankr. S.D.N.Y. 1986), the standard is "adequate protection," not absolute protection. The debtors argued that the lender's objections were inconsistent with its prior approvals of nearly identical protections and were therefore unpersuasive. The conversion motion was ultimately resolved through a consensual settlement incorporated into the debtors' plan of liquidation.

These cases cited by the *Fisker* debtors collectively reinforce that adequate protection is a flexible, context-specific standard that is not limited to the presence or absence of an equity cushion. A debtor's use of collateral—particularly cash collateral—does not inherently result in diminution of value. In fact, where the debtor uses that collateral to conduct an orderly liquidation, fund a value-maximizing sale, or preserve business operations in a manner that protects or enhances the secured creditor's position, these are grounds for courts to find that such use can itself satisfy the adequate protection requirement. As the Third Circuit observed in *Swedeland Dev. Grp.*, 16 F.3d at 564, adequate protection is intended to preserve—not improve—a secured creditor's position. Thus, when a debtor can demonstrate that its use of collateral will stabilize or maximize estate value, such use may be consistent with fulfilling the statutory mandate of adequate protection.

<u>Per Plan/Per Debtor Approach to Confirmation</u>

Section 1129(a)(10) of the Bankruptcy Code requires that for any Chapter 11 plan involving an impaired class of creditors, at least one such class must vote to accept the plan, excluding votes cast by insiders. This requirement is often called the "statutory gatekeeper" to cramdown and must be satisfied whether the plan is confirmed consensually or non-consensually under the standards of Section 1129(b). While simple to apply in single-debtor cases, this requirement becomes more complicated in multi-debtor Chapter 11 cases when a joint plan is proposed for the affiliated debtors.

A key issue is whether Section 1129(a)(10) must be satisfied on a "per debtor" basis or a "per plan" basis. The "per debtor" approach requires that each debtor included in a joint plan must have at least one impaired class that votes to accept the plan. By contrast, the "per plan" approach holds that only one impaired class in the joint plan needs to vote in favor, regardless of which debtor the class holds claims against.

Bankruptcy courts in the District of Delaware and the Middle District of Florida have adopted the "per debtor" approach. See *In re Tribune Co.*, 464 B.R. 126, 182–83 (Bankr. D. Del. 2011), *on reconsideration in part*, 464 B.R. 208 (Bankr. D. Del. 2011), *aff'd*, 587 B.R. 606 (D. Del. 2018), *aff'd*, 972 F.3d 228 (3d Cir. 2020); *In re Consol. Land Holdings, LLC*, 2021 WL 3701799, *6 (Bankr. M.D. Fla. 2021). In *Tribune*, the bankruptcy court reasoned that the reference to "plan" in Section 1129(a)(10) was not sufficient to justify disregarding debtor separateness in joint plans. Citing Section 102(7) of the Code, which states that the singular includes the plural, the court held that "plan" should be understood to mean "plans" in the context of multi-debtor cases.

The *Tribune* court underscored the importance of maintaining legal separateness in the absence of substantive consolidation and acknowledged that large Chapter 11 cases often involve joint administration for practical reasons, and that joint plans are frequently filed to streamline distributions. However, the court stressed that such convenience cannot override the confirmation rights of impaired creditor classes. *See Tribune*, 464 B.R. at 182 ("[I]n the absence of substantive consolidation, entity separateness is fundamental.").

In contrast, courts in other jurisdictions have endorsed the "per plan" approach. The U.S. Court of Appeals for the Ninth Circuit adopted this interpretation in *Grasslawn Lodging, LLC v. Transwest Resort Properties, Inc. (In re Transwest Resort Properties, Inc.)*, 881 F.3d 724 (9th Cir. 2018). There, the court held that Section 1129(a)(10) does not distinguish between single-debtor and multi-debtor plans. It reasoned that the plain language of the statute requires only that one impaired class vote in favor of "the plan," without reference to the number of debtors involved. *Id.* at 729. Accordingly, the court concluded that a joint plan meets the statutory requirement so long as any single impaired class accepts it. *Id.* at 730.

The *Transwest* court also rejected the argument that this interpretation effectively imposed a form of *de facto* substantive consolidation, which could harm certain creditors—particularly mezzanine lenders who structure deals based on the separateness of borrower entities. The court noted that such concerns are more appropriate for legislative resolution than judicial interpretation. *Id.* at 730.

Several other bankruptcy courts have adopted similar reasoning, applying a "per plan" analysis. *See In re NESV Ice, LLC*, No. 21-11226-CJP, 2023 WL 2278603, *at *19* (Bankr. D. Mass. Feb. 28, 2023); *In re Station Casinos, Inc.*, No. 09-52477-GWZ, 2010 WL 11492265, at *23 (Bankr. D. Nev. Apr. 9, 2010); *JPMorgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009); *In re SGPA, Inc.*, Case No. 1-01-02609, 2001 WL 34750646, at *7 (Bankr. M.D. Pa. Sept. 8, 2001).

Please see below for a chart summarizing the current jurisdictional split on this issue:

Per Plan Jurisdictions	**Per Debtor Jurisdictions**
Ninth Circuit	District of Delaware
District of Massachusetts	Middle District Florida
Southern District of New York	
District of Nebraska Middle District of Pennsylvania	

Faculty

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Stephan E. Hornung is a partner with Morgan, Lewis & Bockius LLP New York, where he represents financial institutions and other creditors in state, federal and bankruptcy courts across the U.S. He has a deep background in complex litigation involving the enforcement of creditors' rights, state and federal court receiverships, and chapter 7 and chapter 11 proceedings. Mr. Hornung defends claims asserted by borrowers, investors, bankruptcy trustees and litigation trustees, including claims for "lender liability," breach of contract and fraudulent transfer and other avoidance actions. He also regularly represents financial institutions in connection with nonjudicial foreclosures, UCC sales, and out-of-court workouts and restructurings. Mr. Hornung represents clients in matters across numerous industries, including financial services, entertainment, real estate, energy, hospitality, health care, aviation, hemp processing and precious metals. Prior to joining Morgan Lewis, he was a partner in another national law firm's bankruptcy and restructuring and litigation practice groups, and before that, he was a partner at a boutique creditors' rights firm in New York City. Mr. Hornung received his B.A. in 2003 from Colgate University and his J.D. *cum laude* in 2007 from St. John's University School of Law.

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Syncora Guarantee in Jefferson County, Ala.'s chapter 9 case and currently leads the firm's engagement for an ad hoc group of COFINA bondholders stemming from Puerto Rico's financial crisis. In connection with the Puerto Rico matter, Mr. Kirpalani testified before Congress regarding the fairness of the restructuring title of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA). He received his J.D. from Fordham University School of Law, where he served as associate editor of the *Fordham Law Review* from 1993-94.

Douglas Mannal is a partner in the Business Restructuring + Insolvency Group of Morrison & Foerster LLP in New York, where he focuses his practice on representing clients in chapter 11 bankruptcy cases, out-of-court restructurings and other distressed situations. His clients include official creditors' committees, ad hoc creditor groups and individual asset managers, as well as corporate borrowers. On behalf of creditors, Mr. Mannal implements strategies focused on maximizing creditor recoveries, and he has experience proposing and confirming plans of reorganization, investigating and prosecuting various estate causes of action, negotiating intercreditor disputes, crafting cash-collateral orders, debtor-in-possession/exit financing packages and creditor-sponsored equity rights offerings, challenging confirmation of nonconsensual chapter 11 plans, terminating exclusivity, participating in § 363 sales, and implementing and defending against coercive liability management transactions. On the company side, he counsels borrowers navigating the complex legal, financial and operational issues that arise in distressed situations, implementing both in- and out-of-court restructurings aimed at preserving value. Mr. Mannal has been recognized since 2013 in *Chambers USA*, and *Turnarounds & Workouts* recognized him as an Outstanding Restructuring Lawyer in 2020 and 2017. He also has been recognized as a Leading Global Restructuring Lawyer by *Lawdragon 500*. Mr. Mannal received his B.A. in government and law in 1995 from Lafayette College and his J.D. from Brooklyn Law School in 2000.

Hon. Jil Mazer-Marino is a U.S. Bankruptcy Judge for the Eastern District of New York in Brooklyn, sworn in on Oct. 23, 2020. She previously was a partner at Cullen and Dykman LLP's Bankruptcy and Creditors' rights department, where her practice was nearly entirely bankruptcy-focused. Judge Mazer-Marino has chapter 11 experience representing debtors, creditors and creditor committees in chapter 11 business reorganizations. She also served as a chapter 7 panel trustee for the Southern District of New York for 10 years. Before joining Cullen and Dykman in 2019, Judge Mazer-Marino practiced with Meyer, Suozzi, English & Klein, P.C. from 2008-19, Rosen Slome Marder LLP from 2003-08 and Willkie Farr & Gallagher LLP from 1991-99. She also clerked for former EDNY Chief Bankruptcy Judge Conrad B. Duberstein. Judge Mazer-Marino served as secretary for the Bankruptcy & Corporate Reorganization Committee for the New York City Bar Association, and she is a founder and past president of the Women's Division of the of the New York Institute of Credit. She received her undergraduate degree from the State University of New York at Albany and her J.D. from St. John's University School of Law.

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David W. Prager, CFA is a principal at The Brattle Group, Inc. in New York and is experienced in complex financial restructurings and corporate valuation disputes, including more than 20 years of experience focusing on complex commercial disputes. He has served as a consulting expert, advisory and testifying witness in numerous bankruptcy and restructuring matters, fraudulent conveyance actions, corporate value and solvency disputes, and forensic and trading investigations. In bankruptcy disputes, Mr. Prager has provided valuations of varied assets and evaluated value allocations, the fairness of reorganization plans and the reasonableness of projections. His engagements include the contentious bankruptcies of Enron, Lehman Brothers, Patriot Coal, Adelphia, Tribune and many others. As a financial advisor, Mr. Prager has worked with both debtors and creditors in various high-profile corporate and municipal restructurings, including Archegos, Toys "R" Us, Energy Future Holdings, the Commonwealth of Puerto Rico and the City of Detroit. He has negotiated reorganization plans, investigated causes of action, and provided financial restructuring advice. In company-side restructurings, he has also held C-suite positions, including as the CEO of The PMI Group and CFO of Syncora Guarantee. Prior to joining Brattle, Mr. Prager was a managing director at a global financial and risk advisory firm. He previously worked at a leading financial advisory firm, where he focused on restructuring advisory and complex financial litigations. Mr. Prager is a member of ABI, the CFA Institute and the CFA Society of New York. He received his B.S. in 1996 from the University of Pennsylvania Wharton School of Business.

Carl N. Wedoff is a partner at Jenner & Block in New York. He advises clients on issues arising in corporate restructuring and bankruptcy. Mr. Wedoff helps creditors, statutory committees, special directors and trustees protect their rights in both in-court and out-of-court corporate reorganization. He counsels clients on bankruptcy planning and counterparty risk, and helps clients address insolvency in the municipal and international context. Mr. Wedoff litigates bankruptcy and nonbankruptcy commercial matters and has represented clients in the U.S. Supreme Court, argued in the Second Circuit and Eleventh Circuit Courts of Appeals, and appears in state and federal trial courts. He writes frequently on bankruptcy topics and was a featured speaker at the 2021 Annual Meeting of the National Conference of Bankruptcy Judges. Mr. Wedoff received his B.A. in 2001 from Macalester College, his J.D. *magna cum laude* from the University of Minnesota Law School in 2008, and his LL.M. from St. John's University School of Law in 2011.