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Paths for Committees Post-*Jevic*

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CASE SUMMARIES OF MATTERS CONSIDERED POST-JEVIC

Speakers

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Introduction: Cases Summarized

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2. *In re Fryar,* Case No. 16-13559 (SR) (Bankr. E.D. Tenn. Apr. 25, 2017)
3. *In re Pioneer Health Services, Inc.,* 2017 Bankr. LEXIS 939 (Bankr. S.D. Miss. April 4, 2017)
4. *In re Eternal Enterprise, Inc.*, 2017 Bankr. WL 1373239 (Bankr. D. Conn. April 13, 2017)
5. *In re DB Holdings Liquidation, Inc. (f/k/a DirectBuy Holdings, Inc.)*, Case No. 16-12435 (CSS) (July 19, 2017) [Docket No. 715]

***1. In re Constellation Enterprises LLC, et al*., Case No. 16-11213 (CSS) (Bankr. D. Del. May 16, 2017)**

Relevant Facts:

- The Debtors and the Creditors' Committee filed a joint motion for an order approving a settlement between the Debtors, the Creditors' Committee, the Purchaser of the Debtors' assets, and the Ad Hoc Noteholder Group (the "Settlement").
- The Settlement provided for the avoidance of costly litigation and a recovery to unsecured creditors who otherwise had no prospect of achieving a recovery. The Settlement also provided for the establishment of a "GUC Trust" into which cash and other estate assets, including litigation, would be transferred by the Purchaser. The GUC Trust was structured in a way that by-passed or skipped certain priority creditors out of the distribution equation.
- The Settlement contains the following provision for the disposition of the chapter 11 cases – the cases would be "(a) dismissed by structured dismissal on terms that are consistent with this Term Sheet and/or the Settlement and are otherwise acceptable to the Debtors, Creditors' Committee and Ad Hoc Noteholder Group, or (b) resolved by such other process as may be agreed to by the Parties and approved by the Bankruptcy Court."

Key Points:

- In response to objections, the Debtors argued that the Settlement did not involve the distribution of the estates' assets, was in the best interests of the estates, and would provide a distribution to unsecured creditors that otherwise would be impossible absent the Settlement. The Debtor also made the argument that *Jevic* did not apply in this instance because the distribution to unsecured creditors involved non-estate assets -- the contribution of CIT's cash and release of Sun's lien. The Judge agreed, stating that even *Jevic* involved the "transfer of assets that were not property of the estate as part of the settlement." (Exhibit 1, p. 248).
- The Debtors argued that in *Jevic*, "[t]he Court expressly declined to prohibit other non-case ending distributions which occur earlier or do not involve property of the estate or have other code-based justifications. It did not endorse a blanket rule that all structured dismissals are *per se* valid." (*Id.*, p. 150).
- The Debtors' view of the Settlement was that the "purchased assets…became property of the noteholders at closing. They cannot be considered property of the estate... the settlement contemplates the contributions of only non-estate property to the GUC trust." (*Id.,* p.151). The Debtors argued that the facts were "virtually identical" to those in *ICL Holdings*.
- The priority creditors who were by-passed (the DDTL Parties") argued that the Settlement was a "back-door means to avoid *Jevic*."

- DDTL Parties argued that the Supreme Court was very clear that there are certain times where you can have non-priority or priority-violating distributions; *i.e.*, where there's a significant bankruptcy-related objective. In this situation, the DDTL Parties argued that the Settlement did not preserve the Debtors as a going concern and it did not promote the possibility of a confirmable plan; in other words, the Settlement did not further any objective of the Bankruptcy Code (*Id.,* p.173)
- The Creditors' Committee urged the Court to adopt the narrowest interpretation of *Jevic*, that "only end of case priority skipping distributions of estate assets are prohibited." However, the U.S. Trustee argued that *Jevic* cannot be read so narrowly and instead "sets forth the test to determine whether any proposed interim class-skipping distribution is appropriate. The Supreme Court stated that an interim distribution of estate assets in violation of the Code's priority scheme must have a significant offsetting bankruptcy related justification." (*Id.*, p.188).
- The U.S. Trustee argued that there was no reason for the settlement structure to exclude certain assets from the estates prior to contributing them to the GUC Trust, save for an attempt by the settling parties to circumvent *Jevic*.

Outcome:

- Judge Christopher S. Sontchi denied the motion approving the Settlement as there was no evidence before the Court as to why priority creditors were not involved in the Settlement or why deficiency claim creditors were treated differently.
- The Judge did not rule on whether *Jevic* overturned the decision in *ICL Holdings* in relation to priority-skipping distributions (*Id.,* p. 247).
- The Judge asserted that the fact that the case was moving either to a dismissal or conversion to a liquidation was important ("we're at the end of this case's chapter 11 life"). This indicated that there was no bankruptcy related objective that justified violating the normal priority scheme (*Id.,* p. 251). The Judge also stated that "[t]he fact that this settlement wasn't tied specifically to the dismissal motion I don't think distinguishes *Jevic*, either."

Status After Denial of the Settlement:

- On May 30, 2017, the Creditors' Committee filed a notice of appeal with respect to the order denying the Settlement.
- On June 23, 2017, counsel to the Debtors filed a joint motion to withdraw as counsel and a motion to convert the cases to Chapter 7, noting that the primary factors leading to the conversion request were the Court's denial of the settlement, and the fact that the Settlement motion was heard months after it was originally scheduled to be heard (as the Court postponed the hearing on the Settlement until after the Supreme Court issued its opinion in *Jevic*.
- On July 19, 2017, special counsel for the Debtors and counsel for the DDTL Parties filed a joint motion seeking approval of a settlement. A hearing on the motion is scheduled for August 21, 2017. The Debtors adjourned both the withdrawal motion and conversion motion pending the outcome of the motion to approve the DDTL settlement.

2. *In re Fryar*, Case No. 16-13559 (SR) (Bankr. E.D. Tenn. Apr. 25, 2017)

Relevant Facts:

- A settlement motion required Pinnacle Bank's lien to be satisfied by the payment of $350,000 in sales proceeds. Three creditors and the U.S. Trustee objected to the motion on the grounds that Pinnacle was being preferred and the priorities set for distribution under the Bankruptcy Code were being "reordered" for Pinnacle's benefit.

Key Points:

- Applies *Jevic* and sets forth a two-stage test for approving a settlement: (1) have all creditors consented; and (2) if not, does the settlement serve a significant Code-related objective so that a significant deviation is justified?
- As in *Constellation*, the status and stage of the case were significant. The *Fryar* Court stated that "this settlement is more of a preamble to a conversion or a structured dismissal than it is to the situation in *Iridium*, where there was a reorganization anticipated. The Debtor has failed to prove that disregard of the priority scheme will promote 'a significant Code-related objection.'" (citing *Jevic*).
- The *Fryar* Court further noted that "[a]s with the situation in *Jevic*, this case more closely resembles the proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards."
- Finally, the Court noted that the settlement may be been "acceptable if all of the creditors were consenting; however, three creditors and the U.S. Trustee have objected, so the court must consider whether there are Code-related objections being served that are so significant that deviation is justified."

3. In re Pioneer Health Services, Inc., 2017 Bankr. LEXIS 939 (Bankr. S.D. Miss., April 4, 2017)

Relevant Facts:

- The Debtors' filed a motion seeking to pay critical vendors, and in particular the claims of otherwise unsecured vendors (including three physicians) for key goods and services provided to its affiliated hospitals. The Creditors' Committee objected to the motion, and the Court ultimately denied the motion.

Key Points:

- *Jevic* was cited to distinguish non-consensual structured dismissals that vary the priority scheme from critical vendor orders on the ground that the former served no "significant offsetting bankruptcy-related objective." The *Pioneer Health* Court suggested, therefore, that *Jevic* supported the more restrictive line of case with respect to approval of critical vendor motions followed in both *In re CoServ, L.L.C*, 273 B.R. 487 (Bankr. N.D. Tex. 2002) and *In re Kmart Corp*., 359 F.3d 866 (7th Cir. 2004).
- At bottom, the *Pioneer Health* Court denied the critical vendor motion, in significant part, because the Debtors had not met their burden under applicable. In particular, the physicians at issue were parties to executory contracts and no evidence was presented that they would immediately terminate services (in violation of the automatic stay) unless their prepetition claims were paid in full.
- Although the *Pioneer Health* Court cited *Jevic* for the general rule that the priority scheme under the Bankruptcy Code should be followed, ultimately, the critical vendor motion was denied, because the Debtors failed to meet their burden.
- In the future, creditors and others may attempt to use *Jevic* to oppose first day relief, including critical vendor motions, but established case law and practice should prevail provided the moving debtor meets its burden under the "doctrine of necessity" and "necessity of payment" doctrines.

***5. In re Eternal Enterprise, Inc.*, 2017 WL 1373239 (Bankr. D. Conn., April 13, 2017)**

Relevant Facts:

- The Court confirmed a Debtor's chapter 11 plan, but stayed the implementation of the confirmation order to permit the Debtor an opportunity to sell its real property under section 363 of the Bankruptcy Code after competing offers for the Debtors' assets emerged.

Key Point:

- In *dicta*, the Court cited to *Jevic* for the proposition that the Bankruptcy Code's safeguards (here, a fair opportunity to sell assets) should be respected (noting that *Jevic* "compared the structured dismissals it disapproved with transactions that the lower courts have refused to allow on the ground they circumvent the Code's procedural safeguards.")

***6. In re DB Holdings Liquidation, Inc. (f/k/a DirectBuy Holdings, Inc.), et al.*, Case No. 16-12435 (CSS) (Bankr. D. Del. July 19, 2017)**

Relevant Facts:

- The Debtors filed for chapter 11 to reduce their debt burden and allow their various businesses to be sold as going concerns.
- Following the sale of substantially all of the Debtors' assets, the Debtors, the Creditors' Committee, and the Prepetition Secured Parties reached a settlement to pay administrative expense claims, thereby allowing the debtors to exit from chapter 11.
- The Debtors, with the support of the Creditors' Committee, moved for a structured dismissal, which the Judge Sontchi approved.

Key Points:

- Demonstration that Bankruptcy Courts remain willing to approve structured dismissals, provided the ordinary priority rules are not contravened and there is "cause" to do so. In this case, "cause" was demonstrated as being the benefit received by all parties in the case and the fact the objectives at the outset of the case had been achieved.
- The order approving the structured dismissal confirmed that all prior orders, stipulations, settlements, rulings, orders, and judgments would remain in full force and effect and survive the dismissal of the case.
- Judge Christopher S. Sontchi presided over the case. He was also the Judge in *In re Constellation* which, in contrast, rejected a settlement proposal on the grounds that it would be a means to avoid *Jevic.*

Conclusion

- Although the Supreme Court's decision in *Jevic* is young and seemingly popular, bankruptcy courts are already testing the waters and so far, are widely interpreting, applying, and citing to *Jevic* in situations beyond the narrow context of structured dismissals, where the priority scheme of the Bankruptcy Code may be circumvented, especially where there is a non-consenting set of creditors whose treatment deviates from the Bankruptcy Codes' ordinary priority rules.

Exhibit 1

- *In re Constellation Enterprises LLC, et al.* – Hearing transcript

Exhibit 2

- *In re Fryar* – Memorandum Opinion

Exhibit 3

- *In re Fryar* – Rochelle's Daily Wire Article – "*Jevic* Applied to Ordinary Settlements in the Midst of a Chapter 11 Case"

Exhibit 4

- *In re Pioneer Health Services, Inc.* – Memorandum and Order Denying in Part Motion to Establish Certain Claimants as Critical Vendors and to Approve Critical Vendor Payments for Emergency Room Physicians

Exhibit 5

- *In re Eternal Enterprise, Inc.* – Memorandum and Ruling Confirming Hartford Holdings LLC's Second Modified Fifth Amended Chapter 11 Plan

Exhibit 6

- ABI – 2017 New York City Bankruptcy Conference – "Liquidating In and Out of Chapter 11"

Exhibit 7

- *In re DB Holdings Liquidation, Inc. (f/k/a DirectBuy Holdings, Inc.), et al.*, Case No. 16-12435 (CSS) (Jul. 19, 2017) [Docket No. 715] – "Order Dismissing the Debtors' Chapter 11 Cases and Granting Related Relief"

Exhibit 8

- DLA Piper Article – "U.S. Supreme Court Confirms Priority Rules Apply to a Structured Dismissal of a Chapter 11 Bankruptcy Case"

Selected Key Provisions to Consider in Liquidating Chapter 11 Plans

By: Dion W. Hayes[1]

This CLE material focuses on certain key chapter 11 plan provisions that may avoid post-confirmation challenges: (1) preserving causes of action for post-confirmation prosecution; (2) preserving and transferring attorney-client privilege; and (3) maintaining trustee reporting and creditor oversight.

I. Preserving and Prosecuting Causes of Action Post-Confirmation

A. Introduction

Chapter 11 cases are often time-consuming, expensive, and in many instances, pressing. Consequently, debtors opt to use a Chapter 11 plan as a means for preserving and prosecuting causes of action held by the bankruptcy estate after confirmation of a plan. A confirmation order is a final order entitled to preclusive effect, *i.e. res judicata*.[2] Therefore, a confirmation order may preclude a debtor from asserting claims or causes of action that could have or should have been brought pre-confirmation.[3] As such, a debtor's failure to safeguard its causes of action may result in those actions being lost forever under various principles of preclusion and estoppel.[4]

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[1] Dion W. Hayes is the Chair of the Restructuring and Insolvency Department at McGuireWoods LLP. He would like to thank his colleagues, Jessica O. Taylor and Joseph S. Sheerin, for their help on this submission.

[2] *See, Comty. Bank, N.A. v. Riffle*, 617 F.3d 171, 173 (2d Cir. 2010) (noting that bankruptcy court's order confirming debtor's plan was a final order that may be appealed) and *In re Am. Preferred Prescription, Inc.*, 255 F.3d 87, 92 (2d Cir. 2001) ("The confirmation of a plan in a Chapter 11 proceeding is an event comparable to the entry of a final judgment in an ordinary civil litigation.").

[3] *See, e.g., Fleet Nat'l Bank v. Gray (In re Bankvest Cap. Corp.)*, 375 F.3d 51 (1st Cir. 2004).

[4] Roye Zur, *Preserving Estate Causes of Action for Post-Confirmation Litigation*, 32 CAL. BANKR. J. 427, 427 (2013).

Moreover, when a Chapter 11 plan is confirmed, a debtor loses its debtor-in-possession ("DIP") status and, with it, standing to assert a bankruptcy estate's claims.[5]

B. Split Among the Courts

The Bankruptcy Code authorizes the preservation of causes of action belonging to the bankruptcy estate under 11 U.S.C. § 1123(b)(3), which states that a plan of reorganization "may … provide for … the retention and enforcement by the debtor … or any such claim or interest." Some courts have stated the purpose of § 1123(b)(3) is not to provide notice to potential defendants, but is notice to creditors generally that there are assets yet to be liquidated, which are preserved for prosecution by the reorganized debtor or a post-confirmation trustee.[6] Section 1123(b)(3) is silent, however, with respect to the language necessary to preserve a particular claim or cause of action, which has produced a split in authority.[7]

Some courts have determined that pure "blanket reservations" preserving all of the debtor's causes of action are insufficiently specific to preserve a particular claim.[8]

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[5] *See,* ¶ 75,344 IN RE HARSTAD, Bankr. L. Rep. P 75344, 1993 WL 13937788 (June 30, 1993) ("Because a debtor-in-possession does not have the same role as a trustee and the debtor-in-possession does not survive plan confirmation, the debtor loses its right to bring postconfirmation preference actions, having no standing to either avoid [a] transfer or recover [a] preference."). *See also, In re Ice Cream Liquidation, Inc.*, 319 B.R. 324, 333 (Bankr. D. Conn. 2005) ("[I]f the Plan contains the requisite provision, the Debtor has standing to assert the Section 542(b) Counts. However, if an adequate Plan provision is lacking, the Debtor lacks standing to bring such actions."); *In re Goodman Bros. Steel Drum Co., Inc.*, 247 B.R. 604 (Bankr. E.D.N.Y. 2000) (finding debtor did not lack standing to pursue post-confirmation claims where debtor's disclosure statement gave notice of debtor's intention to file post-confirmation an adversary proceeding against insurer).

[6] *In re Pen Holdings, Inc.*, 316 B.R. 495, 500-01 (Bankr. M.D. Tenn. 2004).

[7] *Id*. at 501.

[8] *See, e.g., Browning v. Levy*, 283 F.3d 761 (6th Cir. 2002) (blanket reservation did not preserve legal malpractice claims) and *D & K Props. Crystal Lake v. Mut. Life. Ins. Co. of N.Y.*, 112 F.3d 257, 250-61 (7th Cir. 1997) ("[a] blanket reservation that seeks to reserve all causes of action reserves nothing").

Below are selected examples of "blanket reservations":

> The Liquidating Supervisor, under the supervision of the Post–Effective Date Committee ... is authorized to investigate, prosecute and, if necessary, litigate, any Cause of Action [the definition of which expressly includes avoidance actions] ... on behalf of the Debtor and shall have standing as an Estate representative to pursue any Causes of Action and Claim objections, whether initially filed by the Debtor or the Liquidating Supervisor....
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> *In re Bankvest Capital Corp.*, 375 F.3d 51, 59 (1st Cir. 2004).

> All claims, rights, defenses, offsets, recoupments, causes of action, actions in equity, or otherwise, whether arising under the Bankruptcy Code or federal, state, or common law, which constitute property of the Estates …
>
> *Golding Assocs., L.L.C. v. Donaldson, Lufkin & Jenrette Securities Corp.*, No. 00 Civ. 8688 (WHP), 2004 WL 1119652, at *1 (S.D.N.Y. 2004).

Courts within the Second and Third Circuits have concluded that general provisions or categorical language purporting to preserve all of the debtor's claims may be sufficient to preserve such claims for post-confirmation prosecution. Courts adopting this approach do not require that a plan or disclosure statement identify the prospective defendants or the particular transactions giving rise to claims.[9] These courts reason that Section 1123(b)(3) is intended to allow debtors to confirm a plan without fully investigating and pursuing all claims of the estate.[10]

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[9] *See, e.g., In re Jesup & Lamont, Inc.*, Adv. No. 12-01169 (ALG), 2012 WL 3822135, at *5 (Bankr. S.D.N.Y. Sept. 4, 2012) (denying defendants' argument that debtor's plan required more specificity to preserve causes of actions against particular defendants where plan "specifically provided that all Causes of Action were preserved and transferred to the Liquidating Trust unless '*expressly* waived' ") (citation omitted) (emphasis in original).

[10] *See, Ampace Freightlines, Inc. v. TIC Fin. Sys. (In re Ampace Corp.)*, 279 B.R. 145, 159 (Bankr. D. Del. 2002) ("Indeed, in large chapter 11 cases, the investigation and litigation of all possible avoidance actions to final judgment can take years. To force the debtor to remain in bankruptcy until a final determination of all possible preference actions is made would act as a detriment to both the debtor and it creditors by slowing down the reorganization process").

A representative sample of cases follows:

- *In re Perry H. Koplik & Sons, Inc.*, 357 B.R. 231, 247 (Bankr. S.D.N.Y. 2006) (finding that the plain language of section 1123(b)(3)(B) does not require a plan to specify every claim; rather "section 1123(b)(3)(B) provides that a plan *may* do so") (emphasis in original).

- *Cooper v. Tech Data Corp. (In re Bridgeport Holdings, Inc.)*, 326 B.R. 312 (Bankr. D. Del. 2005) (holding that language preserving "all Causes of Action arising under sections 544 [and] 547 through 551" sufficiently preserved a preference claim, even though the plan did not specifically identify any particular claims).

- *In re Bridgeport Holdings, Inc.*, 326 B.R. 312 (Bankr. D. Del. 2005) (finding that general reservation of claims language in plan sufficed to preserve trustee's right to bring preference claim).

- *In re Ampace Corp.*, 279 B.R. at 160-61 (Where plan preserved "all avoidance actions," and the disclosure statement incorporated the statement of financial affairs, which listed every transfer made during the ninety day period prior to the petition date, ruling that debtor's language was adequate to preserve a preference claim: "[I]n my opinion, a general reservation in a plan of reorganization indicating the *type* or category of claims to be preserved should be sufficiently specific to provide creditors with notice that their claims may be challenged post-confirmation.") (emphasis in original).

- *But see*, *BPP Illinois, LLC v. Royal Bank of Scotland Grp., PLC*, No. 13-CV0638 (JMF), 2015 WL 6143702, at *6 (S.D.N.Y. Oct. 19, 2015) ("[A] debtor may not … rely on a general retention clause to preserve undisclosed causes of action known to him when he filed for bankruptcy"), *citing D & K Props.*, 112 F.3d at 261 (7th Cir.1997) ("A blanket reservation that seeks to reserve all causes of action reserves nothing.").

C. Additional Methods of Preserving Causes of Action in a Chapter 11 Plan

Although plan provisions are the preferred way of preserving estate causes of action, disclosure statements, schedules, and statements of financial affairs may provide additional support.[11] This proposition is supported by the rule that a confirmed plan includes "all

[11] *See, In re I. Appel Corp.,* 300 B.R. 564, 566 (S.D.N.Y. 2003) (summary order): The debtor's disclosure statement apprised creditors that the debtor was "investigating certain pre-petition acts or omissions of [the defendants] which may give rise to claims by the Debtor against [them.]." *See also, Coney Island Land Co., LLC v. Domino's Pizza LLC*, 15-CV-4746 (ARR) (PK), 2017 WL 213016, at *5 (E.D.N.Y. Jan. 18, 2017) (finding debtor's disclosure of claim against Domino's in footnote of debtor's monthly operating reports was insufficient to preserve claim, but noting "to

documents which were confirmed together to form the contract."[12] When read together with the disclosure statement, the sweeping reservation of rights in a plan "adequately disclose[s] to … creditors" that claims against them "[are] being explored and that any such claims, if pursued, would not be part of the bankruptcy estate."[13]

D. Standing to Assert Third Party Claims

Bankruptcy Code § 1123(b)(3) allows a debtor to preserve estate claims, but it does not address whether a debtor can retain and pursue claims owned by creditors. In *Caplin v. Marine Midland Grace Trust Co.*, the Supreme Court held that in the absence of an assignment, a debtor cannot pursue claims belonging to creditors because those claims are not part of the bankruptcy estate.[14] *Caplin* held that under Chapter X of the Bankruptcy Act, a trustee lacks standing to assert claims on behalf of a bondholder creditor.[15] The Court found nothing in the Bankruptcy Act enabling a trustee to assert third party claims on behalf of creditors.[16]

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preserve its cause of action, [the debtor] needed to list it 'in the schedule of assets filed with the bankruptcy court' ") (citation omitted).

[12] *Goldin Assocs., L.L.C. v. Donaldson, Lufkin & Jenrette Sec. Corp.*, No. 00 CIV.8688 (WHP), 2004 WL 1119652, at *3 (S.D.N.Y. May 20, 2004) (considering whether a debtor can preserve post-confirmation claims in a plan or disclosure statement) (citation omitted).

[13] *In re I. Appell Corp.*, 104 Fed. App'x 199, 200-01 (2d Cir. 2004); *see also, Goldin Assocs., LLC v. Donaldson, Lufkin & Jenrette Securities Corp.*, No. 00 Civ. 8688 (WHP), 2004 WL 1119652, at *3 (S.D.N.Y. May 20, 2004), *citing In re Kelley*, 199 B.R. 698, 705 (9th Cir. BAP 1996) ("[I]f the debtor fails to mention the cause of action in either his schedules, disclosure statement, *or* plan, then he will be precluded from asserting it postconfirmation.") (emphasis added).

[14] 406 U.S. 416 (1972).

[15] *Id*. at 434.

[16] *Id*. at 428-29.

Caplin is still good law under the Bankruptcy Code[17] and its holding has been examined in the context of post-confirmation trusts and whether the trust may assert claims on behalf of creditors. More recent cases in the Second and Third Circuits have distinguished *Caplin* in cases where creditors have formally assigned their claims to a liquidation trust created in a plan of reorganization.[18] Moreover, *Caplin* does not extinguish a liquidation trustee's authority to pursue those assigned claims.[19]

E. Practitioner Tips

Based on the discrepancy among courts' requirements regarding the specificity of language required to preserve pre-confirmation actions belonging to the debtor's estate, counsel should be as specific as practicable when drafting preservation language in a plan. Even if claims are

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[17] *See, In re Tribune Co.*, 464 B.R. 126, 192-93 (Bankr. D. Del. 2011) (distinguishing *Caplin* ruling from creditor assigned claims); *In re I.G. Servs., Ltd.*, Adv. No. 04-5041-C, 2008 WL 783551, at *4 (Bankr. W.D. Tex. March 19, 2008) (citing *E.F. Hutton & Co., Inc.)*; *E.F. Hutton & Co., Inc. v. Hadley*, 901 F.2d 979, 985-86 (11th Cir. 1990) (holding *Caplin* remains the law under the Bankruptcy Code where "Congress considered and rejected a provision that expressly would have overruled *Caplin*")).

[18] *See, e.g. In re Tribune Co.*, 464 B.R. at 193

> I … conclude that [a] Plan's establishment of [a] [c]reditors' [t]rust and procedure for assignment of creditors' claims is not inconsistent with *Caplin*. [A] [p]lan's claim assignment procedure is voluntary because it allows creditors to 'opt out.' The possibility of inconsistent results is no greater than if the creditors pursued their separate claims individually. Moreover, [a] [c]reditors' [t]rustee is not acting as a representative of the Debtors or their estates …

(citations omitted). *See also, Grede v. Bank of N.Y. Mellon*, 598 F.3d 899, 90-02 (7th Cir. 2010) (*Caplin* does not apply to plan-created litigation trust) and *Semi-Tech Litig., LLC v. Bankers Trust Co.*, 272 F.Supp.2d 319, 323-24 (S.D.N.Y. 2003) (distinguishing *Caplin* where creditors assigned their claims to liquidation trust).

[19] *In re Tribune Co.*, 464 B.R. at 193.

described in the disclosure statement, those claims should also be addressed in the plan as well (or an exhibit) because the court may consider the plan to take priority over other documents.

Below is an example of a litigation preservation provision:

> 14.10 Retention of Causes of Action/Reservation of Rights. … nothing contained in this Plan or the Confirmation Order shall be deemed to be a waiver or relinquishment or any rights, claims or Causes of Action, rights of setoff, or other legal or equitable defenses that the Debtors had immediately prior to the Effective Date on behalf of the Estates or of themselves in accordance with any provision of the Bankruptcy Code or any applicable non-bankruptcy law. The Post-Effective Date Estates and the Trusts, as applicable, shall have, retain, reserve, and be entitled to assert all such claims, Causes of Action, rights of setoff, or other legal or equitable defenses as fully as if the Chapter 11 Cases had not been commenced, and all of the Debtors' legal and/or equitable rights respecting any Claim left unimpaired, may be asserted after the Confirmation Date to the same extent as if the Chapter 11 Cases had not been commenced …
>
> *In re LandAmerica Fin. Grp., Inc., et. al.*, No. 08-35994 (Bankr. E.D. Va. 2008), ECF. No. 3203 (Order Confirming Joint Chapter 11 Plan and LandAmerica Financial Group, Inc. and It's Affiliated Debtors with Respect to LandAmerica Onestop. Inc.)

II. Preserving Attorney-Client Privilege Post-Confirmation

A. Introduction

Attorney-client privilege has proven a complicated area of bankruptcy because of its various moving pieces, including shifting corporate entities, changes in interests, and changes in management. This can result in surprise to both the debtor and the debtor's counsel whose privileged communications and work-product protection may be waived or invaded by a bankruptcy trustee. Plan provisions maintaining attorney-client privilege post-confirmation may alleviate some of these challenges.

B. General Principles Pertaining to Legal Privileges

Attorney-client privilege may be asserted to protect from compelled disclosure communications between attorneys and clients.[20] For the privilege to apply, there must be "(1)

[20] *In re Teleglobe Commc'ns Corp. (In re Teleglobe Commc'ns Corp.)*, 493 F.3d 345, 359 (3d Cir. 2007).

communication (2) made between privileged persons (3) for the purpose of obtaining legal assistance for the client."[21] A communication must be made in confidence to be privileged.[22] Therefore, if "persons other than the client, its attorney or their agents are present, the communication is not made in confidence."[23] Further, "if a client subsequently shares a privileged communication with a third party, then it is no longer confidential."[24]

Work-product protections shield from production documents and other tangible items prepared in anticipation of trial.[25] To determine whether a document was prepared in anticipation of litigation, courts consider two questions: (1) subjectively, "whether the party actually thought it was threatened with litigation" and (2) objectively "whether that belief was reasonable."[26]

C. Pre-Filing Corporate Family Issues Affecting the Assertion of Privilege Post-Filing

Post-petition, a divergence of interest between a parent company and its subsidiaries may result in disputes between corporate family members regarding the discoverability of communications. For example, a debtor subsidiary may have causes of actions it seeks to bring against the non-debtor parent company.[27] This issue was best illustrated in *In re Teleglobe*

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[21] *Id*.

[22] *Id*. at 361.

[23] *Id*.

[24] *Id*.

[25] *See, AIU Ins. Co. v. TIG Ins. Co.*, No. 07 Civ. 7052 (SHS) (HBP), 2009 WL 1953039, at *7 (S.D.N.Y. July 8, 2009) (citing *Matter of Grand Jury Subpoenas Dated Oct. 22, 1991, and Nov. 1, 1991*, 959 F.2d 1158, 1166 (2d Cir. 1992) (stating the work-product doctrine protects an attorney's selection and compilation of documents because disclosure of this process would reveal the opposing attorney's thinking or strategy)).

[26] *Gulf Islands Leasing, Inc. v. Bombardier Capital, Inc.*, 215 F.R.D. 466, 475 (S.D.N.Y. 2003).

[27] *See generally, Teleglobe*.

Commc'ns Corp.[28] In *Teleglobe*, the Third Circuit was faced with a dispute between a debtor-subsidiary and non-debtor/parent over documents created by attorneys who had contemporaneously represented the entire corporate family. The Third Circuit examined the question of which communications with counsel are entitled to protection.[29] In *Teleglobe*, the debtor-subsidiary sued its parent company on various legal theories. In the litigation, the debtor sought production of privileged documents created by an attorney for the parent company based on the common interests between the parent and debtors.[30]

The court examined the common interest doctrine, which is an exception to the general rule that voluntary disclosure of confidential communication to a third party waives privilege.[31] The common interest doctrine protects "all communications shared within a proper 'community of interest.' "[32] To demonstrate that a proper community of interest exists, the interests "must be 'identical, not similar, and be legal, not solely commercial.' "[33] Moreover, to show that members of a community are "allied in common legal cause," the party claiming the privilege must show

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[28] *See Teleglobe*, *supra* note 20.

[29] *Id*. at 360.

[30] *See generally, Teleglobe*.

[31] *See, Delaware Display Grp. LLC v. Lenovo Grp. Ltd., Lenovo Holding Co., Inc.*, Civ. A. Nos. 13-2108-RGA, 13-2109-RGA, 13-2112-RGA, 2016 WL 720997, at *4-5 (D. Del. Feb. 23, 2016) (citing *Teleglobe*).

[32] *Teleglobe*, 493 F.3d at 364.

[33] *Leader Techs*, 719 F.Supp.2d 373, 376 (D. Del. 2010).

"that the disclosures would not have been made but for the sake of securing, advancing, or supplying legal representation."[34]

The court in *Teleglobe* engaged in a lengthy analysis of joint representation and whether a corporate family may be considered a "single client."[35] Because a parent company may centralize its legal services to the entire corporate group, the court in Teleglobe found it important to consider how the disclosure rule affects sharing of information among corporate affiliates.[36] Teleglobe's parent company, Bell Canada Enterprises, Inc. ("BCE") urged that the corporate family is a single client for purposes of privilege and the privilege is held exclusively by the parent.[37] The Third Circuit rejected the concept of a corporate family as a single entity because it "fails to respect the corporate form."[38] Further, the court stated that joint representation arises only "when common attorneys are affirmatively doing legal work for both entities on a matter of common interest" because a "broader rule would" permit a subsidiary to "access all of its former parent's privileged communications."[39]

In sum, the *Teleglobe* court concluded that a debtor-subsidiary could only compel production of privileged documents if the parent company and debtor were "jointly represented by the same attorneys on a matter of common interest that is the subject matter of those

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[34] *Delaware Display*, 2016 WL 720977, at *4 (citing *In re Regents of the Univ. of Cal.*, 101 F.3d 1386, 1389 (Fed. Cir. 1996)).

[35] *Teleglobe*, 493 F.3d at 353.

[36] *Id*. at 370.

[37] *Id*.

[38] *Id*. at 371.

[39] *Teleglobe*, 493 F.3d at 379; *see also, Kirby v. Kirby*, No. 8604, 1987 WL 14862 (Del. Ch. July 29, 1987) (examining joint client representation in context of directors and officers).

documents."[40] The lesson from *Teleglobe* is that in-house counsel should proceed with caution when representing both a parent and subsidiary corporation as the principle of joint representation may authorize a later trustee, acting on behalf of a subsidiary corporation, to compel the production of privileged communications between the parent company and in-house counsel. On the other hand, *Teleglobe* may enable a bankruptcy trustee or debtor to obtain documents subject to a joint interest that can be very helpful in advancing a claim against a non-debtor affiliate.

D. Post-filing Privilege Issues

i. The Bankruptcy Trustee's Access to Debtor's Privileges

Another frequent attorney-client privilege concern arising in chapter 11 involves relationships among a trustee, a debtor, and a creditor's committee. In the pre-confirmation portion of a chapter 11 case, the DIP owns the debtor's legal pre-bankruptcy privilege; however, as the bankruptcy case progresses, that ownership may change.[41] When a trustee is appointed, he takes control of the debtor's assets, including control of attorney-client privilege.[42]

In *Weintraub*, the Supreme Court analyzed the passage of control of the attorney-client privilege in a bankruptcy case:[43]

> In light of the lack of direct guidance from the Code, we turn to consider the roles played by the various actors of a corporation in bankruptcy to determine which is most analogous to the role played by the management of a solvent corporation. *See*

[40] *Teleglobe*, 493 F.3d at 379.

[41] *See,* ¶ 75,344 IN RE HARSTAD, Bankr. L. Rep. P 75344, *supra* note 5.

[42] *See, In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 662 (S.D.N.Y. 2006) (noting any trustee appointed in the debtor's case could waive the debtor's privilege and could share new privileged information and/or work product with the ad hoc committee of noteholders of the debtor-holding company).

[43] *Commodity Futures Trading Com. v. Weintraub*, 471 U.S. 343 (1985).

> *Butner v. United States*, 440 U.S. 48, 55 (1979). Because the attorney-client privilege is controlled, outside of bankruptcy, by a corporation's management, the actor whose duties most closely resemble those of management should control the privilege in bankruptcy, unless such a result interferes with policies underlying the bankruptcy laws.[44]

For a solvent corporation, the power to waive attorney-client privilege is controlled by the solvent corporation's management.[45] Therefore, "the actor whose duties most closely resemble those of management should control the privilege in bankruptcy."[46] In a chapter 7 bankruptcy, the corporation's attorney-client privilege is controlled by the trustee, who controls all corporate property and is directed to investigate the debtor's financial affairs to recover, where appropriate, on behalf of the estate, fraudulent or preferential transfers of the debtor's property.[47] Although *Weintraub* involved a chapter 7 debtor, its analysis and conclusion have been applied in chapter 11 cases involving a trustee also. A representative sample of cases applying *Weintraub* outside of chapter 7 follows:

- *In re China Medical Tech., Inc.*, 539 B.R. 643, 653 (S.D.N.Y. 2015) (examining privilege under *Weintraub* in a Chapter 15 proceeding and concluding attorney-client privilege possessed by foreign debtor's audit committee passed to trustee upon his appointment, but work-product protection belonged to audit committee's counsel). The court in *In re China* addressed the question of whether the audit committee's ability to retain independent counsel and conduct internal investigations that implicate corporate management should override the statutory obligation of a trustee in bankruptcy to maximize the value of the estate by conducting investigations into the corporation's pre-bankruptcy affairs. *Id*. at 654. Relying on *Weintraub*, the court concluded that the same considerations that weighed in favor of the trustee in *Weintraub* weighed in favor of the trustee in that case. *Id*. at 655. The Court reasoned that the prepetition interests of an audit committee are aligned with the interests of a trustee or liquidator in bankruptcy; therefore, *Weintraub* applied.

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[44] *Id*. at 351-52.

[45] *Id*. at 348.

[46] *Id*. at 351; *see also, In re China Medical Tech., Inc.*, 539 B.R. 643, 653 (S.D.N.Y. 2015) (quoting *Weintraub*).

[47] *Weintraub*, 471 U.S. at 352.

- *Rahl v. Bande (In re Flag Telecom Holdings Ltd. Sec. Litig.)*, No. 02-CV-3400 (WCC), 2009 U.S. Dist. LEXIS 124061, at *25 (S.D.N.Y. Jan. 14, 2009) (holding that control over attorney-client privilege pertaining to securities litigation against debtor's former directors and officers was transferred to litigation trustee pursuing action).

- *In re Food Management Grp., LLC*, 380 B.R. 677, 709 (Bankr. S.D.N.Y. 2008) ("Upon the appointment of a chapter 11 trustee the power to control the attorney-client privilege passes to the trustee.") (citing *Weintraub*).

ii. Liquidation/Litigation Trust Privileges

Liquidation and litigation trusts are common facets of liquidating Chapter 11 plans. The entry into a liquidating trust agreement results in the appointment of a liquidating trustee. The trust agreement typically contains provisions assigning and conveying to the trustee any and all assets of the debtor that the trust agreement acts to convey, including causes of action. One role of the liquidating trustee is to pursue unliquidated causes of action. This has led to liquidation trustees invoking and waiving privileges formerly held by the DIP and the official committee of unsecured creditors.[48]

In re Hechinger serves as an example of the privilege tug-a-war that can occur between a liquidating trustee and the debtor's former directors, officers, and shareholders.[49] In *Hechinger*, the liquidating trustee under the confirmed and effective chapter 11 plan of liquidation of the official committee of unsecured creditors brought an adversary proceeding against the debtor's former directors and officers and sought to compel from their former counsel production of privileged pre-bankruptcy communications between corporate counsel and the former directors

[48] *See, e.g., Osherow v. Vann (In re Hardwood P-G, Inc.)*, 403 B.R. 445, 461 (Bankr. W.D. Tex. 2009) (finding upon confirmation of plan that provided for creation of liquidation trust, the trustee is "now the holder of the privilege of both the debtors and the Committee and may thus assert such privilege …").

[49] *Official Committee of Unsecured Creditors of Hechinger Inv. Co. of Del. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Del., Inc.)*, 285 B.R. 601 (D. Del. 2002).

and officers. The debtor's former directors and officers, as well as the law firm that previously represented them, argued that although attorney-client privilege is held by the trustee, the documents requested by the trustee concerned the representation of the former directors and officers before the debtor merged to form a new corporation.[50] Relying on New York law, the law firm argued that "attorney-client privilege regarding pre-merger representations concerting the merger transaction does not pass to the buyer, but remains with the former shareholders of the seller."[51] The trustee countered that former directors and officers have no continuing right to assert privilege over the debtor's documents and refuted the law firm's argument that a joint representation or joint defense privilege applied.[52]

Relying on *Weintraub*, the trustee asserted that the liquidating trust controlled the right to assert or waive privilege with respect to the privileged documents.[53] The directors and officers countered that, under *Weintraub,* only a trustee "succeeding to the management of a Chapter 11 debtor had the right to waive the attorney-client privilege with respect to pre-petition communications," implying that the trustee was not a successor of the debtor, but rather a successor of the official committee of unsecured creditors, whose liquidation plan created the liquidation trust.[54] The court concluded that the liquidation trust controlled the privilege because all of the debtor's assets and privileges were transferred to the trust, and the joint defense

[50] *Id*. at 608.

[51] *Id*. (citation omitted).

[52] *Id*. at 607.

[53] *Id*. at 606.

[54] *Id*. at 608.

privilege did not apply.[55] Moreover, the court dismissed the law firm's argument that attorney-client privilege regarding pre-merger representations concerning the merger transaction did not pass to the buyer.[56] The court found that "absent the parties' acknowledgement in the merger documents, the privilege transferred would have included the pre-merger information."[57]

E. Practitioner Tips

As *Weintraub*, *Hechinger*, and *Teleglobe* teach, an in-house or outside attorney should be aware of all common and joint clients and anticipate when those interests may diverge. Additionally, where there is a common or joint interest, counsel should enter into a written agreement that identifies specifically the parties and the extent of their common or joint legal interests.[58] While the mere assertion of a common or joint legal interest in a written agreement cannot alone create such an interest,[59] it can be relevant to demonstrating actual cooperation toward a common legal goal. In addition, such an agreement may address the preservation and joint ownership of the relevant privileges.

The transfer and preservation of privilege should also be addressed in a plan. Below are certain representative privilege provisions from Chapter 11 cases:

> Successor; Preservation of Privilege. The Liquidation Trust shall be the successor to the Debtor and/or the Equity Committee for the purposes of §§ 1123, 1129, 1142 and 1145 of the Bankruptcy Code and with respect to all Causes of Action and other litigation-related matters. In connection

[55] *Id*. at 611-13.

[56] *Id*. at 612.

[57] *Id*.

[58] Frank A. Oswald and Lauren L. Peacock, *Legislative Update, Litigator's Perspective: The Common-Interest Doctrine: Preserving Privilege Post-Petition*, 34-6 American Bankruptcy Institute Journal 34, 73 (June 2015).

[59] *See, In re Rivastigmine Patent Litig.,* No. 05 MD 1661 (HB/JCF), 2005 WL 2319005, at *4 (S.D.N.Y. Sept. 22, 2005).

with the rights, Claims, and Causes of Action that constitute the Trust Assets, any attorney-client privilege, work-product privilege, or other privilege or immunity attaching to any documents or communications (whether written, or oral) transferred to the Liquidation Trust shall vest in the Liquidation Trust and its representatives, and the Debtor, the members of the Equity Committee, and the Liquidation Trustee are authorized and directed to take all necessary actions to effectuate the transfer of such privileges. The Liquidation Trustee and the Oversight Board shall be deemed to have a joint and common interest and, as such, communications among the Liquidation Trustee and the Oversight Board shall be protected from disclosure. The Liquidation Trustee may waive its attorney-client privilege with respect to any Cause of Action or other litigation-related matter, or portion thereof, in the Liquidation Trustee's discretion, subject to the approval of the Oversight Board.

In re CDC Liquidation Trust, No. 11-79079 (Bankr. N.D. Ga. 2011), Liquidation Trust Agreement.

Preservation of Privilege: In connection with the rights, claims, and causes of action that constitute the Liquidating Trust Assets, any attorney-client privilege, work-product privilege, or other privilege or immunity attaching to any documents or communications (whether written or oral) transferred to the Liquidating Trust shall vest in the Liquidating Trust and its representatives, and the Debtor and the Trustees are authorized to take all necessary actions to effectuate the transfer of such privileges.

In re First Regional Bancorp, No. 2:12-bk-31372-ER (Bankr. C.D. 2015), Second Amended Chapter 11 Liquidating Plan.

III. Reporting and Oversight Rights

A. Introduction

The extent of authority of a bankruptcy court and the United States Trustee ("U.S. Trustee") to continue monitoring a bankruptcy case after confirmation of a plan is a question of debate among courts. Some chapter 11 plans include retention clauses purporting to authorize the bankruptcy court to retain jurisdiction over various matters post-confirmation. Moreover, chapter 11 plans and trust agreements typically specify the roles and responsibilities of U.S. Trustees and oversight committees.

B. Post-Confirmation Bankruptcy Court Oversight

A bankruptcy court's jurisdiction over bankruptcy cases is set forth in 28 U.S.C. §§ 1334

and 157, which gives district courts jurisdiction over bankruptcy matters, which they refer to bankruptcy courts in standing orders of referral.[60] It is generally accepted that the subject matter jurisdiction of a bankruptcy court in a bankruptcy narrows after plan confirmation, although the precise extent is unclear.[61] For example, the Third Circuit determined that a bankruptcy court lacked post-confirmation jurisdiction over accounting malpractice claims asserted by a litigation trust established under the debtor's confirmed Chapter 11 plan.[62] The court reasoned that the malpractice claims would only have an incidental effect on the reorganized debtor and would not interfere with the implementation of the reorganized plan.[63]

Chapter 11 plans should provide for the bankruptcy court's retention of jurisdiction after confirmation. However, courts differ over the efficacy of such retention of jurisdiction clauses. The Third and Ninth Circuits have held that retention clauses providing for bankruptcy

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[60] *See, Standing Order of Reference Re: Title 11*, United States Bankruptcy Court Southern District of New York (2012), http://www.nysd.uscourts.gov/rules/StandingOrder_OrderReference_12mc32.pdf; *Amended Standing Order of Reference Re: Title 11*, United States Bankruptcy Court for the District of Delaware (2012), http://www.ded.uscourts.gov/sites/default/files/general-orders/AmendedTitle11Order_2-29-12_0.pdf.

[61] *See, In re General Media, Inc.*, 335 B.R. 66, 73 (Bankr. S.D.N.Y. 2005) ("all courts that have addressed the question have ruled that once confirmation occurs, the bankruptcy court's jurisdiction shrinks"). *But see, In re Boston Regional Medical Center, Inc.*, 410 F.3d 100, 107 (1st Cir. 2005) (holding that post-confirmation jurisdiction does not shrink in liquidating Chapter 11 cases).

[62] *See, In re In re Resorts International, Inc.*, 372 F.3d 154, 166-67 (3d Cir. 2004). *See also, In re Kassover*, 448 BR. 625, 633 fn. 71 (S.D.N.Y. 2011) ("Bankruptcy courts plainly lack jurisdiction over post-confirmation litigation where the case has been fully administered and all of the recovery will go to the reorganized debtor rather than to the creditors.") (quoting *In re General Media, Inc.*, 335 B.R. 66, 75 (Bankr. S.D.N.Y. 2005)); *In re The Fairchild Corp.*, 452 B.R. 525, 531 (Bankr. D. Del. 2011) ("claims based on pre-petition conduct that were asserted post-confirmation, but could have been brought prior to confirmation lack a nexus sufficient to confer jurisdiction upon the bankruptcy court").

[63] *In re In re Resorts International, Inc.*, 372 F.3d at 169.

jurisdiction post-confirmation are valid where there is a "close nexus to the bankruptcy plan or proceeding."[64] As the Third Circuit noted, "a close nexus to a bankruptcy plan or proceeding is particularly relevant to situations involving continuing trusts, like litigation trusts, where the plan has been confirmed, but former creditors are relegated to the trust *res* for payment on account of their claims."[65] The Second Circuit also limits the court's post-confirmation jurisdiction to that provided by Congress by noting that "a bankruptcy court cannot, through confirmation of a reorganization plan, expand its own jurisdiction."[66]

Below is an example of a plan provision reserving the bankruptcy court's jurisdiction post-confirmation:

> Retention of Jurisdiction. The Court shall retain jurisdiction over the Chapter 11 Case (a) pursuant to and for the purposes of section 105(a), 1127 and 1142 of the Bankruptcy Code, and (b) as set forth in Article XV of the Plan, which is incorporated herein by reference as if set forth in extensor. As set forth in the Confirmation Bench Decision, this Court shall retain exclusive jurisdiction to consider any claims concerning the Covered Matters.
>
> *In re Adelphia Commc'ns. Corp., et al.*, at ECF No. 12952.
>
> Article XV. Retention of Jurisdiction. Pursuant to sections 105(a) and 1142 of the Bankruptcy Code, the Bankruptcy Court shall retain and shall have exclusive jurisdiction over any matter (a) arising under the Bankruptcy Code, (b) arising in or related to the Chapter 11 Cases or the Plan, or (c) that relates to the following: (i) [t]o hear and determine any and all motions or applications pending on the [c]onfirmation [d]ate … (ii) [t]o determine any and all adversary proceedings, applications, motions, and contested or litigated matters ... (v) [t]o consider any modifications to the [p]lan and/or [p]lan documents …(xiv) [t]o enter an order or final decree closing a Chapter 11 case …
>
> *In re Adelphia Commc'ns. Corp., et al.*, at ECF No. 11832-2, Fifth Amended Joint Chapter 11 Plan for Adelphia Communications Corporation and Certain of Its Affiliated Debtors, Article XV, Retention of Jurisdiction.

[64] *See, id*. at 166-67; *In re Pegasus Gold Corp.*, 394 F.3d 1189, 1194 (9th Cir. 2005) (same).

[65] *In re Resorts International, Inc.*, 372 F.3d at 167.

[66] *See, e.g., U.S. v. Bond*, 762 F.3d 255, 261 (2d Cir. 2014) (citing *In re Resorts International*).

C. Post-Confirmation U.S. Trustee Oversight

As with the bankruptcy court, U.S. Trustee oversight may substantially decrease after the Plan becomes effective. It is important therefore that a Chapter 11 plan and/or liquidating trust agreement also provides for the retention of trustee oversight post-confirmation. Pursuant to 28 U.S.C. § 586 and 11 U.S.C. § 704(8), the U.S. Trustee established its Operating Guidelines and Reporting Requirements for Chapter 11 DIPs and Chapter 11 trustees, which may be applied post-confirmation.[67] Reporting requirements are part of the checks and balances in the oversight of a trust.[68] Reporting requirements for U.S. Trustees after confirmation of a plan or upon commencement of a trust vary by jurisdiction.[69] Typically, operating reports are submitted monthly after the petition is filed and until a plan is confirmed.[70]

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[67] *See,* Operating Guidelines and Reporting Requirements of the United States Trustee for Chapter 11 Debtors in Possession and Chapter 11 Trustees, U.S. Department of Justice. *See, e.g., In re Dallas Stars, L.P.*, No. 11-12935(PJW), 2011 WL 5829885, at *31 (Bankr. D. Del. 2011), approving debtor's disclosure statement, stating:

> *Waiver of Filings*. Any requirement under section 521 of the Bankruptcy Code or Bankruptcy Rule 1007 obligating the Debtors to file any list, schedule, or statement with the Court or the Office of the U.S. Trustee (except for monthly operating reports or any other post-confirmation reporting obligation to the U.S. Trustee), is hereby waived as to any such list, schedule, or statement not filed as of the Confirmation Date.

See also, In re Genesis Health Ventures, Inc., 280 B.R. 95, 99 (D. Del. 2002) (concluding that "each individual debtor must satisfy the United States Trustee requirements for reporting and payment of quarterly fees" post-confirmation).

[68] *See,* Legally Defining Management of the Liquidation Trust, *supra* note 59 at 112.

[69] *See,* Legally Defining Management of the Liquidation Trust, *supra* note 59 at 115.

[70] *See,* Office of the United States' Operating Guidelines and Reporting Requirements For Debtors in Possession and Trustees. *See also, In re Adamo*, No. 14-73640-las, 2016 WL 859349, at * 9 (E.D.N.Y. March 4, 2016); *In re Bedford Commc'ns., Inc.*, No. 10-10902 (SMB), 2010 WL 2881414, at *6 (S.D.N.Y. April 19, 2010).

Practitioners should note that U.S. Trustee fees continue post-confirmation until the bankruptcy case is closed.[71] Therefore, the trust's governing documents should specify the party responsible for post-confirmation U.S. Trustee quarterly fee payments.[72] Failure to do so may lead to unnecessary litigation.[73]

Below is an example of a plan provision specifying U.S. Trustee reporting requirements:

> Quarterly Filings with Bankruptcy Court and U.S. Trustee. From the Effective Date until a Final Decree is entered, the Liquidation Trustee shall, within 45 days of the end of each calendar quarter, file with the Bankruptcy Court and submit to the U.S. Trustee quarterly reports setting forth all receipts and disbursements of the Liquidation Trust as required by the U.S. Trustee guidelines.
>
> *In re CDC Liquidation Trust*, No. 11-79079 (Bankr. N.D. Ga. 2011), Liquidation Trust Agreement.

D. Post-Confirmation Creditor Oversight

Typically, liquidating trustees operate with the oversight of a governing or oversight committee.[74] Bankruptcy plan documents (disclosure statement, plan, trust agreement, and confirmation order) frequently contain provisions authorizing the appointment of an oversight committee, which is often comprised of an odd-numbered subset of members of the official committee of unsecured creditors. The oversight committee's role is to provide advice (and in

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[71] *See, In re Aquatic Dev. Grp., Inc.*, 352 F.3d 671, 674 (2d Cir. 2003) (noting that the current version of 28 U.S.C. § 1930(a)(6) requiring quarterly fees to U.S. Trustee "requires debtors to pay fees to the United States Trustee 'for each quarter … until the case is converted or dismissed.' "); *In re Genesis Health Ventures, Inc.*, 280 B.R. 95, 99 (Bankr. D. Del. 2002) (granting the U.S. Trustee's motion to compel post-confirmation reporting and payment of quarterly fees by each debtor).

[72] *See,* Legally Defining Management of the Liquidation Trust, *supra* note 59 at 112.

[73] *See, e.g., In re CSC Indus., Inc.,* 226 B.R. 402, 406 (Bankr. N.D. Ohio 1998) (questioning whether a liquidation trust was required to pay U.S. Trustee post-confirmation quarterly fees where the trust did not specify the party responsible for payment).

[74] *See,* Legally Defining Management of the Liquidation Trust, *supra* note 59 at 115.

some cases, consent) to the liquidating trustee regarding the performance of the liquidating trustee's duties.

An oversight committee usually monitors the trust's operations. In addition to responsibilities regarding the post-confirmation trust's assets and beneficiaries, the liquidating trustee is often tasked with winding up the debtor and the bankruptcy estate.[75] Those tasks may include updating books and records, paying allowed administrative and priority claims, providing reports to the U.S. Trustee, filing tax returns, filing corporate dissolution papers, and winding up payroll and benefit plans.[76] The need for an oversight committee depends on the case; however, the oversight committee's power and obligations should be clearly stated in the trust agreement and plan to avoid later confusion or uncertainty.[77]

Below are examples of Chapter 11 plan provisions establishing the duties and powers of a liquidating trustee, subject to the consultation and approval of the Liquidating Trust Oversight Committee:

> The Liquidating Trustee shall have the rights and powers set forth in the Liquidating Trust Agreement . . . [s]ubject to the terms of the Liquidating Trust Agreement, which includes, among other things, limitations of the Liquidating Trustee's discretion to take certain action without consultation or approval of the Liquidating Trust Oversight Committee or, in some circumstances, the Court …
>
> *Health Diagnostic Lab., Inc., et al.*, No. 15-32919-KRH (Bankr. E.D. Va. 2015), ECF No. 1095 (Order Confirming Debtors' Plan of Liquidation under Chapter 11 of the Bankruptcy Code) (Bankr. E.D. Va. 2015).

> Quarterly Reporting. The Liquidating Trustee (i) shall report to the Liquidating Trust Oversight Committee on at least a quarterly basis … as to the status of all material matters affecting the

[75] *Id*. at 109; *see also, In re Consolidated Pioneer Mortg. Entities*, 264 F.3d 803 (9th Cir. 2001) (finding liquidating corporation created under confirmed plan had a fiduciary duty to account to investors and delay in doing so constituted cause to convert case to Chapter 7)

[76] *See,* Legally Defining Management of the Liquidation Trust, *supra* note 59 at 109-110.

[77] *Id*. at 114.

Liquidating Trust; and (ii) shall provide to the Liquidating Trust Oversight Committee within thirty (30) days after the end of the first full month following the Effective Date, and within twenty (20) days after the end of each quarter thereafter …

In re Health Diagnostic Lab., Inc., et al., No. 15-32919-KRH, at 1095 (Order Confirming Debtors' Plan of Liquidation under Chapter 11 of the Bankruptcy Code), Ex. C (Liquidating Trust Agreement).

Oversight Board. The Liquidation Trustee must regularly consult with and seek approval from the Oversight Board regarding the prosecution and/or settlement of Causes of Action …

In re CDC Liquidation Trust, No. 11-79079, Liquidation Trust Agreement (Bankr. N.D. Ga. 2011).

E. Practitioner Tips

As the trust and liquidating trustee retain control and management of a corporation's finances, employees, and operations post-confirmation, it is important for the oversight committee, appointed by the trust, to monitor these activities. The trust agreement and incorporating plan should provide for the retention of jurisdiction and continued compliance with U.S. Trustee's reporting and payment requirements, and oversight committee governance, ensuring that a checks and balances system is maintained and that the liquidating trustee complies with all applicable laws.

In The Matter Of:

In re: Constillation Enterprises, LLC, et al.

Hearing

May 16, 2017

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
Constellation Enterprises LLC, et al.,	)	Case Number 16-11213 (CSS)
Debtors.	)	

Courtroom 6
824 Market Street, 5th Floor
Wilmington, Delaware
Tuesday, May 16, 2017
10:00 a.m.

BEFORE:

THE HONORABLE CHRISTOPHER S. SONTCHI, Judge

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For the PBGC

THE COURT: Good morning.

MR. SHAPIRO: Good morning, your Honor. For the record, Zac Shapiro of Richards, Layton & Finger here today on behalf of the Debtors. With me at counsel table are my colleagues, Mr. Ramos and Mr. Barsalona. Behind me is Mr. Dana LaForge, who is among other things a board member of Constellation.

We have two items on today's agenda. The first is a joint motion filed by the Debtor and the Committee to seek approval of the settlement; and the second is what we call the Committee's related mechanics motion. We would propose to take those items in the order which they're listed on the agenda.

We would also propose to get right into evidence. We have one witness; the Committee has one witness. And then after each of us do our direct and redirect and our cross and redirect, then we would get into arguments of counsel. And at this point, I would pause to see if that proposal is acceptable to your Honor or other parties wish to weigh in.

THE COURT: Anyone wish to be heard on that?

MR. KAPLAN: Your Honor, if I may, we had discussed with Debtor and the Committee beforehand that we thought we brief openings would be helpful just to frame the testimony here, but obviously, we would defer to your Honor.

THE COURT: Brief openings are fine. I did read the briefs, so I'm aware of the issues, obviously. But if people would like to make openings, that's fine. So I'll turn to the Debtors first and the Committee. If you don't want to, that's fine, as well.

MR. SHAPIRO: Your Honor, I'm going to make my opening very brief. I think the papers made clear that at the very outset of these cases, our goal was to achieve one or more going concern sales of the Debtors' businesses. And to do that, we needed financing and a buyer or buyers. And it was critical, in our view, to achieve those goals that we obtain as much support as we could from our key creditors. And just one day

before the August 16th hearing, which was at that time the hearing on the approval of the sales, and it was going to be the hearing on approval of the DIP but we adjourned that into later, and that was three months into the case, we hadn't yet received final approval of our DIP and neither of our sales were approved.

And I think as the testimony will make clear, at that stage, we didn't have support for either sales or the DIP. And then on the morning of August 16th, we were sent a term sheet that not only resolved inner-creditor disputes and provided funding to out of the money creditors solely from non-estate sources, but it resolved the Committee's objections to the sales and the DIP.

And importantly, it also resulted in the Committee supporting the sales and the DIP, something that I think it's safe to say carries a lot of weight in this court. And to us, that sounded like a no-brainer. So we agreed to the term sheet.

But it was clear that the term

sheet was still subject to further documentation and finalization. In fact, the record makes clear that counsel to each party stated on the record in no uncertain terms that there was still a lot of work that needed to be done with respect to the settlement, and the Debtors even expressly said we would work in good faith to finalize it. In fact, it was not until more than three weeks later that the term sheet was finalized and filed with the Court.

But what we really agreed with on August 15th and 16th, and I think this is important, is the concept. And the concept was get the support from the Committee for your sales and your DIP, give up nothing, and get something for certain of your creditors, but admittedly not for others. Or don't get the Committee support for your sales and the DIP. Give up nothing, and get nothing for none of your creditors.

And I would submit, your Honor, that really wasn't a difficult choice. Was it a perfect settlement? No. We would not be

here today before your Honor if it were a perfect settlement. Would it have been better if the objectors in this room received what we thought they were entitled to? Sure. Of course, that would have been great. And the record will reflect that we tried to help as much as we could in that regard. But the fact is, as is true in most Chapter 11 cases, the Debtors didn't control the economics. We were limited in what we could do.

But I don't think anyone can credibly argue that the Debtors' decision to enter into the settlement was anything but a sound exercise in their business judgment, nor can they argue the settlement does not fall above the lowest point in the range of reasons.

And I think that's it from me, your Honor. Thank you.

THE COURT: You're welcome.

MR. ABER: Good morning, your Honor. Norman Kinel, Squire Patton Boggs, on behalf of the Creditors' Committee.

I don't have much to add to what

Mr. Shapiro had to say. We're obviously the co-movant on the settlement motion. We brought our own motion which we referred to as the mechanics motion, which to some degree was precipitated by the first round of objections where the objecting parties wanted to know exactly what the mechanic would be for distribution of the settlement proceeds, assuming it was approved by this Court.

I think your Honor, and I think the reasons that the Debtors and the Committee didn't see the need for opening statements, I think there's going to be a lot of noise in the courtroom today, not necessarily loud, but a lot of things that are distracting for what's really at issue before the Court. And what's at issue before the Court is approval of the settlement, and the standard for approval is, as we all know, pretty low. Not that I think this is even close to approaching the lowest level, but certainly we believe that both the Debtors and the Committee, to the extent relevant, entered into a hard-fought, good-faith settlement after

lengthy negotiations, primarily between the Committee and the noteholders, and that the parties, the constituency that we represent, the Unsecured Creditors Committee, this settlement is the only last-best-chance hope for obtaining substantial consideration, consideration that would not have been predicted to have been possible to obtain at the outset of the cases given the huge amount of debt that came before unsecured creditors. And that only through the Committee's efforts in pressing its objections to the DIP, to the sale motions, and conducting investigations and doing all that a Committee should do, has the results which we're seeking approval of come before your Honor for approval.

We took a long detour easily referred to as the Jevic detour. We're back we believe where we started, and as we'll get into argument at closing, we don't believe that Jevic is relevant or in any way precluding the Court's approval of the settlement, and we believe that, frankly, it should be almost a routine matter to approve

this type of settlement given the binding third circuit precedent at LCI.

And as to the mechanics motion, your Honor, the Committee is faced with economic realities that there was never a bar date set in these cases and that there is a claims resolution process that needs to occur, we're asking the Court to approve a mechanism which we think is fair with respect to which all creditors have been on notice for many, many months, and the only parties who have ever objected are sitting in this room. And we think it's an efficient way to get a substantial distribution to unsecured creditors in these cases. Thank you.

THE COURT: Mr. Kaplan?

MR. KAPLAN: Thank you. Good morning, your Honor. For the record, Gary Kaplan from Fried, Frank, Harris, Shriver & Jacobson on behalf of the DDTL parties.

First, your Honor, I wanted to start with one of the issues that was covered in the reply and one of the reasons why I wanted some openings was there's a lot of the

argument that the Debtors and the Committee make is, well, the APA always provided that certain of these assets were going to be sold, and that's all that's relevant is look at what the APA said, and we're trying to relitigate the APA. We're not trying to relitigate the APA. We understand what the APA said, but that's besides the point.

Because what we're here on today is a settlement term sheet. And the record is going to show, and we put it in our brief and it will come very clear as we go through the testimony today, when the Debtors and the Committee announced that they had a settlement, there were assets that were going to be left behind by the purchaser in the estate and then the estate was going to be distributing out. That is what was announced in court on August 16th. That is the settlement that was approved by the Debtor and the Committee.

And we're going to also show that then after that, because of Jevic or otherwise , it changed, so that assets that

were going to be left in the estate, plainly estate assets that had agreed to be carved out, were now going to be sold to the purchaser and immediately contributed back to the Debtor.

And when the Committee and the Debtor want your Honor to consider this, they sort of want to you bifurcate pieces of the settlement which you're assessing. What we argue is when you're looking at the claims and causes of action, you can't look at anything today because clearly the sale has closed, the DIP has been assumed by the purchaser, so you have to step back and look at the world on August 16th when they stood up in court and announced the settlement. That's when they argue you have to look at the claims that are being settled. But don't look at the facts and what was agreed to on the 16th, because that would run smack into Jevic and that would be impermissible.

So they want you to sort of bifurcate how you look at the settlement and what you look at the settlement. And frankly,

we don't think there's any precedent for that.

Now, Mr. Kinel mentioned you're going to hear a lot of noise today. Well, that noise is the facts. They may be inconvenient, they may be unhelpful to the Debtors, but that's what you're going to hear.

In terms of the settlement and the Martin factors and the Committee's argument that this was a home run considering where, you know, what their claims were, we think that sort of misses the point on this. Because what we're really not talking about is a settlement. What we are talking about is effectively a distribution scheme to wrap up the Chapter 11 case. You have a Debtor who as the testimony show cannot, has no hope of confirming a plan. So they have to figure out a way, how do we get out of Chapter 11, and that's what they created. They've done it under the guise of 9019 and they're trying to use the 9019 standard, but we're not talking about a settlement, because as the facts will show, there was really nothing to be settled. The challenge period had expired. There were

no claims against the noteholders. They say, oh, look at what we extracted from them, they had to release them. There were no claims against them. They were negotiating a distribution mechanism, and that's it.

And then lastly, in terms of the Debtors' business judgment, the record is going to be pretty clear that the Debtor, as they said and it says in the declaration, they had a take it or leave it proposition right before the hearing. They said, hey, it's better than nothing, it gets our DIP and our sale approved, we'll take it. That may be fine, maybe the Debtor can do it, it wasn't conditioned, none of those orders were conditioned on approval of the settlement, so I'm not criticizing them for making that judgment. But this Court has a role in reviewing that settlement and looking at it, saying, okay, it's nice they did it, they got their sale approved, but is it the appropriate thing and does it actually comply with the law?

And it's important to consider,

as Mr. Shapiro said, the Debtors had already addressed the DIP objection. We're not talking about an exigent circumstance with a deadline blowing up where they were about to lose the DIP. They had already moved a deadline or, I'm sorry, moved the hearing on the DIP. So it wasn't an exigent situation where they could have taken time to actually negotiate.

And one other point is that, and the Committee has already made the point and will continue to make the point, if this settlement is denied, there's going to be a windfall to noteholders and the creditors are going to be out and they're not going to get anything. You know what, your Honor? It's a little bit like the child that kills his parents and then begs mercy because they're an orphan. The Committee and the Debtor structured this in this way. Evidence will show it wasn't the noteholders who insisted you must skip priority claimants, you must skip the DDTL parties deficiencies. The Committee and the Debtors decided, gee, maybe

we can try to get around Jevic if we structure it this way, then they'll beg and say, well, Judge, but if you deny it, then we won't get anything. They could have simply accepted the terms that the noteholders proposed and said, yeah, we'll make it correct amongst creditors, we'll follow the absent priority rule. If they did that, we wouldn't have an objection, none of the parties on this side would have an objection. They chose to go down that path, your Honor, and whether the outcome ultimately is negative for them, you know, we make strategic decisions all the time, and they have to live with those strategic decisions.

So to avoid beings repetitive, in closing I will address ICL and Jevic and all those other issues. Thank you.

THE COURT: Ms. Casey?

MS. CASEY: Good morning, your Honor. Linda Casey on behalf of the United States Trustee.

Your Honor, while we have some technical objections to both the settlement motion and the procedures motion, I think the

main issue today can be framed by the following: Can the Supreme Court's Jevic decision be interpreted so narrowly as to permit an end-of-case priority skipping distribution of assets by finding that the consideration paid to resolve objections to a sale and thereby permit the sale to move forward are not estate assets, and therefore continue the harms that the Supreme Court attempted to avoid, altering the balance struck by the code; changing the parties' negotiating positions; decreasing the likelihood of settlement; and increasing the uncertainty of distributions resulting in a battle between all parties to obtain the purported side deals or gifts provided by the purchaser?

THE COURT: Thank you, Ms. Casey:

MR. RAISNER: Good morning, your Honor. Jack Raisner on behalf of the WARN class.

We have joined in Ms. Casey's objection and made our own. I just want to

highlight a chief concern of ours. Regardless of whether this is a gifting case or this is not quite a Jevic case and may be a Jevic case, the way which the distribution of proceeds have been set up in a lopsided way, which has none of the hallmarks of fairness, of a disinterested broker looking over the process, puts the employees' claims fully to the discretion of the Debtor and the noteholders and control that process and all the decisions that are made, except potentially for a person who would come for a full hearing in court. But that is not a convention that belongs within any Bankruptcy Code or bankruptcy resolution, your Honor. Thank you.

THE COURT: Thank you, sir. Anyone else?

MR. RAMOS: Good morning, your Honor. Marcos Ramos, Richards, Layton & Finger.

Your Honor, as Mr. Shapiro indicated, we intended to call Debtors' witness first on the settlement motion.

THE COURT: Okay.

MR. RAMOS: Then we would be, after the other parties are finished, proceeding with the Committee witness on that motion, as well. The Debtors' witness is Mr. Dana LaForge. And your Honor, we included in the binders that we provided to the court and to the clerk the Debtors' exhibits. Volume 3 includes the declaration of Mr. LaForge. It's volume 3, and it's Exhibit 13 in volume 3. I have some extra copies of the declaration itself, if I can approach.

Your Honor, the declaration of Mr. LaForge was filed shortly before the December hearing at which the settlement motion was last considered by the Court. We intend to proceed by way of his declaration in terms of offering it as his direct testimony with only a few limited follow-up questions. We've advised the parties of that, and there's no objection to proceeding in that fashion.

THE COURT: Any objection to the admission of the declaration? Okay; it's admitted without objection.

MR. RAMOS: And we would call Mr. LaForge to the stand, your Honor.

THE COURT: Okay, very good. Mr. LaForge, if you would step up to the stand, remain standing for your affirmation.

DANA LAFORGE, after having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. RAMOS:

Q. Good morning, Mr. LaForge.

Mr. LaForge, can I ask you to pull out the binder that I was just referring the Court to? It's identified as binder 3 of 3. And in that binder, ask you to turn to what's identified as Debtors' Exhibit 13.

A. I'm there.

Q. Sir, can you identify that document for the record?

A. Yes. It's the declaration I submitted in December.

Q. Are you familiar with the contents of that declaration?

A. I am.

Q. Can I ask you to take a quick look at paragraph 1?

A. Okay.

Q. And would you please describe whether the information set forth in paragraph 1 is accurate as of today?

A. It's all accurate. It leaves out the fact that I'm also the chairman and sole director of all those companies.

Q. With that caveat, Mr. LaForge, regarding your position with the Debtors, do you affirm the contents of this declaration as your testimony today in support of the joint settlement motion?

A. I do.

Q. Mr. LaForge, let me ask you to stay in binder 3 and ask you to turn to tab 9.

A. I'm there.

Q. And I'd ask you to turn two pages in or so into the document and ask you if you can identify that document.

A. I can identify it. It's our motion to approve the settlement.

Q. And is this the motion under which

you're today appearing?

A. It is.

Q. And let me refer you to Exhibit A to that motion, and Exhibit 1 to Exhibit A, two or three pages into what's under Exhibit A.

A. Okay, I'm there.

Q. And sir, are you familiar with that document?

A. I am.

Q. What is it?

A. This is the executed version of the settlement term sheet.

Q. And is this the settlement agreement for which the Debtors and the Committee jointly today seek Court approval?

A. Yes, it is.

Q. Sir, just stay on page 1 of the settlement term sheet, about three or four paragraphs down. See the reference to CD Star Holdings, LLC?

A. I do.

Q. It refers in that same paragraph to an APA, correct?

A. Yes, it does.

Q. And sir, do you know, has the closing occurred?

A. The closing occurred in late November.

Q. Do you remember the date that that closing occurred?

A. The date?

Q. In November?

A. I believe it was -- the document is dated the 28th of November.

Q. Sir, to your knowledge, was the APA referred to here in the settlement term sheet, was that amended prior to the closing?

A. My understanding is it was amended prior to the closing.

Q. May I ask you to turn to tab 16 in the same binder that you have before you?

A. I'm there.

Q. And sir, can you identify that document?

A. Yes, this is its amended asset purchase agreement that I was referring to.

Q. You're familiar with this document, sir?

A. I am.

Q. Is it your understanding this is the final form of the APA referred to in the settlement term sheet?

A. Yes, that's my understanding.

Q. I'm going to ask you to do a little flipping back to tab number 9 for me, sir. And back to the settlement term sheet that you were just discussing.

A. I'm there.

Q. And, sir, do you know whether or not under the settlement term sheet an escrow agreement was contemplated?

A. It was.

Q. And do you know in connection with the closing we were just referring to whether that agreement was executed by the Debtors?

A. It was executed, yes.

Q. Let me ask you to turn to tab 17.

A. Okay, I'm there.

Q. Are you familiar with that document, sir?

A. I am.

Q. And can you just describe what it is for the record?

A. Yes. As part of the settlement, there was some funding as part of the settlement that needed to be put into escrow, and this is the agreement that contemplated that.

Q. To your knowledge, sir, is that the final form of the escrow agreement executed by the Debtors as of the closing?

A. Yes, it is.

Q. Thank you. One last question from me, Mr. LaForge. Tab number 9 again; I'm sorry. Put you right back where I started you.

A. Okay.

Q. Let me ask you to turn to page 3 on the settlement term sheet.

A. Okay, I'm there.

Q. It's page number 3 at the bottom. And sir, you see the second bolded header on the left-hand side called Claims and Causes of Action?

A. I do, yes.

Q. And that long paragraph, that's next to it, right?

A. I do, yes.

Q. Let me refer you to the last sentence

of that long paragraph, sir. Have you reviewed that, sir?

A. I have, yes.

Q. Sir, can you just clarify for me, are the Debtors today asking the Court to approve the Debtors' contribution of any claims or causes of action to the trust?

A. We are not.

Q. And sir, have the Debtors considered whether to add a clarifying provision to that effect in the proposed order that they will submit to the Court in connection with this joint settlement action?

A. I believe we have added that clarification to the order, and have indicated that they would be prepared to augment that as any matter that would be helpful.

MR. RAMOS: Thank you, Mr. LaForge.

Your Honor, subject to redirect, I'll pass the witness to the objecting parties.

THE COURT: All right.

MR. KAPLAN: Good morning, your

Honor. Your Honor, for the record, again, Gary Kaplan, Fried Frank.

Your Honor, because we haven't killed enough trees, we also have our own witness binder, if we may approach the witness and your Honor to hand out the binders.

THE COURT: Yes.

CROSS-EXAMINATION

BY MR. KAPLAN:

Q. Good morning, Mr. LaForge. As you know, Gary Kaplan from Fried Frank on behalf of the DDTL parties.

I want to start actually back on August 16th. At the hearing on August 16th, the Debtors announced that a settlement had been reached, correct?

A. Correct. Yes, an agreement to move forward and consummate the settlement that had been agreed to, yes.

Q. And the first that you had learned that settlement had been reached was actually the morning of August 16th, right?

A. Of that settlement and that structure, yes.

Q. You were at Richards Layton's offices when you learned of it?

A. I was.

Q. And at that point in time, you weren't the sole director of the Debtors, right?

A. That's correct, I was not.

Q. Mr. Dennis Smith was the other director?

A. That's correct.

Q. But Mr. Smith wasn't present in Delaware at that time, was he?

A. He was not.

Q. And just to be clear, you were not involved in any way in the negotiation of the August 16th term sheet, correct?

A. Of that term sheet, no.

Q. And you were, in fact, completely unaware of the structure of the term sheet, meaning use of the trust and the contribution of assets or cash, prior to receiving it on the morning of the 16th, right?

A. That structure was new to me on the 16th, yes.

Q. And so then after receiving the term

sheet that morning of the 16th, you then came to the courthouse for the hearing, right?

A. Correct.

Q. And when you got to the courthouse, it was your first chance to actually discuss the term sheet at all with any of the representatives, correct?

A. That's right.

Q. And prior to the start of the hearing, you had a brief conversation with Committee counsel about the term sheet, right?

A. I did.

Q. But because of the time constraints of the start of the hearing, you were somewhat limited in the amount of time you could discuss it, right?

A. That's correct.

Q. And in that brief conversation, there was one item of the term sheet that you were attempting to negotiate, right?

A. Yes, there was a -- yes.

Q. And that item was expanding the released parties under the term sheet?

A. That's correct.

Q. But the Committee wasn't prepared to negotiate any of the terms with you, were they?

A. The Committee was not prepared to discuss the term that I raised, and so, yeah, there was the term sheet that was given to me was the one that we had to make a choice on.

Q. Okay. And you didn't talk to the noteholders prior to the start of the hearing, did you?

A. That morning? Not between receiving the term sheet or the concept of the term sheet and the hearing, no.

Q. And so you don't know, between that time, you don't know whether the noteholders would have been willing to make any modifications to the term sheet, do you?

A. I don't know.

Q. And the Debtors didn't seek to adjourn the August 16th hearing to have more time to try to negotiate, did they?

A. We did not.

Q. Okay. And then after receipt of the term sheet and your conversations, at some

point, the Debtors approved the term sheet, right?

A. It actually was a little bit different. We had had a discussion among the directors. We had had a discussion before, and I don't recall if we had one afterwards, but we had a -- the directors, which were only two, had a discussion about how we would handle each of the alternatives. That is that term sheet or, you know, one with changes.

Q. And let's take a look at the August 16th term sheet. If you could turn to tab 20 in your binder.

A. I have it.

Q. And you see that the cover page of this document is an email transmittal from Ms. Hazan, counsel to the Committee, to a number of parties saying here's a black line, the term sheet showing changes to circulate this morning?

A. I do.

Q. And is this -- obviously a clean version, but is this version of the term sheet like the board approved on the 16th?

A. Yes. This is the version of the term sheet that the board agreed to give our commitment that we would work forward to documentation to apply the concept, yes.

Q. But it's the one that the board members met and decided --

A. That's correct.

Q. And approved?

A. Yes.

Q. And this term sheet provided for -- this term sheet changed over time from the one you're seeking approval of today, right?

A. Yes, it did.

Q. And were there any significant changes to the terms?

A. The concept never changed that we agreed to, no.

Q. And when you say the concept never changed, could you just be more specific about what it is that you're referring to?

A. Sure. There were -- this was simply, this was what it was. And as we documented, we drilled, my understanding is, between the sides, they drilled down the language to

accurately document the verbal discussions that our counsel had had prior to me coming to the courthouse and talking to the Committee counsel.

Q. Wasn't it your understanding when you approved the term sheet that none of the Debtors' assets were going to be distributed?

A. Yeah, that is my -- that was my understanding, yes.

Q. And your understanding was because all the assets were going to be sold to the purchaser, so it was up to the purchaser and the Committee how they were going to allocate the assets, right?

A. That's correct.

Q. And were you aware at the time that the term sheet contemplated that the APA would be amended so that certain assets of the estate would be excluded assets and remain back in the Debtors' estate?

A. I don't think that's -- let me try to answer, see if I've accomplished what you want. I was -- in a deposition, I acknowledged that I was unaware of the

mechanic that the assets that were being sold to the purchaser would get to the trust. There was never, as part of this transaction, a situation where assets were coming back to the Debtor for the Debtor to do something with.

The concept, as I referred to it, was that assets would be contributed, assuming the purchase was approved, those assets purchased by the buyers, the purchasers, would then be contributed to the GUC. The mechanism of how that happened was, quite frankly, not a big discussion that morning.

Q. You testified on direct that you're familiar with the asset purchase agreement, correct?

A. I am, yes.

Q. And are you familiar with the concept of excluded assets?

A. I am.

Q. I'd like you to turn to page 2 of the term sheet, and in particular the side where it says claims and causes of action.

A. Yes.
Q. And if you see there at the beginning, it says, "The purchaser shall cause the APA to be amended at closing so that the following shall be excluded assets under the APA." Do you see that?
A. That's what it says, yes.
Q. So doesn't that mean that the term sheet that you agreed to on the 16th contemplate that had certain assets would be excluded assets and thus remain with the Debtor under the APA?
MR. RAMOS: Objection, your Honor. It mischaracterizes the term sheet, pause it was an incomplete referral to the term sheet, his question, because he omitted the clause after the term APA. But he's calling for a legal conclusion in addition to that.
THE COURT: Overruled.
THE WITNESS: Would you repeat the question, please?
BY MR. KAPLAN:
Q. Sure. Doesn't the term sheet that you

approved on the 16th provide for the APA to be amended so that certain assets would be excluded assets from the APA to remain back with the estate and then contributed to the GUC trust?

A. The mechanism was not something we got into that morning. The discussion was whose assets would end up in the GUC trust. The settlement agreement would only be relevant if the purchase agreement was approved. If the purchase agreement was approved, then there were no assets that the Debtor estate would still have that would be contributed. In my mind, that language there was simply a mechanism to distribute the assets which would or wouldn't work to be determined by the professionals, legal professionals, when they had time. We never assumed that the assets were being contributed back to the estate for it to, you know, for it to do something with.

Q. Why not? I mean, doesn't the term sheet clearly say that they are going to be excluded assets?

A. We were very interested that morning

in whether or not there were any estate assets being contributed. There was a fulsome discussion about that. Not about the term sheet, but about whether or not any of our assets would be included. And it was presented to me by our counsel that the very fact it wasn't helped make this a term sheet that we could consider.

So the thought that there might be language that if I went back and mapped to a definition would imply something to a different reader wasn't the issue. I had a concept in mind. I confirmed verbally that that was the concept, and we ensured that by the time we had an executed version, that that's what was in the agreement.

Q. By prior to receiving the term sheet, you never heard of the concept that is in the term sheet, right?

A. I hadn't seen the structure.

Q. So how could you have a concept of mind of what the term sheet would provide until you got the term sheet and read it and understood what it provided for?

A. The discussion, I think the way, if you can imagine the way this would play out in the offices that morning, was there was a term sheet. The time on this term sheet was 10:23. I don't know what time the hearing was; I believe it was a late morning hearing. The discussion wasn't about the language as much as that the board was involved with, it was about the concept. The concept was that the purchasers would contribute their, the assets that they would have acquired under the APA, and they would contribute that to the GUC trust. If I thought for a moment there was a chance I could get those assets back, I would have done that. I would have tried to do that.

Q. And you didn't try to do that, though, after receiving and approving this timesheet, did you?

A. I did not try to do that; that's correct.

Q. Now if we could turn to tab 21?

A. I'm there.

Q. You see there's a cover email, and

this one comes from Nava Hazan to Kramer Levin and to Akin Gump attaching another draft of the term sheet, right?

A. Yes.

Q. And this one says attached is the draft term sheet that reflects the agreement reached yesterday, right?

A. It does, yes.

Q. Let's turn to, just going to the same provision we just looked at on page 2, this term sheet continues to provide that same language about the APA being amended so that certain assets would be excluded assets under the APA and contributed to the GUC trust, right?

A. It does, yes.

Q. Do you remember reviewing this term sheet?

A. I don't remember reviewing this term sheet.

Q. Let's turn to 21; tab 21.

A. We're on 21.

Q. I'm sorry, 22.

MR. KINEL: Excuse me, your

Honor, I'm going to object at this time. I could save it until the end, but if Mr. Kaplan is going to go through numerous iterations of term sheets, the objection is relevance. What's before the Court today is the settlement term sheet that was marked by Mr. Ramos earlier, not these drafts.

THE COURT: Overruled, Mr. Kinel. Of course it's relevant.

BY MR. KAPLAN:

Q. Mr. LaForge, if you could turn to the, again, the language on claims and causes of action. Actually, before you get there, to be clear, if you go to the first page, this is actually an email from Kramer Levin, Debtors' counsel, to the other parties, the purchaser and the Committee, right?

A. That is, yes, that's the email.

Q. And then if you turn, we'll go to the black line because it's easier to see the changes, so page 2 of the black line?

A. Yes.

Q. You see that the Debtors have added in some language into that provision that we've

been focused on, right?

A. I see the changes that, yeah. It's a KL draft, yes.

Q. And in particular, the Debtors, Debtors' counsel drafted to this draft term sheet was clarification that these assets which were going to be excluded assets would be contributed to the GUC trust by the debtors. Do you see that?

A. I see that, yes.

Q. Were you aware that at least your counsel was continuing to propose that the Debtors would be receiving these assets and contributing them to the GUC trust after you had approved the settlement?

A. I can't -- I don't recall reviewing any of these term sheets from the first one we saw to the last one. I don't know what the thinking of the marked change was. It reads as you read it. I know what the board approved, and I know what the final term sheet said, and I'm just afraid I can't get at this with any more information than what it says on the page.

Q. And the board certainly, as far as you're aware, didn't authorize this change, did it?

A. I don't recall seeing this, so no, the board would not have approved interim drafting.

Q. We may get back to the term sheets, but we can move to another topic for a few minutes.

Do you have your declaration in front of you still?

A. I'm sure it's...

Q. 13.

A. 13 of 3?

Q. Yes.

A. I have it.

Q. I'd like to you turn to paragraph 22, if you would, which is on page 6.

A. I'm there.

Q. All right. You see in there you testify that the terms of the settlement are fair and reasonable, right?

A. I see that, yes.

Q. Do you remember being deposed a couple

of weeks ago?

A. I do.

Q. And do you remember that we had a dialog about whether it was fair or not?

A. I do.

Q. And do you recall saying that you couldn't answer whether the settlement was fair?

A. I recall telling you I wouldn't answer the question the way you had phrased it.

Q. And do you recall why you said that?

A. Yes, because the question was getting at an equitable -- in my mind, it was a question about equity that was not a matter that the board or I would have considered at the time. I'd be happy to entertain the question again, but that's the best recollection I have.

Q. Okay. Do you recall that I asked you whether the allocation of value to some creditors and not others was fair?

A. I do recall that, yes.

Q. And do you recall saying that you could not answer that question?

MR. RAMOS: Your Honor, perhaps he could refer him to his deposition transcript.

MR. KAPLAN: Yeah, I was going to ask him the question first.

THE WITNESS: Yeah, it would be helpful to see it. Thank you.

MR. KAPLAN: May I approach, your Honor?

THE COURT: Sure. Thank you.

BY MR. KAPLAN:

Q. And in particular, let's go to the bottom of page 48, line 24. Let me know when you're there.

A. I'm sorry, 48?

Q. Yeah, page 48, then there's a question beginning on line 24. Mr. Diaz asked you, "But sitting here today, you're not prepared to say that the settlement, that the allocation of value in the settlement to some creditors and not others is fair?" Mr. Ramos objected. Then you can read your answer. And you can read it out loud and tell me if it's changed.

THE COURT: It's a long answer.
THE WITNESS: I was criticized for that.
MR. RAMOS: Your Honor, I'd just note, as well, that he directed him to 24, starting in line 24. For completeness, it may be appropriate to direct the witness starting at line 8 of the same page, 48.
BY MR. KAPLAN:
Q. I'm happy to start there, if that's easier. You can start at page 48, line 7, to avoid the objection; that's fine. Again, it's going to be another long answer.
THE COURT: All right, read to us.
THE WITNESS: Would you like me to read it out loud?
BY MR. KAPLAN:
Q. Read it and tell me if that's still your view today.
A. I'm sorry, am I being asked to read it out loud or just read it?
Q. Yeah, you can read it out loud and let me know if that's still your testimony today.

A. I want to go back before 7 to get the question.

Q. Let me know where you need to start.

A. Maybe someone can help me.

Q. You can start, if you'd like, on 46.

A. Yeah, yeah. So look, starting on 47, the question is, you were going to the fairness, and I don't recall if it was earlier or later, but we certainly talked about a settlement, a more wholesome settlement that I would have much preferred. And I believed what you were asking here was whether in my heart of hearts I personally thought this was fair.

And I had said what -- and I believe at some point in this, I referred to that I had a responsibility when I came to work every day, and what I would have preferred to see, I had to leave at home. And the determination at the time we had this term sheet was given the situation we were facing, which was we had vendors, all the normal constituents in any operating company, vendors, employees, clients, customers, et

cetera. And we were trying to preserve the value of the ongoing operation, that with the decision we had in front of us, which is what I believe we get at on page 6, paragraph 22 of my declaration, was that was a fair determination of what the right thing to do was for the -- taken as a whole for the estate. It is not, and I have not ever tried to imply, that it is the agreement that I would have drafted myself.

I'm sorry if I didn't answer your question.

Q. Yeah, just go to the basic question, which is do you believe that the terms of the settlement, including the disparate treatment of unsecured creditors, is fair?

MR. RAMOS: Objection, your Honor. No foundation in terms of the disparate treatment issue embedded in this question.

THE COURT: Overruled.

THE WITNESS: I'm sorry, I've got to get some context, a little more context for the question. And I'm sorry that I need

to do that, but I do.

Do I personally think, or do I think it was a fair decision -- it was fair to make that decision?

BY MR. KAPLAN:

Q. Do you think the term sheet -- putting aside your decision-making process, and I'm not questioning your decision-making, I'm asking you sitting here today, is it your testimony that you believe the term sheet and the disparate treatment of creditors is fair?

MR. RAMOS: Objection, your Honor; relevance. He's appearing on behalf of the Debtors as their board member and to discuss the decision he made in that capacity. So his personal view --

THE COURT: He says in his declaration it's fair. Overruled.

THE WITNESS: I said in my declaration it's fair. It was -- yes, it was fair.

BY MR. KAPLAN:

Q. So today it is your view that it is fair?

A. It is fair.

Q. And why is it fair to have certain creditors -- you're aware, for example, that priority creditors don't receive any distribution from the GUC trust, right?

A. I am aware of that.

Q. And you're aware that under the Bankruptcy Code priority scheme, they're called priority creditors because they're supposed to be paid before general unsecured creditors, right?

A. I am aware of that.

Q. And why is it fair to have a settlement that provides -- that the priority creditors don't receive any value?

A. It is -- they were assets of the purchaser. The purchaser and the Committee negotiated this term sheet and presented it to us. Taken as a whole, I believe it was fair. I had a decision to make, and my decision was that the term sheet was fair, taken as a whole to the overall company, the value of the estate.

Q. Was it fair to those creditors, to the

priority creditors?

A. There's never -- when people -- there's not much of an answer to that. There is -- there were all throughout the case and my term at the companies, there were parties exercising their contractual rights. They made those determinations. I wish in many cases those determinations were different.

Q. You haven't tried to negotiate the terms of the term sheet since you received it back on August 16th, right?

A. I have had discussions around changes to -- I've had discussions around agreements that were not in the term sheet that I would have liked to have had in the term sheet, yes. So I have -- I didn't pull the term sheet out, send it to someone, and say let's negotiate this paragraph. There were elements of the term sheet, of the settlement, that I preferred would have been different, and I on several occasions had those discussions.

Q. You never had specific discussions, for example, to have priority creditors receive a distribution from the GUC trust,

right?

A. I did not have that discussion.

Q. And you never had specific discussions about the deficiency claimants getting any distribution from those aspects of the GUC trust?

A. I did not.

MR. KINEL: Objection; it assumes facts knots in evidence.

THE COURT: Which facts?

MR. KINEL: That deficiency claimants are not receiving anything under the term sheet. That's just factually incorrect.

MR. KAPLAN: I said under the provisions of the term sheet under which they do not receive a distribution.

THE COURT: The objection is overruled.

BY MR. KAPLAN:

Q. Let's go back just to make sure that we get the record complete with respect to the term sheets. So we can go back to the binder of the term sheets. Go to 24.

THE COURT: You can use our

handy shelf there. Isn't that a nice shelf?
BY MR. KAPLAN:
Q. I apologize; I'll wait until you get it in front of you.
A. So I'm at the witness binder, correct?
Q. Correct, and tab 24.
A. Yeah.
Q. Are you there, Mr. LaForge?
A. I'm there.
Q. It's an email forwarding from Nava Hazan to Steve Leonard, and below is an email from Joe Shifer to Nava, right?
A. Yeah.
Q. And this is also attaching a revised term sheet red lined to the prior one, right?
A. Yes, it is.
Q. Okay. And now if you could turn to on the black line, that's actually what we've been focusing on, the claims and causes of action?
A. The black line, page 2?
Q. Yeah, the black line, page 2.
A. I'm there.
Q. And you see now there's markup, it now

provides that the purchasers will cause the APA to be amended, so rather than being excluded assets, that upon the later date the bankruptcy court enters an approval order on the formation of the GUC trust, these assets will be contributed to the GUC trust.

A. Yes.

Q. Did you authorize that change to the term sheet?

A. I don't recall seeing an interim term sheet, so I don't recall authorizing it, no.

Q. Did you recall any discussion about the fact that this change was being made to modify it from these assets being excluded assets to now being assets that would be sold to the purchaser?

A. There was -- I don't recall any discussion on the mechanism of transferring from the purchaser to the GUC trust, which this is an element of. As I said, when I read it the first time, given the timing, how they got there was irrelevant to the decision that we made at the time. So no, there was no discussion about making this change.

Q. We talked a little bit about the decision-making back on August 16th. Let's fast forward to where we are today.

A. Okay.

Q. You testified earlier that the C Star transaction closed at the end of November, right?

A. I did, yes.

Q. And the Columbus sale closed, as well?

A. The Columbus sale was closed. I don't remember the specific date, but yes, it closed about the same time.

Q. And the DIP has long been approved in this case, right?

A. The DIP has been assumed by the purchasers.

Q. And you personally, I guess it's your testimony in deposition was you're continuing to support the settlement because you gave your word you would support it, right?

A. That's correct.

Q. And what is the reason that the Debtors are continuing to seek approval today, besides your word? Is there any other reason?

A. I think it's been covered, but not by me, so I'll say it. When we negotiated the APA, that is the point in time where we crossed the bridge of letting these causes of action leave the estate. And it was with great reluctance that we agreed with that provision of the APA. And I recall during those discussions trying to change that all along the way. Those assets were no longer ours. Somebody had acquired them as part of the APA. The ability to share those among some of the creditors struck me as, continues to strike me as maybe not as good as sharing them with all the creditors, but better than not sharing them at all.

Q. When you say that ship sailed, you were unaware that the actual terms of the term sheet contemplated modifying the APA so they wouldn't be transferred, correct?

MR. RAMOS: Objection, your Honor; misstates his prior testimony.

THE COURT: Overruled.

THE WITNESS: I've tried to reply to that by telling you I did not believe

that's what the term sheet said. The words are what the words are. We, because of the time that we had, much of the discussion on what we were agreeing to was verbal, and I believe that the terms were read into the hearing that day, which probably didn't address the mechanics, but certainly addressed the concept that I had agreed to either in RLF's offices or out in the hallway here that the board had agreed to. And that was not that we were getting the assets back. There may have been a mechanism proposed in my mind amended as proposed that there was a mapping, but it was never my assumption that we would get those assets without a quid pro quo that they would be directed to the GUC trust.

Q. But it's different between getting the asset back and directing them to the GUC trust and never getting them back and having the purchaser deal with it as they please, right?

A. I'm not sure of the distinction you're trying to draw.

Q. Do you see a distinction between that?

A. Between?

Q. The Debtor retaining certain causes of action and contributing them to a trust versus the purchaser buying them and contributing to the trust.

A. If that were the case, I would see a distinction, yes.

Q. If that were the case -- explain that; I don't think I follow that. I apologize.

A. You created a hypothetical that in my mind didn't exist at the time.

Q. Not with standing the words of the term sheet?

A. Notwithstanding the words of the term sheet.

Q. We talked a little bit earlier about the time before the hearing. Do you recall that prior to the August 16th hearing, the Debtors had already agreed to adjourn the DIP hearing?

A. Can you repeat the question?

Q. Yes. Do you recall that prior to the morning of August 16th, the Debtors had already agreed to adjourn the DIP hearing?

A. So I recall that now, after reading

some documents preparing for this, I did not -- I didn't, certainly didn't recall that at deposition time.

Q. And you weren't expecting the sale to close immediately upon approval of the sale order, were you?

A. No.

Q. And in fact, it took several months for it to close after the sale order, right?

A. It did.

Q. And would there have been any harm during the sale hearing for a week while the term sheet was finalized?

A. There was pressure all the time from the three operating companies. They weren't strong companies to begin with. Usually in the food chain of making the product, they were not the strongest provider, and so I can't calibrate sitting here the effect of being able to go to employees and customers and say the sale has been approved I can't recall what actions were taken upon the approval, pardon me, the approval of the sale and the closing of the transaction. But it's

not like those were three months where nothing, where no -- where we didn't utilize the benefit of the information of the sale being approved by the Court.

Q. But sitting here today, you can't say one way or another whether adjourning the sale by a week would have had any impact?

MR. RAMOS: Objection; calls for speculation.

THE COURT: Overruled.

THE WITNESS: I can't say that.

BY MR. KAPLAN:

Q. And just to go back to a couple of questions before, you said you sort of refreshed your recollection that the DIP hearing, that the DIP motion had been adjourned prior to August 16th. On the morning of the 16th when you approved the settlement term sheet, were you aware that the DIP hearing had already been adjourned?

A. I don't recall. I'm sorry.

MR. KAPLAN: One minute, your Honor.

THE COURT: Mm-hmm.

MR. KAPLAN: I have nothing further.

THE COURT: Okay. Any other objectors wish to cross-examine the witness? No? Yes. Okay. Before you do so, we're going to take a short recess, then we'll have your cross.

During our break, you may not discuss your substance of your testimony with any person. Okay?

THE WITNESS: Understood.

THE COURT: About five minutes.

(A brief recess was taken.)

CROSS-EXAMINATION

BY MR. RAISNER:

Q. Good morning, Mr. LaForge, Jack Raisner, the Trevor Miller WARN class.

A. Good morning.

Q. Mr. LaForge, it's correct to say you are familiar with the August 19, 2016 sale order?

A. The sale of Columbus?

Q. Correct, the sale of Columbus.

A. Yes, I am.

Q. And you're familiar with the provision in that sale order which provides for something called an employee funding escrow?

A. Yes, I am.

Q. Are you also familiar with something called the CFC Employee Reserve?

A. I may be mixing those terms. I'm familiar with an escrow of $4.6 million. I believe it may fall under the latter, not the former.

Q. Is it correct to say or does this refresh your recollection that after the September 13th closing of the Columbus assets, the escrow was renamed the CSC Employee Reserve, that the two things are one in the same, or is that not correct?

MR. RAMOS: Your Honor, if I could just lodge a quick objection. I'm not sure of the relevance of these questions. I think the questions are arising under the terms of the sale order, which is not at issue today; we're here under the settlement term sheet.

MR. RAISNER: Your Honor, the

question before there Court is a hearing on the settlement, the global settlement of this case leading to the dismissal of the case, and what provisions have been made for creditors in this case. And therefore, I'm asking questions that are not precisely pertinent to the declaration that Mr. LaForge provided in his direct testimony, but he has knowledge as a witness that is pertinent to the fairness and the appropriateness of this entire transaction.

THE COURT: Yeah, overruled. Do you recall the question?

THE WITNESS: Well, I think the question is about a change in names of an escrow agreement. And in preparation for this, in reviewing public documents, I didn't review public documents. And I'm afraid I can't answer the question of the name change. I'm very familiar with an escrow of $4.6 million, whatever its name may be, if that's helpful.

BY MR. RAISNER:

Q. Is it your understanding that this

escrow of $4.6 million is part of the Debtors' estate, or is it your understanding it has been alienated from the estate of the Debtors?

A. It never was the Debtors estate, to the best of my knowledge. It is an escrow provided by the purchasers or the noteholders, it's an overlapping group, that the directors insisted upon after the sale or during the sale process to provide in the event that -- well, there are a couple of elements. To provide certain claims that employees might have with respect to severance and vacation, of the Columbus entity only; and in the event it was deemed that the company was responsible for any WARN wages, that it would cover that, too, and legal fees.

Q. Whose legal fees?

MR. RAMOS: Your Honor, if I may renew an objection. I think counsel is examining him without the benefit of putting the documents before him, and so it's unfair to the witness to ask for his recollection in that way. And I'd simply note that we have some sensitivity as we understand that these,

that there are ongoing issues with the WARN claimants in the separate adversary proceeding, so we're cautious in terms of the scope of what counsel is inquiring into.

THE COURT: I think the witness said he was familiar with the escrow and with the APA, although he didn't review the documents, so I think he can answer the questions. Overruled.

BY MR. RAISNER:

Q. Mr. LaForge, I'm correct that your testimony is that the escrow in question is not part of the Debtors' estate. My question to you, is there any provision that the Debtors have made in its estate to pay for any employee priority claims of any sort?

A. Of the Columbus estate?

Q. Yes.

A. Assuming that the priority claims include severance and vacation, which I assume is the case, we have made a provision. We have negotiated as part of that sale agreement that $4.6 million would be escrowed that would revert back to the folks that funded it in the

event that it was not used.

Q. But my question a moment ago was whether it is your understanding that at present, this escrow is part of the estate of the Debtors or is alienated from the estate? And I understood you to say that you thought it had never been part of this estate, and now you just said that the Debtors are relying on this $4.6 million to pay the claims of the estate. And am I correct that without that $4.6 million from the escrow, the Debtors have no capability or intention to pay any employee priority claims?

MR. RAMOS: Objection; compound and argumentative.

THE COURT: Overruled.

THE WITNESS: There are a few questions in there; I'll do my best to sort them out. Taking them in reverse order, from a capacity standpoint, in the absence of the escrow, there would be no ability, probably no, I can't think of any, ability to pay claims. That was the primary reason that we negotiated that into the agreement.

Help me, what didn't I answer? What's the second part?

THE COURT: I think that was the question. I didn't hear more than one question.

BY MR. RAISNER:

Q. Are you aware of any documentation that exists that set terms for this escrow?

A. I don't believe there's an escrow agreement, to the best of my knowledge. I believe the only reference to it is in a file -- a document that was filed with the Court, and I can't remember which document it was. But it does refer to it as an escrow. I have since that date looked for an escrow agreement and have been told there is not one.

Q. So there is nothing that describes whether this escrow is revocable or not, is there?

A. The only --

MR. RAMOS: Objection, your Honor; calls for a legal conclusion.

THE COURT: Overruled.

THE WITNESS: The only

documentation is what appears in the documents that were provided to the court. I would have to -- I would have to read that again. I'm sorry, but I would have to read that again to know if there are any provisions.

BY MR. RAISNER:

Q. Is there any understanding as to whether that escrow will survive if the Debtors' estate is converted into a Chapter 7?

A. Is there any -- will it survive?

Q. Yes.

A. I don't know the answer to that.

Q. And do you know or have any understanding as to whether the escrow would survive if the Debtors' estate is dismissed?

A. I'm sorry, I don't know the answer to that.

Q. The escrow as it's described in the sale order and in the Debtors' dismissal order, which is docket 685, refers to an amount that the escrow would contain that would satisfy what are called the estimated or anticipated employee priority claims if they are non-WARN claims, and would pay the

anticipated or estimated WARN claim. Are you familiar with that language generally?

A. I'm familiar that that is the intent that the directors had when they negotiated that provision.

Q. Is there any provision that you're aware of that purports that the employee priority claims will be paid in full?

MR. RAMOS: Objection, your Honor. The question is based on the dismissal motion which is not before your Honor this morning. And we renew the relevance motion.

THE COURT: Look, I know you and Mr. Kinel have a very specific theme, which is you want me to focus, laser focus on one thing. I have to say I disagree. I think it's a package deal. So I'm not going to not have testimony that's focused on the dismissal motion. I don't see how you can separate them.

THE WITNESS: Can you repeat the question, please?

BY MR. RAISNER:

Q. Sure.

A. Thanks.

Q. Are you aware of any document or do you have any understanding whatsoever based on anything that the Debtors and the noteholders intend to use the escrow to pay the priority claims in full?

A. The calculation that was done, there was a calculation done by the CFO of Columbus that came up with an amount. And the intent of the amount was -- and it was to ensure that if, in fact, some court or some other party determined that there were amounts owed, that there would be adequate funding to cover those amounts. That included, remembering the columns from that lengthy spreadsheet, which I believe you have, was vacation pay, severance pay, and potential WARN, in the WARN subject, there's a WARN case going on at the moment. And in the event that the company were deemed by a court to be responsible for the WARN wages, that the intent initially was to calculate an adequate amount to cover that, plus an amount for the taxes around that, workers' comp, payroll taxes, and legal fees.

So the intent would have been, would be to pay vacation, to pay severance, and to see if the company is responsible under WARN. As most people probably know, there's two sides, two differing opinions on the liability there, and that will be sorted out in another venue, I suppose.

Now, the reason I went through that is because if the question is is it fully adequate, as I think you know and there have been the issue raised with us, or your partners have, that there are different calculations when you go from Columbus court to Delaware court with respect to how you calculate some of those numbers. To the extent that those, that post funding the escrow those amounts have gone up, then there would not be enough to cover all of those claims in full. But that doesn't change the vacation, severance, and the non-WARN priority claims.

Q. So there is a reasonable scenario in which the escrow at $4.6 million would fall short of what a court might award the

claimants in that fund; is that correct?

A. If -- I don't know about a reasonable chance. I can imagine a scenario where that's the case where it is fully determined without any settlement that the company is responsible for the full WARN wages as calculated subject to the caps that exist, that given the fact that it is moved from Columbus to Delaware or that was just not factored in, if you will, at the time of the calculation, that that would not cover it. So that's correct.

Q. And in the event that the funds in the escrow were insufficient to cover the employees' priority claims, what would happen then? Would the distribution then be at some fraction of the full amount of those claims, or would there be added funds to the escrow in order to pay the claims in full?

A. At the moment, there have been no discussions about adding funds. So it would be, if we got there, we would have to answer that question, but it's quite frankly hard to know who would come up with that money and why they would.

Q. And that would be up to whom to determine whether funds should be added or could be added?

A. Well, whoever the board at the time -- I say board, it's just me, right? So whoever I would go to and ask if they would consider topping that up.

Q. And you would go to the noteholders?

A. That would be the only relevant place to go, although it's hard -- I'll just stop there. I don't know what their reaction would be. I suspect -- I don't know what their reaction would be.

Q. But they would have veto power to not fund the claims in full by topping up the escrow?

A. Well, the -- I'm sorry to interrupt.

Q. That's okay.

A. It's not an agreement that they made that they have a veto over, it's that there was a calculation made, there was a deal cut at the time to protect the employees. In the event -- and it still would fully cover the employees under the assumptions of the laws

that were deemed the calculations would be made. Because, as you've pointed out to us, that in the event that the company is, in fact, responsible for those WARN wages, and there are defenses that suggest it's not, but if it is, and since we are in Delaware, there's additional -- the calculation is different. Same number of days, but business days, work days, and it becomes more money and there's inadequate funds.

Q. Mr. LaForge, I'd just like to return to your itemization of what would be payable out of the escrow, and you mentioned the various types of claims, and you also mentioned at the end attorneys' fees. So I just wanted to ask you your understanding of what the attorneys' fees payment would be. Are you referring to the attorneys' fees that might be part of a statutory remedy to the claimant, or are you referring, as well or as opposed to, the fees and expenses of the defendant who is defending the claims against the employee claims?

A. I think, you know, depending on what

the company chose to do, it will probably come to court to, you know, to see. But this was -- although for the reasons I mentioned before, the numbers turn out to be somewhat inadequate in Delaware calculation rather than Ohio calculation where they are adequate, the attorneys' fees were a bit of a sway. There's a lengthy spreadsheet, as you know, a lengthy, hard-to-follow spreadsheet.

But in fact, what the directors were trying to protect themselves and to ensure we could do is if the defenses that the company has and believes are strong held up, this went to court and held up in court -- pardon me, did not hold up in court, and the full amount was, the full WARN wages were granted to the employees, then we estimated that what the legal expenses would be, and I think that was without -- it was a very, it was around -- it was $500,000.

Q. Legal expenses of whom, Mr. LaForge?

A. I don't believe -- I would have to look back to the document to see if it's referred to exactly who that would be.

Q. So you're not sure if it refers to the legal expenses of the plaintiffs' counsel or the defendants' counsel?

A. Well, we were -- as directors, we were interested in both. So I don't know that there's any specific language that deals with that. I think that would be a matter, if we get to the point where the company believes it needs to defend the claims in court, that we would have to see, you know, we'd have to figure out how to pay for that, and that's a source of funding.

Q. Would it be consistent with your understanding of this fee provision element that the defending Debtor would be able to have its attorneys have its fees paid and expenses out of the fund, even without a court order?

A. It is not my -- and I'd rather see the document and understand what it says before I comment on it, but I'll tell you my understanding in the absence of that, which is that there are multiple signatories to that document. We would probably err on the side

of cautiousness and reach out to other parties, whether it's the Court or not. But I would certainly take advice from counsel as to what would be the prudent way to deal with the situation.

Q. Turn for a moment, Mr. LaForge, to the non-WARN employee priority claims. Are you familiar with a process whereby a notice would be sent upon a dismissal to holders of the non-WARN employee claims which they would be informed that they were being allowed a certain amount of money for one of their claims?

A. Only in the most general terms from reviewing a potential settlement agreement with respect to this. Prior to that, I have not participated in WARN claims before.

Q. So you have no personal understanding of the terms of that sequence of events or the procedures, other than what the documents themselves say?

A. That is correct.

Q. Mr. LaForge, you're aware of the GUC trust which is I think indisputably part of

today's agenda?

A. I am.

Q. And you're familiar with the terms of the GUC trust in that it creates a body of oversight, board members of whom a majority of creditors, correct?

A. I am aware that there's a mechanism, and that, whether it's been fully worked out or not, I'm not sure. But yeah, there's oversight.

Q. And there's a disinterested trustee who is handling the administration of that trust, the distributions, and all of the operative functions of that trust; is that more or less true?

MR. RAMOS: Your Honor, I don't know if a document could be put in front of the witness. I think he just testified he wasn't familiar.

THE COURT: If you don't know the answer, that's an adequate answer.

THE WITNESS: I don't believe I know the answer to that.

BY MR. RAISNER:

Q. You're aware that a liquidating trustee is contemplated to administer that trust?

A. I'm aware of that.

Q. Was there ever any discussion of there being a liquidating trustee of sorts or a set of written procedures for the employees' priority claims as there is for the GUC trust?

A. There was never a discussion, to the best of my knowledge.

Q. Do you know why that was never discussed?

A. I don't know why it was never discussed.

Q. Do you know of any participation that employees are contemplated as having in administering or overseeing the employee priority claims distribution mechanism?

A. I don't. I'm not aware of that. I think there's a -- I won't draw the distinction between the GUC trust, which was negotiated by parties other than the directors of the company, and the task undertaken by, the negotiation undertaken by the directors of

the company and their professional advisors to protect the employees in a sale that generated cash. And with great confidence, I can say that we've got somebody looking after, you know, that can handle this. It's law, and the law will be what it is as opposed to a highly structured GUC trust that needs to be administered.

Q. Who is the person who will be handling this?

A. Well, there are calculations which will be shared among the parties, have been shared among the parties, the interested parties, the professionals, and that will be worked out. But on the Debtor side, I am the, other than the assistance of the former CFO who has access to the information, it is me.

MR. RAISNER: No further questions.

THE COURT: Thank you.

MR. RAISNER: Thank you.

THE COURT: You're welcome.

MR. BENSON: Your Honor, for the record, Ward Benson, Department of Justice tax

division here on behalf of the Internal Revenue Service.

CROSS-EXAMINATION

BY MR. BENSON:

Q. Just a few questions, Mr. LaForge.

Are you aware that the Internal Revenue Service has filed proofs of claim in this case?

A. Has what? I'm sorry.

Q. Has filed proofs of claim in this case? In these cases, I should say.

A. I'm sorry, I'm not familiar with the term. I'm not familiar with the term.

Q. When you say term, proof of claim?

A. Proof of claim.

Q. Okay. Are you aware that the Internal Revenue Service has asserted that it has claims against the Debtors?

A. Oh, yes. Yes.

Q. Do you know what I mean by the phrase priority claim?

A. I do, generally.

Q. What does that mean?

A. It means it comes ahead of other

creditors. Priority claim comes ahead of other creditors.

Q. Would a priority claim come ahead of the beneficiaries of the GUC trust?

A. I'd have to remember who all the beneficiaries -- it's just the unsecured Creditors' Committee. If the company were distributing money, that's correct, the priority claims would come ahead of the unsecured claims, non-priority claims.

Q. Okay. Do you have any reason to believe that the asserted priority claims of the Internal Revenue Service are not, in fact, entitled to priority?

MR. RAMOS: Objection, your Honor; calls for a legal conclusion. Not relevant.

MR. BENSON: As to relevance, it goes to the fairness of the settlement. It also goes, the direction I'm going in, in terms of bringing in priority creditors, which the Jevic court said was very important.

As to legal conclusion, I'm not asking him to determine whether they're

entitled to priority, I just want to know if the Debtors have any reason to believe we're not entitled to priority.

THE COURT: Overruled.

BY MR. BENSON:

Q. Do you have any reason to believe --

A. No. As a matter of fact, I assume they are priority claims. I just didn't want to make a -- draw a conclusion that I can't back up with the law. But I'm assuming they are priority claims.

Q. And are you aware that the priority claims of the Internal Revenue Service are approximately 2.4 million?

A. That sounds right, yes.

Q. Do you have any reason to believe that the amount the IRS has asserted in claims is incorrect?

A. I haven't looked at the numbers, but it would not surprise me that that's the correct amount.

Q. Okay. Now, at any point between the initiation of the negotiation of the settlement term sheet and the filing of the

objection by the Department of Justice to the settlement, did you or any of the Debtors' professionals reach out to the Internal Revenue Service or the Department of Justice to include them in negotiations?

A. I just want to make sure I -- did the Debtors or any of their professionals reach out to the participants to the, did you say the UCC or the noteholders?

Q. Did you or the professionals reach out to the Internal Revenue Service or the Department of Justice?

A. Not to the best of my knowledge of my knowledge.

Q. Did you ever ask the professionals whether they should be reaching out to either the Internal Revenue Service --

A. I did not.

Q. And as to the Department of Justice? Did you ask them or ask whether you should be reaching out to the Department of Justice?

MR. RAMOS: I apologize, your Honor, could I just clarify the time period? I'm afraid I didn't hear that part of the

question.
BY MR. BENSON:
Q. From when the negotiations of the term sheet commenced, term sheet versions, Mr. Kaplan asked you about, to the filing of the objection by the United States to this settlement motion.
A. And the question was did I think to ask the professionals if they should?
Q. Yes.
A. I did not think to ask the professionals if they should.
Q. Why not?
A. It comes back to the decision that we were making on August the 16th, which was the only situation where the settlement would be relevant would be where the purchase was approved, and the purchase approved all of the assets would be owned by the purchaser. And we could have reached out to the IRS, but we didn't have anything to share with them, unfortunately, and it was the purchaser who decided to contribute those assets to the GUC trust. So we wouldn't have reached out

directly to the -- why it did not cross my mind to reach out to the IRS.

Q. Did it occur to you you should reach out just to let the IRS know that this type of settlement was being contemplated?

A. Not to hide here, but I was a director. Whether things get filed, we reach out to professionals. We've been blessed to have good advisors, and I rely on them to make those kind of suggestions.

Q. Was there any discussion that perhaps the sale hearing should be adjourned to allow the inclusion of priority creditors such as the Internal Revenue Service?

A. Sale hearing on the 16th of August?

Q. Correct.

A. There was no discussion of that.

Q. Is there any reason why the sale could not have been postponed to include the Internal Revenue Service as a negotiating party?

A. The only answer, two answers to that, first is the pressure was extraordinary at these companies. I answered Mr. Kaplan

earlier in his follow-up questions, so those will speak for themselves. To suggest that we come out of a hearing with no decision and that there would not have been damage caused was not a risk we were prepared to take at that moment. And risk -- these were fragile companies that were relying on people paying their bills, were relying on people to ship, and fulfilling, more importantly, fulfilling orders and keeping employees.

So that was the primary decision for feeling a sense of urgency that morning in spite of the fact pattern that's been discussed.

Q. Okay. And so as a result of that sense of urgency, it was deemed unnecessary to bring in priority creditors to these negotiations?

A. As I said in my deposition, while the term sheet was new on the 16th to me and the structure and the narrowness of it, discussions of a settlement had been going on in some form or another since prior to filing. There were inner creditor matters that we

tried to resolve at every step along the way. There were -- I can't give you specific dates in the context, but our professionals were encouraging the parties to get together to talk, to come up with what I would have termed a global resolution. We had come to the conclusion that that was probably not happening since we were a couple of days before the settlement, and -- pardon me, the August 16th hearing, and we didn't have anything.

So when the term sheet was handed to us, it was the transaction that appears in the settlement term sheet, which was the purchasers and the Unsecured Creditors' Committee coming up with that arrangement, and the Creditors' Committee would drop their oppositions. It wasn't that -- we weren't doing something, we weren't distributing some of our assets. We didn't feel like we had anything to bring people in. We had made the case for months that we would prefer a settlement that would resolve these cases and end litigation, and this one has

seemed to, you know, keep it going for some obvious, you know, legal reasons outside of this case. But nonetheless. Our -- we were not giving anything -- we were not giving anything we had to anyone at the time.

Q. You mentioned that there were negotiations, including between creditors starting before the petition date through the sale hearing, and there was a hope that there would be a global settlement. Did those parties ever include the Internal Revenue Service?

A. When you say include, did they talk to -- if the question is did they actually reach out and talk to them, as I mentioned in the deposition, if we go pre-filing, there was a settlement with the IRS. The IRS claim, I believe, is primarily from one company, Columbus Metal Forming, and the claim was larger. And there was a settlement reached with the IRS where payments were made, monthly payments were made to the IRS to whittle down, if you will, that obligation. Prior to fully whittling it down, there was a filing.

So again, the timing matters here. To the best of my knowledge post filing, I don't know of any conversations directly with the IRS by any of the parties. I'm just not aware.

MR. BENSON: All right, that's all, your Honor.

THE COURT: Thank you, Mr. Benson. Any further questions? Any redirect?

MR. RAMOS: Two very quick ones, your Honor.

REDIRECT EXAMINATION

BY MR. RAMOS:

Q. Mr. LaForge, you were asked during the cross-examination whether after the August 16th date, after that term sheet that was being looked at with counsel for the DDTL parties, did you try to negotiate for the assets to come back into the estate, and I believe your answer was no. But my question to you is prior to that time period, from the outset of these cases, had you tried to have claims and causes of action kept in the estate

that otherwise were going under the proposed purchase agreements?

A. I -- yes. The answer is yes. And it was one of the more important matters for me, because to the extent that damage had been caused, and there were causes of actions that would with Stan, you know, the scrutiny of people who determined that, those struck me as better belonging to the estate than to the purchasers. There were, I think it's been documented here there was a term sheet about mid May from the purchasers that included all the causes of actions, and then there was an APA in late May from the same people with the same causes of actions. We had, I believe, filed with the Court an APA after that date keeping the causes of action.

It was very important to me personally, and I know the directors as a whole, to maintain those. And in the negotiation of the sale and the results of the sale auctions, that's where we ended up, disappointingly.

Q. So in the context of the sales, then,

the Debtors were not successful in terms of those discussions to try to retain claims and causes of action?

A. We were not successful.

Q. Sir, I think you testified, there was discussion during your examination about the August 16th hearing and the DIP motion and the timing issues related to that. But my question is do you have any recollection as to whether the Committee's objections to the DIP, were they actually withdrawn?

A. They were -- to the best of my recollection, they were withdrawn. That was important, there's a timing difference there that was pointed out to me, but, yeah, they were withdrawn.

MR. RAMOS: No further questions, your Honor.

THE COURT: Thank you, sir; you may step down.

THE WITNESS: May I leave the books?

THE COURT: Yes, please.

MR. RAMOS: Just one

housekeeping matter, then, your Honor. From the Debtors' perspective, we would move the introduction of the exhibits in the binders, which I understand there was no objection to by the various parties. That would be Debtors 1 through 17, and your Honor, just so you know, we handed copies to you; we're obviously retaining the originals of the exhibits being offered into evidence.

THE COURT: Right. Any objection to the admission of Debtor 1 through 17?

MR. KAPLAN: No objection, your Honor.

THE COURT: They're admitted.

MR. RAMOS: Thank you, your Honor.

THE COURT: You're welcome. Next witness? Let's at least get started on the next witness before we break for lunch.

MR. KINEL: Your Honor, the Committee calls Steven Sass.

THE COURT: All right, Mr. Sass, please take the stand and remain standing,

please.

STEVEN D. SASS, after having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. KINEL:

Q. Good afternoon, Mr. Sass.

A. Good afternoon.

Q. Could you briefly describe your educational background?

A. Sure. In addition to an undergraduate degree, I have an MBA in management, I have a law degree and am admitted as an attorney in Maryland, state and federal, and I'm qualified for CPA certification.

Q. Are you in good standing in the bar?

A. I'm sorry? Yes, I'm in good standing.

Q. And do you practice law currently?

A. I do at times, yes.

Q. Can you tell us what your role is in the Constellation cases?

A. Sure. In the Constellation case, I participate as a member of the Creditors Committee on behalf of Praxair, one of the

large creditors.

Q. And how big is the Committee?

A. The Committee has seven members.

Q. And you are Praxair's representative on the Committee?

A. That's correct.

Q. Do you participate in Committee meetings and calls?

A. Yes. It's very important to me and it's important to the process, so yes, I do?

Q. Would you say that you've participated in nearly all of the Committee meetings and calls?

A. Yes, I would say if not all, very close to all.

Q. Okay. Have you ever been on a Creditors' Committee before?

A. I've been on approaching 100 Creditors Committees over the last 20-some-odd, 30-some-odd years. Thirty-ish.

Q. So you have a lot of experience in Committee matters?

A. Yes.

Q. Would you consider the Creditors'

Committee in these cases to have been active?

A. This particular Committee was very active, much more so than average.

Q. Did there come a time when the Committee, you as a Committee member, became aware of settlement negotiations that were occurring between the Committee on behalf of the Committee and the noteholders?

A. Yes, settlement negotiations -- well, this case moved very fast in the beginning and then went into a hiatus more recently through a bunch of extraneous reasons. So yes, I was aware of negotiations ongoing.

Q. And was the Committee kept apprised of the developments in those negotiations?

A. Yeah, in my opinion, Committee professionals did a very good job keeping the Committee apprised of the ebb and flow and development of the negotiations, both through -- mostly through conference calls, but through a few emails, as well.

MR. KINEL: Your Honor, may I approach?

THE COURT: Mm-hmm.

MR. KINEL: I apologize, we're doing this out of order. But I've handed the witness what has been marked as Committee 3, which is simply the settlement term sheet, which I believe is already in the Debtors' binder, but not to make people look through binders.

BY MR. KINEL:

Q. Mr. Sass, I direct your attention to Committee 3. Do you recognize that document?

A. Yes, I do.

Q. Was this document approved by the Creditors' Committee?

A. Yes, it was. It was brought to the Committee's attention and approved through a Committee meeting, telephonically, I believe.

Q. Was there a discussion about the terms of this settlement?

A. As was all of the calls that we had about the ebb and flow of the negotiations, there was extensive discussion, questions raised and answered, so yes, there was a lot of discussion.

Q. Mr. Sass, do you believe the

settlement embodied in Committee 3 is fair?

A. Is it fair? Yes, I believe it's fair.

Q. Do you believe it's a reasonable settlement?

A. Given the circumstances in which the creditor body found itself, it's a more than reasonable settlement to the general unsecured creditors.

Q. To your knowledge, was it negotiated at arm's length?

A. I'm sorry, say that again?

Q. To your knowledge, was the Committee settlement negotiated arm's length?

A. Yes, absolutely.

MR. KAPLAN: Objection, your Honor. There's been no foundation whatsoever about any firsthand knowledge. All the testimony so far was he learned everything through counsel.

THE COURT: Overruled.

MR. KINEL: I asked to his knowledge.

THE COURT: Overruled.

MR. KINEL: Thank you. You can

answer.

THE WITNESS: I'm sorry, what was the question again?

MR. KINEL:

Q. To your knowledge, was the settlement negotiated at arm's length between the parties?

A. Oh, yes, it was.

MR. KINEL: May I approach once again?

THE COURT: Mm-hmm.

BY MR. KINEL:

Q. Mr. Sass, I've handed you what's been marked as Committee Exhibit 1. Do you recognize that document?

A. Yes, I do.

Q. What is that?

A. This is the liquidating trust agreement presented here as an exhibit to one of the other documents.

Q. Okay. Have you had a prior opportunity to review this document?

A. Yes, I did, more than once.

Q. Do you believe that the terms of the

liquidating trust agreement are fair and reasonable under the circumstances?

A. I do. For the most part, they are not unusual as to liquidating trust agreements I've seen before.

Q. I direct your attention to Committee Exhibit 2. Could you identify that document?

A. Yes. That is the, as it's called, the binding claims mediation agreement.

Q. I'm sorry, could you --

A. Yes, I do recognize it.

Q. What's the title of that document, for the record?

A. Liquidated trust binding claims mediation agreement.

Q. Have you seen that document before?

A. I have.

Q. You've had a chance to review it before?

A. I have.

Q. Do you believe that the terms of the proposed mediation procedures are fair and appropriate under the circumstances of these cases?

A. Yes, I believe they are fair and appropriate and created for the situation we find ourselves in.

Q. Why is that?

A. Well, we've got a situation right now where, as I understand it, the claims are unknown, so the GUC trust that's created in the case is kind of going into an unknown situation which normally would create a lot of work for the Court and for the trust. And this mediation structure seems to be a much more efficient way of dealing with it and saving the Court and the trust money and time.

Q. Mr. Sass, you said you served on approximately 100 creditors' committees. Do you believe the creditors' committees in these cases have exercised their fiduciary duties?

A. Absolutely.

MR. KINEL: Thank you; no further questions.

THE COURT: Cross?

MR. KAPLAN: Should I continue?

THE COURT: Yes.

CROSS-EXAMINATION

BY MR. KAPLAN:

Q. Good afternoon, Mr. Sass. Gary Kaplan from Fried Frank on behalf of the DDTL parties. I believe you have a witness binder still up there; we're going to go through that in a few minutes. I just want to make sure it's still up there in front of you.

Just to go back to --

THE COURT: You want to help him out? I don't think he knows which one.

THE WITNESS: I don't know which one. Which one are we talking about?

BY MR. KAPLAN:

Q. You had no involvement in the negotiation of the settlement, correct?

A. I was not on hand at the negotiation, that's correct.

Q. You didn't witness a single conversation between any representative of the Committee and the noteholders in negotiating the settlement, correct?

A. That's correct.

Q. All of those negotiations were handled by counsel and the financial advisors,

correct?

A. That's correct.

Q. And in fact, in your deposition, you testified there would be nobody on the Committee who would have firsthand knowledge of the negotiations between the Committee and the purchaser on the terms of the agreement, right?

A. I think I said I wasn't aware of anybody. If I wasn't clear enough, I wasn't aware of anybody.

Q. Now, your counsel you asked you some questions about your fiduciary duties. Do you recall those?

A. Yes, sir.

Q. And you testified that you think the settlement is consistent with your fiduciary duties to unsecured creditors, correct?

A. That's correct.

Q. And as a member of the Committee, your fiduciary duties run through all unsecured creditors, correct?

A. The general unsecured creditors, yes.

Q. When you say general unsecured, is

there a category of unsecured creditors that are excluded from your fiduciary duties?

A. Is there a category excluded from general unsecured? No, not that I'm aware of.

Q. So your fiduciary duties run to priority creditors, right?

A. Priority are not unsecured, they're priority.

Q. So you don't have duties to priority creditors?

A. I don't believe so.

Q. How about creditors to the extent they have a -- secured creditors to the extent they have a deficiency claim, do you have a duty to those creditors?

A. Secured creditors as to their secured interest, we would not. As to an unsecured deficiency, we would be at times looking after them, as well.

Q. At times, you said. When would you not be looking after those deficiency claims?

A. It depends in how they got to where we are at that point in time. General unsecured, unsecured creditors for the most part, those

that serve on committees tend to be think trade employees and related. Other groups that tend to be priority may not be in that category and come in with a different perspective and different ability to represent themselves. May not need our help as much.

Q. So is it your testimony that your fiduciary duty is to those who serve on the Committee as opposed to those who hold unsecured claims?

A. No, no. It's very clear, it's to all of the creditors that hold claims, specifically not to our own companies or just those on the Committee, but to all creditors.

Q. And that would include secured creditors to the extent they have an unsecured deficiency claim?

A. Yes, it would.

Q. Are there any exceptions that you're aware of to that?

A. Exceptions? No, not normally.

Q. Let's go to the binder, if you will, and start on tab 17. Let me know when you're there.

A. I'm at tab 17.
Q. And the first page of it is an email from a lawyer at Akin Gump to Committee counsel, right?
A. It appears to be, yes.
Q. And the email says that it attaches a term sheet for global resolution and asks that it be shared with the Committee?
A. Yes.
Q. Do you recall this term sheet being shared with the Committee?
A. It probably was. I believe so. But there were a lot of term sheets that went back and forth. Most of them were shared with us, and mostly tracked to the one that came out at the end of the day that's now in the documents before the Court. So probably yes, but I don't recall this specific one.
Q. If you could turn to page 2 of the term sheet.
A. Mm-hmm.
Q. And you see there's a paragraph close to the bottom that talks about, that says the beneficiaries of the litigation trust. Do you

see it starts there, and it's highlighted on the screen if that's easier.

A. Yes, I see that.

Q. So the term sheet proposed by the noteholders proposed a litigation trust, and goes on to say it shall be all of the Debtors' general unsecured creditors, including noteholders to the extent of any deficiency claim, right?

A. Yes, it says that.

Q. So this proposal didn't carve out any specific unsecured creditors, it said all would receive the benefit of the liquidation trust, right?

A. Not as far as the paragraphs we looked at, so I don't see it, where they carve anything out.

Q. And then if you go down to the bottom of the next paragraph on that page, the bottom of page 2, you see it talks about specified causes of action?

A. Yes.

Q. And you see it says the proceeds recovered from the proceed of any specified

causes of action will be allocated on a ratable basis among the holders of general unsecured claims. Do you see that?

A. Yes.

Q. So the noteholders' proposal that was sent to the Committee in mid July proposed that the allocation of what was being put into trust, if you will, would go to all unsecured creditors, right?

A. That's what this one appears to do, yes.

Q. And after receiving that term sheet, do you recall the Committee discussing that it shouldn't be allocated, that proceeds to the unsecured should not be allocated ratably, and instead should only go to certain creditors?

A. No, I don't recall a discussion of that nature.

Q. Let's turn to tab 18, if you would.

A. Yes, I'm there.

Q. And tab 18, we've already established, this term sheet is on August 10th, and this goes from Nava Hazan, who is Committee counsel, to the noteholders' counsel,

Mr. Rubin and Mr. Alberino, right?

A. Yes.

Q. And it attaches a revised version of a term sheet, right?

A. There is a version of the term sheet there, yes.

Q. Okay. And let's turn to page 3, if we will.

A. Of the term sheet? Yes.

Q. And in the middle, there's a paragraph that starts the exclusive beneficiaries of the GUC trust.

A. I see that.

Q. And this term sheet provided, and you can read the language, provided that the beneficiaries of the GUC trust would be holders of allowed general unsecured claims, and the only carve out was the deficiency claims of the holders of the notes, of the purchasers with whom you're negotiating, right?

A. That's what that paragraph says, yes.

Q. And then you see the next paragraph talks about, again, the specified causes of

action, and there, too, it says the proceeds recovered from the pursuit of any specified causes of action will be allocated on a ratable basis among the GUC trust beneficiaries, right?

A. Yes.

Q. So here, too, there was no carve outs for deficiency claims or priority claims, that they wouldn't be beneficiaries of the distributions, right?

A. I don't see language that does that; that's correct.

Q. Let's see if we can turn to tab 19. And this one, the cover page, it's an email from Committee counsel back to the counsel to the noteholders or purchasers that says attached please find a revised draft of the term sheet. Do you see that?

A. I see that, yes.

Q. And if we could turn to, the black line would be easier, turn to page 3, if you will.

A. Is this the black line attached?

Q. Yeah, the black line should be

attached.

A. I'm on page 3.

Q. You see there's a paragraph in the middle that says the holders of general allowed unsecured claims --

A. Actually, my page 3 is not the black line.

Q. They're repaginated, so if you go past the claims, you'll see the black lines after that, and the page numbers start again.

A. There it is; thank you. I'm sorry, you were saying?

Q. And you see there's language in the middle of the page that says the holders of allowed general unsecured, and new language now, non-priority claims against the Debtors, excluding deficiency claims of pre-petitioned secured creditors. Do you see that that's been added?

A. I do see that addition.

Q. Do you recall the Committee directing its counsel to change the term sheet so as to exclude certain creditors from participating in the GUC recovery?

A. No, I do not recall us directing them to do that.

Q. Do you recall discussion amongst the Committee about changing the term sheet so that holders of priority claims and deficiency claims would no longer receive a distribution under the -- from the GUC recovery?

A. As I think I mentioned, there were numerous versions of the settlement term sheet. We discussed many of them. I can't even say that we discussed all of them. There were probably some we didn't see where the change was very minor. I don't recall this particular change coming in at a particular point in time, but it did come in. I can't tell you why it came in at that point in time.

Q. But you can't tell us why this change was made, right?

A. That's correct.

Q. You certainly can't say it was because the noteholders were insisting on it, right?

A. I can't say that. I have no knowledge.

Q. Let's move on. Now, you've testified

earlier that you thought that the settlement was fair and reasonable to all unsecured creditors, right?

A. Yes, I did.

Q. And you understand, obviously, based on your experience, that priority creditors ordinarily would receive a distribution ahead of other unsecured creditors, right?

A. Often, that's correct.

Q. When you say often, is there -- other than when priority creditors agree to not come first, you understand that under the Bankruptcy Code, priority creditors are supposed to be paid before general unsecured creditors are paid?

A. When the Debtor is making payments, yes, that's correct.

Q. Okay. But as we've seen here, the term sheet no longer provides for priority creditors to be paid ahead let alone receive any recovery from the GUC trust, right?

A. Well, the discussion here, unless I missed something, was mostly about their deficiency portion. I didn't see a lot of

discussion about the priority payments.

Q. Well, let's go back. The language is on the screen if it's easier, but obviously if you need to refer to the whole document, you should. But you see the first addition is to add the word non-priority, right?

A. Right.

Q. So that would carve out priority claims?

A. Right. It's not addressing what happens with priority, correct. It's saying what isn't happening with the priority.

Q. But under this, based on this language, because it says the holders of allowed general unsecured non-priority claims against the Debtors excluding deficiency claims, will be the sole and exclusive beneficiaries of the GUC trust, correct?

A. It does say that, yes.

Q. So we both agree that priority claimants will not be a beneficiary of the GUC trust, correct?

A. Under this language, that's correct.

Q. Why is that fair to holders of

priority claimants?

A. The holders -- there's a lot of reasons that the holders of the priority claims are more favorably situated in the entire process than the general unsecured creditors. Well, first of all, by nature of priority claim, they're going to get payments first for the priority portion. Typically, and as was the case here, many of them had their own counsel and were very vocal and visible in the process as compared to the general unsecured creditors, which tend not to be and need the support and protection of the general unsecured creditor committee, Official Committee of Unsecured Creditors.

So it's not unusual in my experience for priority claimants to end up with a lesser than standard distribution in a case through a plan or other vehicles.

Q. When they don't agree to it?

A. Most often they agree to it, but not always.

Q. Which circumstances are you aware of where priority claimants haven't agreed to it

and in a plan or otherwise, they've been forced to --

A. It's not the Debtors' money when it's coming from a third party, often a third party can have a very strong influence, I won't say dictate, but can have a very strong influence on the structure of where the money goes, what happens to it, and who gets it. And I've seen that before on occasion.

Q. How many cases have you've been involved with have you seen that?

A. Not a lot. Of the approaching 100 committees I've been on, probably single digits.

Q. But let's go back to the situation in front of us that you testified previously was fair, okay?

A. Yes.

Q. My question was is the treatment being afforded to the priority claims fair under this settlement?

A. Yes, I think it is for a number of reasons. As I said before, they are getting distribution of the priority portion. Without

this settlement structure coming forth, the unsecured creditors would be getting nothing. So is there a trade-off happening that is less than optimum? Sure. But that happens sometimes, and in order to get something for the creditors, that was a structure that had to happen.

Q. Explain to me what you mean, if you would, they're getting paid on their priority portion?

A. If they have a priority claim. They're not getting paid by us, but pursuant to any other money in the estate or any other vehicle for payment, they would be getting paid before us.

Q. And it's your understanding there's other money in the estate to pay other priority claims?

A. I don't know that.

Q. You're on the Committee, right?

A. Yes.

Q. And you're an active member of the Committee, right?

A. Yes.

Q. And you understand the Debtors' current financial circumstances, right?

A. That's correct.

Q. And you understand that the Debtors, for example, haven't been paying Committee counsel for some time, right?

A. That's my understanding.

Q. So are you aware of any source of funds that the Debtors have to pay any of the priority claims aside from the WARN act claimants?

A. I am not.

Q. And under the terms of this settlement, there's no money allocated to pay the priority creditors, right?

A. That's correct.

Q. So go back to my question, then. If we've established there's no money to pay the priority claimants, putting aside the WARN claimants, we've established there's no money in the Debtors' estate to pay the priority claimants, they're going to receive nothing under this settlement, how is this settlement fair to priority claimants?

MR. KINEL: Objection, your Honor. It assumes facts not in evidence. We haven't established that there's no money in the estate. Mr. Sass testified he's not aware of any method of payment from the estate. That's not dispositive of the issue.

THE COURT: Mr. Ramos, how much money is in the estate?

MR. RAMOS: Your Honor, I can't answer that question just standing here today. Obviously, in addition to whatever funds there might be, there are claims and causes of action in the estate that have some value, and those have quantified.

MR. KAPLAN: Your Honor, the Debtors have put on the record repeatedly, including in refusing to set a bar date, that these estates are administratively insolvent. And again, we've had the fight about a bar date and the Debtors' refusal to do it. It is clear, we can pull out their pleadings and admissions, but to have this debate right now about whether the Debtors have funds or don't have funds is a little bit silly.

MR. RAMOS: Your Honor, I frankly wasn't trying to be part of a debate, I was trying to ask the question that the Court posed. Certainly, as counsel indicated, the Debtors have made filings including with regard to the bar date issue and talk about the exigent circumstances from a financial perspective of the estates.

THE COURT: I'll allow it, overrule the objection. I think that, you know, it actually boggles my imagination why we would even be having this debate if there was -- well, maybe with you, Mr. Kaplan, but why we'd be having this debate if there was sufficient money to pay unsecured creditors.

So I'm not going to close my eyes to the reality of this case. You know, if I'm wrong, if this case is fully administratively solvent and there's enough money to pay priority unsecured claimants in full, that still doesn't solve Mr. Kaplan's problem. But I'd be shocked.

So I think, you know, based on my experience with the case, to sort of get up

here and imply there's no evidence that there's insufficient money to pay priority unsecured claimants I think is unrealistic. So I'll allow the question. Do you want to restate it?

BY MR. KAPLAN:

Q. So Mr. Sass, having established that the priority creditors will receive nothing under the terms of this settlement, and that there's no money in the estate to pay priority creditors, how is this settlement fair to priority creditors?

A. There's no money in the estate to pay the priority creditors except for the ones that are getting paid that you mentioned, so we have a structure that even treats priority claimants differently. We had a situation here where we could try to get some money for the creditors through someone willing to put some into a put through a trust, and it was the best deal that could be negotiated. It still seems fair.

Q. You previously testified that you have no idea who insisted on this language and how

this language got in here, right?

A. That's correct.

Q. So you can't sit here and testify that that's the best deal you could have gotten, right?

A. I can, because I trust my professionals. They seem to have been doing a good job. I've seen professionals -- this was a difficult negotiation from what I could see from a distance, but yet it kept moving and kept move ing in a direction that had the result of turning up some money for my constituency. That's fair. That's a good result. They worked hard.

Q. But we established your constituency includes, for example, the holders of deficiency claims, right?

A. Normally who would be included.

Q. Do you think they did their best job to get a recovery for the holders of deficiency claims?

A. Yes.

Q. Then let's look back at this paragraph. Do you see the language that was

added by Committee counsel excluding holders of deficiency claims from the GUC recovery trust?

A. I don't know it was added by Committee counsel, but it is in this version, yes.

Q. And we established at the beginning that this was a term sheet that was sent with changes sent by Committee counsel, right?

A. Right, subject to I think a discussion they had previously, so I don't know -- I mean, they did the crafting of the words and sent it around, but I don't know who put the concept in.

Q. You are aware that the current version of the term sheet contemplates that certain claims and causes of action will be purchased by the or were purchased by the purchaser then contributed to the GUC trust, right?

A. Yes, I'm aware of that.

Q. And you're also aware that that provision changed over time, right?

A. Yes.

Q. And that that provision originally provided that those claims and causes of

action would be excluded assets and thus left behind for the Debtor to contribute to the trust, right?

A. I'm gathering that from the flow of documents. I didn't really recall it otherwise, but yes, that makes sense.

Q. But you don't recall that, right?

A. No.

Q. And you don't know why that changed?

A. I do not.

Q. And you certainly are not testifying it was insisted by the purchaser or any other party, right?

A. I generally cannot ascribe any particular change to any particular party. I wasn't there for the discussion.

Q. Any particular changes that you can ascribe to the Committee having demanded?

A. Not specifically, no.

Q. Okay. Sitting here today, what benefits are there to the Debtors of pursuing this approval of the settlement?

A. I'm sorry, say again, please?

Q. Sitting here today, what benefits, if

any, do the Debtors receive from approval of the settlement?

A. It moves them towards completion of the case.

Q. And how does it move them towards completion?

A. Well, we get a trust created to pay creditors, and I presume there's a settlement, that the settlement is approved, and they get an opportunity to be left with very little to do to get out of the bankruptcy.

Q. The case could be concluded tomorrow by converting it to Chapter 7, right?

A. It would, and nobody would get anything. Except the noteholders I guess I would get a bonus.

Q. When you say nobody would get anything, is that -- aren't there -- why do you say that?

A. As we were discussing, I don't think there are substantial assets in the estate. I'm not up to date on the numbers, but my general understanding is there wouldn't be any money coming in that would flow to the

creditors.

MR. KAPLAN: I have nothing further.

THE COURT: All right, thank you. Anyone else? Ms. Casey?

CROSS-EXAMINATION.

BY MS. CASEY:

Q. Good afternoon. Linda Casey on behalf of the Committee -- excuse me, on behalf of the U.S. Trustee.

I'm a little confused, and I just want to see if I can drill down on one point. I believe your testimony was you were not aware who requested that the deficiency claims be excluded from the distribution of the cash portion of the GUC trust, correct?

A. Yes, that's correct.

Q. And I believe your testimony was that you are not sure why they were excluded from the distribution of the cash portion of the GUC trust?

A. I think I expressed that I was not at those discussions, so I really wasn't -- didn't have much direction as far as who

requested which change and what the quid pro quo might have been. It was give and take. We got a little bit of a flavor of that from counsel reporting back, but I wasn't there, so I don't know.

Q. I'm not sure if you were asked and I'm not sure if I heard, when the Committee approved the settlement agreement, what did the Committee rely upon to determine that the exclusion of the deficiency claims from the distribution of the cash portion was fair?

MR. KINEL: I'm going to object to the extent it calls for attorney-client communications.

THE COURT: Without saying the substance, I mean, if you can answer the question without disclosing any attorney-client communication, or the specifics of any attorney --

THE WITNESS: Can you restate the question, please?

BY MS. CASEY:

Q. Yes. When the Committee approved the settlement agreement, what did it rely upon to

determine that the exclusion of the deficiency claims from the distribution of the cash portion of the GUC trust was fair?

A. Let me give you a little bit of a flavor of what was happening as we looked at these various versions, including the last one. We would get reports from our professionals of what had changed and what the impact of that change was on us. They typically would highlight the pros and cons, people would have questions, and it would be explained and discussed as to whether it was a good thing or not. So I think without giving any specifics, that's...

Q. Are you aware of any facts that would justify the exclusion of the deficiency claims from the distribution of the cash portion of the GUC trust?

A. To justify the exclusion? Well, there's the arithmetic and the economics. You have parties involved who are negotiating who are in equal bargaining positions which gets you to a point where they'll willing to put together a deal of this nature. But I'm not

sure what you're looking for in particular.

Q. I'm not sure what you mean by the economics. Are you aware that there are secured creditors in this case who have 100 percent deficiency claims and are not going to be receiving any payments as a secured creditor?

A. That's my understanding, yes.

Q. So are you aware of any facts that would establish that a fully unsecured deficiency claim, it is fair to not include them with the other general unsecured creditors sharing the cash portion of the GUC trust?

A. If we were talking about the distribution of assets of the Debtor, I would be looking at it somewhat differently. But we're looking at a third party making a payment to a trust to give to the creditors, giving them a lot more influence on how that should be structured. So it's really not -- as I mentioned, I've seen this a few times, but it's an unusual circumstance and not the one contemplated by the code I think for the

most part.

Q. I'm a little confused. How is the fact that the money is not the Debtors', if you can't testify that the person providing the money insisted that it not go to the deficiency claims, affects the analysis as to whether it's fair to exclude the 100 percent deficiency claims?

A. Well, the end result is they accepted a structure that had it that way, meaning they thus approved it. Whether they proposed it or not probably isn't all that relevant; they approved it. And I would thus say that, you know -- and it isn't money of the Debtor, it's money being provided to a GUC trust from a third party.

Q. So is it your testimony that the fact that the Committee relied upon to exclude the deficiency claims was that it wasn't money of the Debtors?

A. That's a large component, yes, a recommendation of professionals and so forth.

MS. CASEY: Thank you; no further questions.

THE COURT: Any further questions? Mr. Benson?

CROSS-EXAMINATION

BY MR. BENSON:

Q. Mr. Sass, first I want to clarify something you said earlier. Did you say that priority creditors are not included in the class to which Committee professionals owe a fiduciary duty?

A. I didn't say Committee professionals. I was referring to the Unsecured Creditors Committee. If I wasn't clear on that, I'm sorry.

Q. I'll rephrase it. Did you say that priority creditors are not within the class to which Committee members, such as yourself, owe a fiduciary duty?

A. I believe the fiduciary duty of the members of the Official Committee of Unsecured Creditors are to the unsecured creditors, not the priority creditors.

Q. You've, I guess, distinguished priority creditors versus unsecured creditors. Are you aware that an unsecured creditor could

have a claim entitled to priority?

A. I'm sorry, say again?

Q. An unsecured creditor could have a claim entitled to priority under section 507 of the Bankruptcy Code?

MR. KINEL: Objection; calls for a legal conclusion.

MR. BENSON: He is --

THE COURT: He's an attorney. I've known Mr. Sass my entire career. If he can't answer this question, nobody in the room can.

THE WITNESS: Can we restate it one more time? Thank you, your Honor.

THE COURT: You're welcome.

MR. KINEL: Can we qualify him as an expert, your Honor?

BY MR. BENSON:

Q. Are you aware that a priority creditor -- withdraw that.

Are you aware that an unsecured creditor could have an unsecured claim that is entitled to priority under section 507 of the Bankruptcy Code?

A. Yes.

Q. So the fact that a creditor is a priority creditor is not exclusive with being an unsecured creditor?

A. That's true, but the entire priority structure relates to the property of the Debtor and is contemplated that way under the code. We're talking about property not of the Debtor, which I don't think is contemplated.

Q. But we're talking about your fiduciary duties and to whom they're owed. And are you saying that your fiduciary duties are inapplicable when dealing with non-estate property?

A. It's an interesting question. I haven't really thought about that. I don't know.

Q. Okay. Moving on. I have some questions similar to what I asked Mr. LaForge. Are you aware that the IRS has filed proofs of claim in this case?

A. Yes.

Q. Are you aware that the IRS has asserted priority claims?

A. Yes.
Q. Are you aware that the IRS has asserted priority claims in the approximate amount of $2.4 million?
A. That's a number I heard, yes.
Q. Do you have any reason to believe that the asserted priority is invalid?
A. No, although I do believe that our professionals reached out to the IRS more than once to discuss whether to address that claim, make some or all unsecured, and those attempts to have been not fruitful.
Q. Two parts to that. Were those attempts by the Committee to, I guess, negotiate down the priority claim based on a perceived inaccuracy as to the asserted priority?
A. I don't know. I don't recall what they were, where they arose from, but there was a $2.4 million claim out there.
Q. But you have no reason to believe that the IRS erred in claiming a priority claim?
A. No, I have no information on that.
Q. Do you have any reason to believe the

IRS erred in calculating the amount of the claim?

A. I have no information on that.

Q. So you don't have any reason to believe the claim is inaccurate in its --

A. I have no reason to believe it's inaccurate, that's correct.

Q. Do you know if there's any intention by the Committee or the Debtor to challenge either the amount of priority the IRS has claimed?

A. You know, we have the procedures that have been promulgated under some of the documents we've looked at, and there is a claims procedure. It's intended for the unsecured claims, but I guess if the IRS wanted to come in as an unsecured claim and assert it, we could have a discussion.

Q. That answer was about your ability to challenge it. My question was is there any intention to challenge it?

A. Not being in that position, I really don't have any intention to do anything yet. It's not ripe yet.

Q. You mentioned your professionals reaching out to counsel for the IRS. I want to specifically talk about the period from the petition date to the time the United States of America filed an objection to the settlement. At any time during that period, do you know if anyone acting on behalf of the Committee reached out to either the Internal Revenue Service or the Department of Justice?

A. I don't have the dates, but I believe so, but I'm not sure. I don't know when it took place, so let me not say. I don't know.

Q. When you say let you not say, are you --

A. I don't know when the dates were that they reached out.

Q. Okay. So you have --

A. Relevant to the IRS.

Q. Do you have any reason to believe that there was any attempt to reach out to the IRS before the sale hearing, for instance?

A. Again, I don't know the timing relevant to the other events.

Q. Do you know if there was any attempt

by the noteholders to reach out to the Internal Revenue Service from the petition date to the sale hearing regarding treatment of their priority claim?

A. I do not know.

MR. BENSON: That's all I have, your Honor.

THE COURT: Thank you, Mr. Benson. Any other questions? Any redirect, Mr. Kinel?

MR. KINEL: Thank you, your Honor.

REDIRECT EXAMINATION

BY MR. KINEL:

Q. Mr. Sass, if you could just turn back again to Committee 3, the term sheet.

A. Yes, I have it.

Q. I want to just direct your attention to the bottom of page 4, the last full paragraph. It starts with the net proceeds.

A. I have that.

Q. Take a moment, just read it to yourself.

Having read that, the Committee

approved a settlement that does provide a recovery to deficiency claims of secured creditors; is that not correct?

A. Yes, thanks for refreshing my memory. There is a provision that provides for some payment to the deficiency claims.

Q. So deficiency claims such as Mr. Kaplan's clients would share in the net proceeds and any specified causes of action?

A. That's correct.

MR. KINEL: Thank you; no further questions.

THE COURT: Thank you, Mr. Sass.

THE WITNESS: Thank you.

THE COURT: Any further evidence by any party? Mr. Kinel, you need to move your documents. I assume you want 1 through 3 admitted?

MR. KINEL: Yes, your Honor.

THE COURT: Any objection?

MR. KAPLAN: No objection, your Honor.

THE COURT: Committee Exhibits 1 through 3 are admitted without objection.

Mr. Kaplan, you had some documents?

MR. KINEL: Your Honor, I have one more.

THE COURT: Oh, you have one more? Okay. Sorry.

MR. KINEL: May I approach?

THE COURT: Yes.

MR. KINEL: Your Honor, we'd like to move Committee 4, which is an official transcript of a hearing held before this court on October 6, 2016.

THE COURT: Any objection?

MR. KAPLAN: No objection, your Honor.

THE COURT: It's admitted.

MR. KINEL: Thank you, your Honor.

MR. KAPLAN: Your Honor, we have several documents that we used, and that's DDTL 1 through 8, which are the tabs in our binder, tab 17, 18, 19, 20, 21, 22, and 24.

THE COURT: Any objection?

MR. KINEL: For the record, I'm

going to object, but I know it will be overruled.

THE COURT: Based on relevancy, I take it?

MR. KINEL: Yes.

THE COURT: That is overruled, so they're admitted.

MR. KAPLAN: And your Honor, I know the Debtors' binders have a lot of pleadings that are already on the docket. I think the Court can take judicial notice; we're not going to burden the record unless you want us to move in all of the different pleadings into the record. But there's a whole host of pleadings that relate to this, and we think the record -- we don't think they need to go in as evidence by evidence.

MR. KINEL: I would agree with Mr. Kaplan on that.

MR. RAMOS: No objection.

THE COURT: I'm not going to disagree.

MR. KAPLAN: Thank you.

THE COURT: Very good. All

right. Last call? That will close the evidentiary record. Let's break for lunch, then we'll hear argument when we return. And let's try to reconvene promptly at 2:00 p.m., if we could. Thank you very much.

MR. KINEL: Thank you, your Honor.

(Whereupon, a lunch recess was taken.)

THE COURT: Good afternoon.

MR. SHAPIRO: Good afternoon, your Honor. For the record, Zac Shapiro on behalf of the Debtors.

I just have a few remarks, and I'll save the balance in response, if that's all right.

What's before your Honor is a settlement. And the standard that your Honor should consider is whether the settlement falls above the lowest point in the range of reasonableness. The standard is not whether everyone is happy. That simply can't be the standard. If it was, no settlement would ever be approved. For example, often the parties

to the settlement themselves aren't happy. So I think, your Honor, while the settlement isn't perfect, it achieved something good, and it did so at no cost to the Debtor.

You can argue about the merits of the Committee's objections, you can argue about the timing of when everything happened. But what you can't argue is as a result of the Debtor agreeing to move forward with this settlement at the August 16 hearing, subject to final documentation, that we gained the support of the Committee. And you can't argue that that support doesn't mean something. Therefore, for that reason, the Debtors would submit that this settlement meets the relevant standards and should be approved.

MR. KINEL: Thank you, your Honor. Norman Kinel, Squire Patton Boggs, on behalf of the Committee.

There are actually two motions pending before your Honor, so I'll mention the second one, and that is the Committee's motion for entry of an order approving the liquidating trust agreement and the binding

claims mediation agreements.

Your Honor, as I said earlier this morning, the settlement is the best possible outcome in these cases for the creditor body as a whole, and the only outcome in which any constituency other than the senior secured creditors receive anything in consideration of their claims against the Debtors. If the objectors today prevail, it will not improve their position, but rather simply ensure that unsecured creditors will receive no recovery in these cases.

The settlement clearly settled the Committee's DIP motion and non-CSC sale motions. And as we said in our papers, the best indicator of the value of the Committee's claims and the Committee's position is what a third party was willing to pay to get rid of those objections, and what the Debtors were willing to pay to get rid of those objections. Mr. LaForge, I don't know if he used the word today, but during his deposition, he testified it would have been catastrophic if either of those motions had not been approved. And

whether or not they were approved together on the same day or whether there could have been a possibility of coming back and dealing with a DIP later, obviously this was an integrated settlement that addressed a number of issues.

It also meets the standards of 9019 because it certainly does not fall below the lowest point in the range of reasonableness. From Mr. LaForge's testimony, it's simply not possible to conclude that it was unreasonable for the Debtors to have accepted this settlement. And his unhappiness had largely to do with the fact that there were not additional releases given to other parties who remain potential targets in the settlement.

The settlement resolved highly contentious litigation, and the objecting parties would like to create a narrative where somehow the timing is suspicious, somehow there wasn't enough time for people to consider the settlement. I can assure the Court that there was a hard-fought negotiation, that while Mr. LaForge may not

have been involved and as Committee members were not involved, counsel for all parties were involved. And the Committee had pending DIP objections, had filed three different objections to the DIP that were still pending, had objections to the sale motion. And there's no question that something was settled on August 16, 2016.

The standard that the parties would have this court require for a settlement that a claim or cause of action in particular was settled is not a -- there's no authority for that, and it's not a realistic standard. Settlements are approved every day in this court and other bankruptcy courts around the country which resolve controversies. That's all the rule says. You can resolve a controversy or settle a matter, but there's no requirement as to there being property of the estate involved in the settlement.

What was before your Honor were two core proceedings. A motion to approve a sale and a motion to approve final DIP financing. Admittedly, that was being

adjourned, but in the broader sense, they were both before the Court. There's no doubt, those core matters, the Court had jurisdiction over. And there was no objection at the time of sales, of the sale or the DIP objection, to the court's jurisdiction to hear those matters. If the court had jurisdiction to hear them, the Court certainly had jurisdiction to settle them. And that's all that was put on the record. And I'm not sure what counsel is getting that there's some deviation between what was put on the record and what ultimately was approved. The core terms of the settlement were put on the record by counsel for the noteholders, they were echoed by my partner who was here that day, and they were also confirmed by the Debtors. And those terms were the economic terms of the settlement, and those have never changed throughout.

What has changed, what counsel pointed out and of course we objected as to the relevancy of those changes, is there were many iterations of a term sheet that went back

and forth over a period of a couple of weeks between three different sets of counsel, with each taking a look at the document and making whatever suggestions, improvements, or changes they believed appropriate. There's no evidence that this was a Jevic plot. As a matter of fact, I sort of find that comical, because Jevic, if it were applicable, and we maintained throughout it was not, would have supported the settlement. So the idea that lawyers were running around conspiring to structure a settlement that would address a Supreme Court ruling that wasn't going to come for six months in the future, is kind of ridiculous.

The economics were always the same. The APA from the very first day, before the Creditors' Committee was ever even formed, provided that the purchaser would purchase all claims and causes of action. And there were excluded assets, but those were a small subset of the assets that were purchased. And from the beginning until the end, that never changed. And while in hindsight some of the

wording in the term sheet may not have been the best, no matter how many lawyers looked at it, it's clear that the economics were always the same. There was no wandering of estate assets. This is what you heard Mr. LaForge testify earlier today, that he fought hard to keep those assets within the estate. It's exactly the opposite of what the other parties are contending. It's not that people conspired to get them out of the estate and then sent them to a GUC trust. The Debtors agreed to give those up before the Committee even was alive and kicking.

We're going to hear from the objectors about Jevic. I argued before your Honor on I think it was December 16th when we had essentially a status conference on Jevic and whether the settlement should go forward on that day. We argued that Jevic was inapplicable. And the Supreme Court's ruling has not changed that argument one bit in our opinion. The Supreme Court in Jevic dealt with a case-ending dismissal coupled with a settlement in a distribution of predominantly

property of the estate, and how that was not permitted where it was inconsistent with normal code priorities, and if the settlement lacked any Bankruptcy Code offsetting value.

The Court expressly declined to prohibit other non-case ending distributions which occur earlier or do not involve property of the estate or have other code-based justifications. It did not endorse a blanket rule that all structured dismissals are pro se and valid.

The settlement here falls squarely within the range of permitted settlements and distributions under Jevic. The deciding factor in Jevic and the one missing here is that Jevic involved predominantly the distribution of estate assets. It is not uncontroverted, it wasn't in December, because I remember your Honor indicating that we would need to have an evidentiary hearing as to whether estate assets were being transferred or not. I believe it is uncontroverted that no estate assets are contributed; and indeed, the

Debtors have modified the proposed form of order to specifically say that to allay any misconception, misperception, or poor draftsmanship that might have been involved along the way. So this is not Jevic.

The Court approved the CSC sale and the non-CSC sale. The appeal period passed; no appeal was filed. The sale closed, and it's now beyond legal challenge. The purchased assets as defined in the APA became property of the noteholders at closing. They cannot be considered property of the estate. Under the settlement, the purchased assets include the specified causes of action, and accordingly, the settlement contemplates the contribution of only non-estate property to the GUC trust.

The DDTL parties do not dispute that the settlement calls for a transfer of the specified causes of action by the purchaser, and they do not allege the distribution of estate assets will be made to the GUC trust. Because of this, they argue that the distinction between property of the

state and non-estate property is not relevant to Jevic and that it's a fallacy. Your Honor, we assert that the Supreme Court's decision turned precisely on that issue, and in our brief, we go through the transcripts of the Jevic hearing, what various of the justices said. And it is clear that the issue of a non-estate property distribution is not decided by the Supreme Court.

On the other hand, we have ICL Holdings, binding precedent in this jurisdiction. And as hard as the objecting parties might try to distinguish it, I see no distinguishing characteristics between ICL and this case.

I also see nothing that renders it non-viable or controlling at this point. The dispositive issue in ICL Judge Ambrose said was whether there was a distribution of estate assets in violation of the priority scheme. Absent a finding that estate assets were involved, there could be no priority violation, and the Court found that estate assets were not implicated.

This case is virtually identical to ICL. The purchaser has acquired substantially all of the estate's assets. The purchaser is contributing them, some of them, to a trust. That trust will make distributions to unsecured creditors together with additional funds from the noteholders.

The claims and causes of action that will be contributed were purchased by the purchaser and belong to them. The $1.25 million that is chartered to go to unsecured creditors is coming from the noteholders pockets. Those were funds that were never in the estate, were never part of the consideration. The $1 million funding for the GUC trust, the exact same thing applies. There is nothing coming from the estate.

So for these reasons, we believe that Jevic is inapplicable, and ICL is good law and in fact binding precedent here.

The U.S. Trustee would like to extend Jevic and ask this court effectively to do so, and to take up the solicitor general's arguments during oral argument, and wants to

turn this into a gifting case or a class-skipping case which involved property of the estate and which involved a plan scenario or some other scenario which is not this scenario. This is not a gifting case. This is a case -- this is not a class-skipping case. This is a case where a settlement was reached and where through an arm's length negotiation, a third party has agreed to provide funding and other assets to a trust for the benefit of unsecured creditors.

U.S. Trustee also attempts to distinguish ICL in four ways. Mentioning releases that the secured lenders and others were getting. However, that argument fails, because all of those claims were released at the time that the final DIP order was entered. In fact, they were released by the Debtors on the first day of these cases pursuant to the stipulations set forth in the first interim DIP order. They became final after the Committee six days before this settlement was reached. There was no ability to challenge them. That was actually the U.S. Trustee's

second argument as to why this is different than ICL.

U.S. Trustee also argues that certain payments for Committee counsel somehow implement each other. That's simply not correct. The fees that were set forth in the DIP orders were capped. The fees for Committee counsel throughout the cases. And as part of the settlement term sheet, one component was an increase in that cap, and an elimination of a sub-cap that had been in all the orders. This was not a gift through a carve out as the U.S. Trustee has alleged, but it was a settlement, part of a settlement of a final DIP order which is hardly unusual. The funding did not come from anyone's collateral, it did not come from estate assets, it came directly from the increase in the cap which was funds that were negotiated as part of this settlement.

I should also note that the analysis falls apart, because attorneys's fees are administrative expenses of the Debtors' estates. So under any scenario , those funds,

administrative claims would have to be paid before priority claims or unsecured claims, even if we were dealing with estate property and even if we followed the absolute priority rule. So we don't believe there's any applicability to that argument.

I want to address a few other issues, and then I will end for now. Part of what your Honor has to consider is the fairness and the appropriateness of the settlement, and there was testimony regarding whether it's fair to skip over the IRS, whether it's fair for the noteholders' unsecured deficiency claim to be treated differently. Not excluded, but to be treated differently under the settlement.

And the question came up during Mr. Sass's testimony as what duties does an unsecured creditors Committee have to priority claimants and to unsecured deficiency claimants or under-secured secure creditors who have deficiency claims? This is an issue we've thought long and hard about. And while it may seem one that most bankruptcy lawyers

would think there's an easy answer to, I hope the Court can trust me, there is no easy answers to those questions.

There is precedent, however, and I'll cite to SPM Manufacturing Corp, 984 F. 2d. 1305 for the proposition that specifically that a Committee's appointment pursuant to 11 U.S.C. Section 1102 charged it only with representation of the general unsecured creditors, not with representation of the IRS or other priority creditors. That case was superceded on other grounds. That's one case that we were able to locate on that specific issue.

With respect to deficiency claimants, the Court in In Re: Fidelity American Mortgage Code, 1981 Bankruptcy Lexus 3272, recognized that the interests of an unsecured creditors committee and an under-secured creditor very well might be different, and suggests that an unsecured creditors committee's fiduciary duty may only be to general unsecured creditors. I will submit that we found no binding authority on

that particular issue.

But let's talk for a moment about the objectors in this case. And as counsel indicated, a lot of people aren't happy. But let's look at who they are. So we have the DDTL lenders. They're a secured creditor. And I had marked as Committee 4 the transcript of the October 16th hearing before this court. If I could only put my hands on it, it would be great. I don't know if your Honor has it before him. But the transcript, the hearing that day was about the DDTL lenders' motion for a $5 million administrative claim. Your Honor ultimately denied that motion. However, throughout that transcript, there are numerous references by Mr. Kaplan on behalf of the DDTL lenders and to the court to the secured status of the DDTL lenders. Specifically, your Honor held on page 66 of the transcript, "As we sit here today, they have an allowed secured claim in the amount listed on the Debtors' schedules. That is the law."

That followed several places in

the transcript where Mr. Kaplan argued that his client was a secured creditor and his collateral had diminished during the case.

On page 12 of the transcript, I can quote him as saying -- I apologize; wrong cite. On page 51 of the transcript, Mr. Kaplan says, "Your Honor, that simply can't be true that a secured creditor who the Debtors corrected, they originally said we were listed as a contingent claim, were disputed, and we were not; it was part of the proffer. So we have a prima facie valid secure claim. We have a claim that the Debtors have acknowledged they have done no investigation whatsoever of any claims."

Mr. Kaplan goes on on page 53, "Let's take a look at some of the other arguments that they make. As I said, we talk about the fact that, well, we were never unsecured. We were never a secured claim. Because of the petition date, we were unsecured." But they have no basis for that. The only basis they attempt to argue is, well, look at the auction results. But the auction

results actually prove the complete opposite. Because as we have noted in our papers, the CE Star transaction contemplated paying off their PNC facility with a first lien on their revolving priority collateral in full regardless of the outcome of the Columbus sale. So even if the Columbus sale had generated zero proceeds, the PNC was paid off in full.

There's another reference of Mr. Kaplan on page 16 of the transcript. "So in sum, your Honor, I think the evidence is uncontroverted and crystal clear that there has been diminution of value, that we have a prima facie allowed claim, that we have a diminution of value under the DIP order."

Then your Honor says to the Debtors on page 64, "You schedule them as undisputed as a secured creditor that the claim is allowed."

And finally, in Your Honor's ruling on page 100 -- I particularly like this passage because your Honor made the observation that I said something astute that

day. On page 100, your Honor said, "To my point to that question, is the value of your collateral actually may not have diminished, it may have increased. I don't know, because you haven't established what the value of your collateral is on the petition." That was Your Honor's ruling in denying the motion.

For the DDTL lender to stand up today and argue, woe is me, we're an unsecured creditor, we haven't been treated fairly, yet in October, months after the settlement, they came before this court and said, we're a secured creditor. And your Honor found that there was no value that's been proven as to what their collateral is worth. So the idea that the Unsecured Creditors' Committee should have somehow figured out at some point along the way in these cases that they were an under-secured creditor and that we owed some fiduciary obligations to them, notwithstanding that they were represented from the very first day by very able counsel who was clearly able to advocate for its interests.

So to rely on the idea that

they're being discriminated against unfairly because they're an unsecured creditor and the Committee has, whatever Mr. Sass says, and I have the utmost respect for Mr. Sass, as I said earlier, there's not a lot of authority on this. But if you look at the situation practically, I think the Committee could only have been said to discharged its duty to general unsecured creditors. Priority creditors are different. Mr. Kaplan's client is different.

The IRS filed two priority claims. Did they do anything to protect their interest in these cases? No, they didn't do anything. They weren't heard from throughout the cases. They were never in the process. They could have come in and objected to the sales motion, they could have objected to the DIP financing, they could have objected to the settlement terms when they were put on the record. They didn't do anything during the cases. Instead, the Committee was aggressive and went out and tried to create value for its constituency. And now that that value has

been created, they want to jump on the bandwagon and receive a portion of that distribution. Number one, it's not property of the estate, it's not the estate's assets, and if they wanted to be involved and if they want to have a voice in these cases, you don't come in in the 11th hour and try to take away what was heavily negotiated months earlier.

They also didn't come in here and complain when the employees who also hold priority claims, when millions of dollars was set aside for them. I didn't see the IRS here that day when those arrangements were made. Why didn't they object to that? Why are we now? Why was it okay for millions of dollars in priority claimants to be paid ahead of others?

That leads me to the WARN claimants who are the last people who should be here objecting. If I were them, I wouldn't come anywhere near this courtroom. They're being paid in violation of the absolute priority rule, exactly what they're alleging today, assuming that their argument holds up

that somehow these are estate assets or are controlled by Jevic. Why were they getting paid? What is the basis for that? They shouldn't be objecting, they should be grateful that that money was set aside for them specifically, and their objections really don't go to this settlement, it goes to the fact that they are being forced to litigate the validity of their claim, and not simply being handed all those funds. And by the way, any funds that aren't handed to them from that pot go back to the noteholders.

So that leads me to my conclusion, at least for now, and that's the noteholders. I want to give them credit, your Honor. They are sitting pretty today, because if the court rules against and does not approve the settlement, they walk off with two and a quarter million dollars plus all kinds of causes of action that otherwise are going to go to general unsecured creditors. To their credit, they have stood by the settlement, have not tried to weasel out of it. I give them a lot of credit for that.

They have been supportive throughout, and certainly have earned the respect of me and the Committee. And are here today, even, and I'm sure will comment, if necessary.

But as much as they have earned our respect and as much as we had a hard fought negotiation, it would be inappropriate for them to walk away today with a multi-million dollar windfall, and I think they understand that, and that's why they have been supportive. And that's what they will be handed if this settlement is not approved. Your Honor, we urge the Court not to set a precedent today that would reverberate around the country, that out of the money unsecured creditors shouldn't even waste their time at a Chapter 11 case such as this in trying to obtain a recovery for their constituency.

The secured creditors in these cases got recoveries, they got assets, the DIP letter got paid off. But we often talk about paying the freight and using the process and not abusing the process. And I would respectfully submit that's exactly what

occurred here. The process played out as it should. Unfortunately, this was not a case where a plan could be confirmed and the Committee created significant leverage, was able to obtain a settlement for its constituency. And it would be respectfully a terrible shame if they weren't able to realize on that after all this effort. Thank you, your Honor.

THE COURT: Thank you.

MR. KAPLAN: Your Honor, Gary Kaplan from Fried Frank on behalf of the DDTL parties. I have some slides that I want to put up, but before I do that, I just want to respond to a couple of the points.

First, I always love when I lose in a hearing and somehow all of my arguments are quoted back to me. There was a fundamental change since that hearing, and that is my collateral is gone, it was sold. I have no collateral left. We have an estate that everybody has admitted has no assets left. So them to argue, no, they're really a secured creditor because they argued pre sale

closing that they were a secured creditor is a little bit ridiculous. I wish I was a secured creditor, I wish I still had my collateral here, but that ship sailed a long time ago. So we are a completely unsecured creditor, have been for some time, and it was well-known to the Committee when they were negotiating that there was no collateral left and no value left for us.

Your Honor, I'll put up the slides. If it will be helpful, I can hand you a hard copy, as well.

THE COURT: That would be great. Thank you.

MR. KAPLAN: So your Honor, yes, Mr. Kinel was right, we are going to start with Jevic, because we think it's pretty clear that what's happening here is simply a back-door means to avoid Jevic, move assets that the documents themselves are very clear, or at least at the time of this settlement contemplated to go into the estate, and then in a change which no witness could explain who insisted on it, why it was there, there was

certainly zero testimony that the purchaser insisted on it, somehow it shifted from assets being left behind in the estate and words of Debtors' counsel, and we'll go through the exhibits, Debtors' counsel changed it and made it crystal clear that the APA was to be amend sod that there would be excluded assets, and then contributed to the GUC trust by the Debtor. You have some very talented lawyers on that side that everybody all of a sudden is saying, oh, gee, that's not what we meant, never meant it, I guess it was really sloppy by the multiple firms from the Committee, from the Debtor, everybody was sloppy, everybody who was using defined terms somehow just completely messed up term sheet after term sheet after term sheet. Even in the documents that say this was the agreement, crystal clear these assets were to come into the estate, be contributed by the Debtor to the trust, then all of a sudden, and it's something that nobody, no witness could explain why there was a change, but all of a sudden, we got a change that now these assets are not going to be

excluded assets, but rather they're going to go to the purchaser.

And so as when I started my opening about the boy who kills his parents, they made this change. If they had kept the term sheet as it was when it was announced, then we wouldn't be dealing with this issue and we wouldn't be, and we wouldn't be standing up saying, woe is me, if you deny this, your Honor, we're not going to get anything. Because under the terms of this, the estate would be getting these causes of action.

The Committee says just ignore all of it, the only thing that's relevant is to look at the final and ignore all of the facts and all of the background.

And then if we continue on in Jevic, I notice Mr. Kinel's terminology changed a little bit from their pleadings to now when they say predominantly. Jevic involved predominantly estate assets. Admittedly it wasn't the focus of the court, it wasn't argued in Jevic about the estate

versus non-estate asset distinction, but the facts in Jevic are pretty close to the facts here. Okay, we had CSC contributing cash and some contributing a lien. They had assets subject to a lien, they contributed. Neither of those are estate assets, and based on the same theory that's being used today, neither of those are estate assets. Granted, it wasn't argued, but to make this distinction and say Jevic was crystal clear, it was only focused on estate assets, well, when the facts according to them were all non-estate assets, it means there's something wrong; the Jevic decision just doesn't make sense.

And this settlement here clearly involves estate assets or estate value, if you want to go to Armstrong and the gifting cases. You have funding to pay estate professionals. You have, again, requiring an increase of the wind-down budget, and directing how the funds are going to be spent, including buying tail insurance for the company's directors. It provides for a lease by the Debtors, and to this point, Mr. Kinel said, oh, no, well

remember the challenge period had expired, so the noteholders got releases. Yes, but the settlement term sheet contemplates broader releases than that. For example, the Debtors' officers, directors, agents, affiliates, et cetera, are not obviously released by the fact that the DIP challenge period expired, and yet under the terms of the settlement, there are these broad releases that goes to the parties. So you get broad releases, including by the Debtor of their claims against officers, et cetera. So you do have estate assets that are being dealt with by the releases.

This settlement involves the Debtor continuing to be involved in the claims reconciliation process. This isn't some assets outside the estate that the Debtor has nothing to do with; the Debtor has to be involved. Then you have the pursuit of Chapter 5 and other causes of action, which we dealt with a lot in our brief and I'm not going to belabor it now. But you have, again, it goes to, and I hate when we use the word launder, but you have estate causes of action

that under the Bankruptcy Code can be brought by the trustee or the Debtor on behalf of creditors, and somehow they're saying, well, those were purchased for a moment and now back in the estate, and the estate can now somehow bring those causes of action. And if those causes of action can only be brought by the estate, and there have been some courts that have granted standing where it benefits the estate. But here they're saying there is zero benefit to the estate because it's outside of the estate, that, Judge, frankly doesn't make sense to say we're going to have a settlement that transfers those assets to a court-approved trust that is now going to be able to pursue it.

And so, you know, part of Jevic was very clear, and as discussed, the Supreme Court was very clear that talked about that there are certain times where you can have non-priority or priority-violating distributions where there's a significant bankruptcy related objective. And the situations they talked about was contributing

to the reorganization. And here, and in Jevic they found, as your Honor knows, that when it was attached to a final disposition, it didn't preserve the Debtor as a going concern, and it didn't promote the possibility of a confirmable bound. There was no bankruptcy -- there was no reason to approve it, and certainly no objective of the Bankruptcy Code that would be further.

And the same is certainly true here. In fact, and going to the woe is me argument at the end, again, that was the argument in Jevic. The creditors will get nothing. If you deny this, if you overturn it, we will get nothing. And the Third Circuit said that was a justification, and Jevic said, no, that's not. The fact that certain creditors will not get the benefit of what they bargained for, if it violates the code, that doesn't matter, and that's not the appropriate justification. And that is the only justification that has been posited.

And one of the things that I think is important was that, you know, there's

an argument, oh, your Honor is going to set this major precedent on limitation of Jevic. Frankly, I don't think your Honor needs to go that far. This case, you don't need to get into the contours of Jevic. Frankly, you can say, I can leave Jevic to another day as to if it's non-estate assets, whether it can be a priority skipping distribution. Because here you're clearly dealing with estate assets. And so your Honor can rule on this and say, we'll deal with Jevic another day, and Mr. Kinel and other committees want to come in some other time and say Jevic still exists, that under Jevic I still have the ability to do this, that may or may not be true. But certainly under the facts here, we are not dealing where a clear issue of non-estate assets, we are dealing with estate assets that we're trying to sort of create this fiction to say they're not estate assets for today.

Then we turn to ICL, which, again, there are questions about whether ICL continues to be viable under Jevic. Again, not something that frankly needs to be

addressed today, because this is clearly distinguishable from ICL. And when you look apartment what ICL did, and in our brief reattached the term sheet that was approved in ICL. And what you had in ICL was a simple cash contribution, period, and that was it. Avoidance actions were purchased and then eliminated, versus here where you have them contributed back and then being pursued, which is a fundamental difference. You had Committee Chapter 11 fees. ICL just had a little bit of fees just for their distribution of the trust, that permitted them to use some of the trust funds for when they distributed the assets. This is actually dealing with incurred fees during the course of a Chapter 11 case.

And again, I talked about earlier the Debtors acted in the reconciliation and the releases. But I think the quote at the bottom from ICL shows the distinction between ICL and this case. And there, the Court was talking about Armstrong and talking about TSIC, and the Court found,

and this was the quote from the Court, the trustee presented no evidence that the settlement funds were, quote, otherwise intended for the Debtors' estate. All are true here. The settlement sums paid by the purchaser were not proceeds from its liens, did not at any time belong to Life Care's estate, and will not become part of its estate even as a pass-through.

We have showed and the documents show absolutely definitively that these were assets of the Debtors' estate, and then, in fact, at the time of the settlement, they contemplated through mean assets of the Debtors' estate, and it was only through this mechanism and through, you know, changes to the term sheet that they now flipped it and said we're going to move these assets outside of the Debtors' estate.

And that takes us to jurisdiction. Your Honor, we don't disagree with the fact that obviously if they settle a DIP objection or settle the sale objection, and that your Honor has jurisdiction to hear

that settlement. But there's a limitation to that jurisdiction. They would have that say as long as it's in connection with resolving a DIP, anything in the world that happens, even if it's between third parties, no matter what the claims are, that now resides with you and you're stuck with it, your Honor. And we can put in our agreements that bankruptcy court has exclusive jurisdiction, they get all the benefits of the different provisions of the Bankruptcy Code.

That frankly can't be, and it just doesn't work that way. If what they are saying is true, that your Honor, don't worry about the Bankruptcy Code, and we don't have to worry about fiduciary duties because this is not estate assets have nothing to do with either the purchaser directing it, these are outside the bankruptcy court. If that is true, how can your Honor hear claims that are being brought by this non-debtor party that has nothing to do with the estate against third parties? And your Honor is going to hear them, there's core matters related, how

are those related if those are assets that are not part of the Debtors' estate, according to them, it's just the purchaser gratuitously giving money off to the side. Your Honor can't hear those. The bankruptcy court wouldn't have jurisdiction overall of those. Yet they want your Honor not only to hear those, they want the chapter 5 actions to somehow be resurrect had, and they want your Honor to establish procedures where every claimant who is, again, apparently some third party creditors who will have claims against this non-Debtor asset that has nothing to do with the Chapter 11 so we don't have to worry about Jevic, we don't have to worry about absolute priority. And your Honor should mandate how they go and seek those funds and require mediation and all of that. Your Honor has to, in essence, create a new sort of Bankruptcy Code just for those type of distributions. And your Honor, we submit that that is well beyond the jurisdictional limits of this court.

And then we'll turn to the

Debtors' business. I have no doubt that the Debtors wanted to get their DIP approved, wanted to get the sale done, and said, hey, if we can get rid of some objections, we'll take it. And the testimony was that's what happened. That, frankly, the term sheet as written, even though the Debtors have a sophisticated director, they didn't even recognize that one of the things he testified was so key to him that he wanted to keep those actions, that the term sheet that he was agreeing to actually contemplated that the estate would keep those actions. But instead, he thought, no, I'm not keeping those, so it's not fair, but I'm going to approve it anyway.

And the Debtors had a rushed process, which they admitted, they never heard of this structure before the morning of the hearing, had no idea this was coming to them, they got a term sheet, said we have a hearing, even though we've adjourned the DIP, even though there's no testimony that there would actually be harm in delaying the hearing by any time, that, well, you know what, let's

just take it, we'll get one objection out of the way and we'll deal with it later. And that frankly is not an exercise of sound business judgment. Yes, the standard -- assuming the settlement actually complies with law, which we argue we don't believe it does, we don't disagree with them on the 9019 standards, although we'll talk about Martin factors in a moment. But this does have to be an exercise of sound business judgment. And a rushed judgment where the Debtors had a take it or leave it proposal that they didn't even have time to understand or read what was in it, didn't negotiate one iota, and just took it, that does not meet the standard of an exercise of their sound business judgment.

And one of the things I started with in my opening, your Honor, was the fact that this wasn't sold. There were no claims and causes of action that were actually being sold. There was a reservation of rights that had been filed , and when we have all the pleadings that we discuss this our brief, the Committee had stood up and said, okay, we're

okay on the sale. The Committee told the Court that the sale produced the highest and best value. As the Committee acknowledged, all of their claims against the noteholders had been waived. The noteholders had under the terms of the DIP order valid binding liens that were not subject to challenge by anyone. So they had liens on all of the assets, there were no claims left by the Committee. So what we have here, as I said before, this isn't a settlement. They would love to use the 9019 standard, but this isn't a settlement. What they're effectively trying to do is create in essence a Chapter 11 plan but have it blessed under a 9019 standard because they could never comply with the standards for approval of anything with any greater scrutiny.

And your Honor, there are standards that courts in this district, as your Honor knows very well, there are standards that need to be looked at when approving a 9019. And they didn't even bother to put on a case to show that they satisfied the Martin factors. They said, well, we had

the DIP objection, we had a sale objection, that should be sufficient. No evidence, no testimony by either their Committee witness or the Debtors' witness as to the viability of those claims, whether they thought there was any likes to those claims. In fact, we heard the opposite; they just wanted to be done with as many objections as they could.

Likely you heard of difficulty in collection and complexity of litigation. It was a DIP objection at most and a sale objection; certainly not anything complex.

Then that takes us to the paramount interest of creditors. And the paramount interest of creditors, when you look at the disparate treatment that's here, it certainly is not in the paramount interest of creditors. For a creditors' committee who now spends a lot of time trying to dig up cases to prove that they don't have fiduciary duties to those people with whom they are actually harming by this settlement is astounding. In fact, if you listen to the argument, it was we think we don't have fiduciary duties to the

DDTL parties' deficiency claims well, because they were represented by counsel, they were active in this case, and since they were active, they didn't need to worry about them so we could ignore our fiduciary duty. And that darn IRS, they just sat quiet the whole time. They could have spoken up. They never spoke up and they were silent the whole time, so we didn't need to deal with them at all. So somehow they don't have duties to you if you're active in the case, they don't have duties to you if you're silent in the case.

And what the record shows that the documentary evidence shows, that it is the Committee itself, not the purchaser, that changed the term sheet and changed it to carve out the priority claimants and to carve out the deficiency claims. I understand why they're worried about breaching their fiduciary duty and why they're very worried to try to point out case law to say, gee, we didn't breach our fiduciary duties. But for them to sit here and for a creditors' committee to be an architect of a priority

violating scheme that discriminates against unsecured creditors to whom they owe a fiduciary duty is pretty outstanding. And for the argument to be that somehow that satisfies the Martin factors that's in the paramount interest of creditors to approve such a scheme, frankly, it just doesn't make sense even arguing it.

So in conclusion, your Honor, the settlement motion has to be denied. This is not a difficult case. Even if we were to agree with them that Jevic applies only to estate assets, there clearly is involvement of estate assets here, and this is clearly tied in instrumentally to the estate. They just failed to exercise any modicum of business judgement. They failed to satisfy their burden under 9019. And as I started and as I'm going to end, your Honor, this is something that they created. The term sheet that's in the record that the noteholders proposed from day one, more than a month before this settlement was reached, said pull out a treatment, everybody can get it. And

also said certain assets would come into the estate. The Committee and of perhaps the Debtors' counsel for whatever reason decided, no, we want to be Smarter, we want to make sure it never comes into the estate so we want to remove that, and we want to take all of this for those people who are on the Creditors' Committee. That was their choice, your Honor, and unfortunately for them, by controlling case law, the settlement must be denied. Thank you, your Honor.

THE COURT: Thank you, Mr. Kaplan.

Ms. Casey?

MS. CASEY: Good afternoon again, your Honor; Linda Casey for the United States Trustee.

Your Honor, the Committee and the Debtors are urging an overly simplified analysis of whether this court can approve the settlement agreement. They argue that the Third Circuit's ICL decision remains binding Third Circuit precedent that this court must apply full stop, and because the assets are

purportedly not estate assets today, then the settlement should be approved.

This is overly simplistic in two ways. First, while it is true that the Jevic decision directly dealt with an end of case distribution of admittedly estate assets, it did not specifically address whether consideration paid to objecting parties in order to obtain the Debtors' assets through a 363 sale could be classified as anything other than estate assets. And a comprehensive analysis of the Jevic decision demonstrates that ICL's holding cannot survive.

In short, the potentially serious consequences that the Supreme Court sought to avoid by refusing to adopt a rare case exception to an end of case priority skipping distribution scheme will be present if the fiction of non-estate assets continues as a viable means of structuring an end of case priority skipping distribution in the context of a case involving a 363 sale.

The second way that the Committee and the Debtors overly simplified

this analysis is even if ICL remains good law, they urge the determining whether the settlement proceeds can constitute assets of the estate must be determined as of today, wholly ignoring that as of the date the settlement agreement was entered into, the majority of the considerations should be provided were clearly estate assets. The willingness of the Committee to provides its quid pro quo, withdraw of its objections and the entry of the orders prior to approval of the settlement does not alter the fact that the parties negotiated and settled upon ultimately class-skipping distributions of estate assets.

So we start with the first step in analyzing whether the settlement agreement can be approved by looking at the Jevic decision. The Committee urges this court to adopt its narrowest possible holding, that only end of case priority skipping distributions of estate assets are prohibited. Those were the facts in Jevic. The distribution was an end of case distribution,

and the assets to be distributed were with no objection estate assets. But Jevic cannot be read so narrowly on either port. The Jevic decision does not authorize any and all distribution of estate assets, but rather sets forth the test to determine whether any proposed interim class-skipping distribution is appropriate. The Supreme Court stated that an interim distribution of estate assets in violation of the code's priority scheme must have a significant offsetting bankruptcy related justification, setting forth several examples, including preserving the Debtor as a going concern, or promoting the possibility of a confirmable plan.

Courts applying Jevic cannot simply ignore those injunctions and say, well, the Supreme Court only discussed end of case distributions, and therefore, all interim distributions are appropriate. Rather, they must apply Jevic's rationale and look at all interim distributions to see if there is, in fact, a significant offsetting bankruptcy related justification before permitting it.

And that same principle applies here whether determining that their justification that there's this fiction of non-estate assets continues to survive Jevic. The Supreme Court specifically addressed whether to create a rare case exception to an end of case priority skipping distribution scheme. It declined to do so. Its reasoning in declining such an exception must be reviewed and analyzed. The Supreme Court noted that if a rare case exception were permitted, the fact that it is difficult to give precise content to the concept of sufficient reasons, would turn the exception into a general rule resulting in uncertainty. This uncertainty, in turn, would result in consequences that would be potentially serious. These serious consequences include the departure from the protections Congress granted particular class of creditors; changes in bargaining power of different classes of creditors, even in bankruptcies that do not end in structured dismissals; risk of collusion where high priority creditors and

low priority creditors team up to squeeze out mid priority creditors; and making a settlement more difficult to achieve.

The Supreme Court specifically noted the importance of clarity and predictability in light of the fact the Bankruptcy Code standardizes an expansive and sometimes unruly area of law, and concluded that the Court cannot alter the balance struck by the statute.

Today we are faced with a different exception to the prohibition of end of case class-skipping distributions, and that is that such distributions are not estate assets. Resting upon a Third Circuit decision that rejected the notion that a payment directly from the purchaser of the Debtors' offers' assets to an objecting party constituted proceeds of the property of the estate.

So what we are really faced with here today is deciding whether ICL's holding can survive Jevic is the following question: Can Jevic be read so narrowly as to create a

rush to the courthouse by individual creditors, an official or ad hoc committee of creditors, perhaps even equity holders or ad hoc committees of equity holders, seeking their share of the side deals or gifts offered by the purchaser of the Debtors' assets?

To continue the holding of ICL that allows this fiction of non-estate assets is to adopt a fiction that creates the same uncertainty that the Supreme Court's decision in Jevic was designed to address. Here my argument was going to go on simply with the facts of Jevic. We have, however, a record now established that shows the exact harm that the Supreme Court was addressing. And your Honor, I would posit that we have that record today, because as the Committee and the Debtors have argued, they weren't trying necessarily to get around Jevic, they were trying to get an opinion with the Third Circuit's decision. And perhaps in future cases we won't have quite the same record, because lawyers will know to dot their I's and cross their T's a little bit better to not

have a record so clearly show the harms that the Supreme Court was trying to address.

But here what we have is the same situation. It is difficult to give precise content to the concept of what is non-estate assets when discussing a sale of the Debtors' assets through a 363 sale. It creates uncertainty. How much is the purchaser willing to gift to rid itself of the objections? Who is the purchaser willing to gift to? How will the purchaser permit such gift to be distributed?

This exception would incentivize future stalking horse bidders and even other bidders at the auction to hold back part of their consideration they would otherwise be willing to pay to ensure that funds would still be available for it to pay objecting parties, thus further depressing the liquidation value of assets already in bankruptcy.

And how does the fiction permitting the ICL fiction to continue despite the Supreme Court's admonition result in the

harm? The first is the departure from protections Congress granted particular classes of creditors. In Jevic, they talked about the fact that Congress established employee party to alleviate the hardships employees face when their employers file bankruptcy and to encourage employees not to abandon ship. Permitting the major parties in a case to structure a sale such that the transfer of consideration goes to some individual creditors rather than the estate, and therefore deeming that structure to create non-estate assets results in that harm.

The record here demonstrates that harm. The record here, the Committee and the purchaser negotiated a payment to certain unsecured creditors while not protecting priority creditors. In fact, what we see here is an email from Committee counsel specifically providing that the priority creditors will not even be able to participate in a pro rata distribution of the assets to the GUC trust. And certainly not protecting the code balance that gives them priority over

everybody else.

This also has the second harm of Jevic, changes in bargaining power of different classes of creditor, even in bankruptcies that do not end in structured dismissals. Continuing the fiction that money is paid to overcome objections to sales are not considerations paid by the purchaser to obtain the assets, shifts the balance struck by the statute, and grants all creditors and all equity holders an equal chance to obtain a payment, as long as it directly comes from the purchaser, altering the code's balance and changing the bargaining power.

Here, again, we have testimony that priority creditors and the deficiency claims of the disfavored unsecured creditors were excluded in a manner that appears not to be directed by the owner of the assets allegedly being contributed but by the Committee.

We also have here the third harm that Jevic addressed, risks of collusion, where high priority creditors and low priority

creditor teams team up to squeeze out mid priority creditors. Sophisticated, well-funded parties, major unsecured creditors, large equity holders committees, can use this non-estate assets fiction exception to 363 sales to force a bargain with a purchaser where the deal is structured in a way that mid priority creditors are squeezed out.

Query, would the Court shall comfortable to approve this same settlement if the settling party were not the Committee but were rather than ad hoc group of equity holders, squeezing out not just priority and administrative creditors, but also unsecured creditors, all with the fiction that, well, it's not estate assets anyway.

The record here shows an attempt to structure this settlement to exclude certain estate assets from the estate prior to contributing it to the GUC trust. We don't really know why. The DDTL parties have indicated that perhaps it's to get around Jevic. That may be the case. It may be the

case to get around a Martin valuation, with a valuation of the settlement -- excuse me, the specified causes of action might be too great compared to the benefit received by the estate for the release of the Committee's objections.

But we see that attempt. We see the attempt to take assets that belong to the estate and find a structure where it can come into this court and say it's no longer an asset to the estate, and now it can go to the preferred creditors and skip over the unpreferred creditors.

We also have a situation here where you not only have the priority creditors and the admin creditors not being invited to participate in this distribution, but you have fully unsecured secured lenders, clearly a disfavored, probably a very large claim that would swamp the unsecured creditors, and they're kicked out of this distribution.

And finally, we have the last harm that the Supreme Court tried to address, which was making a settlement more difficult to achieve. If all parties know the playing

field and any money paid to acquire the assets of the Debtors is proceeds and estate property, then all parties will be invited to the settlement table, and a global resolution is more likely to result. If on the other hand all parties know that, structured correctly, any money paid by the purchaser could go directly to any creditor, settlement will be more difficult to achieve, and there will be a free for all to be the one that the purchaser deems worthy enough of the separate side deal.

The Jevic court did not close the window on end of case priority-skipping distributions, but leaves the barn door wide open to permit creative lawyers to craft individual solutions that transfer estate property into purportedly non-estate property, resulting in the very harm that the Supreme Court was addressing. ICL's blessing of the fiction that consideration paid directly to a creditor to obtain the Debtors' assets without objection is not proceeds of the Debtors' property cannot survive the Jevic decision.

It is also worth to know that the procedures here, the settlement procedures, as your Honor said, we cannot look at this in a vacuum, the settlement procedures that are proposed by the Committee go far beyond anything in Jevic and go far beyond anything that the code or the bankruptcy rules provide. I do have specific objections, and if we get to that point where we have to discuss it, I'll go through them. But in general, the Bankruptcy Code and the rules are flipped on their head. There's no right to take discovery, no right to even provide testimony supporting the claim, binding claims mediation where the claimant has to pay half of the mediation. None of these are in the code, and the entire scheme is just basically saying, as long as there aren't estate assets or as long as this court adopts the fiction that these are not estate assets, we then can just ignore the entirety of the code and the rules and put whatever in place makes sense.

We also heard something very telling in the Committee's argument today.

The Committee said if you disapprove this, then the purchaser will have received a multi-million dollar windfall. That would not be fair. That, your Honor, is exactly what the argument is. This is not a gift, it is not a side deal, it is the purchase of the assets, and that payment came in as consideration to be able to get those assets. And the Committee admitted it. If you disapprove of this, they've received the windfall without paying everything they agreed to pay to get those assets.

The Committee also warned your Honor that if you disapprove this, it will reverberate across the nation and prevent committees in future cases from being able to enter into settlements. But your Honor, it will not be your decision that will reverberate across the nation, it is the Supreme Court's decision. The Supreme Court specifically said that the importance of clarity and predictability in light of the fact that the Bankruptcy Code standardizes an expansive and sometimes unruly area of law

resulted in the Supreme Court saying it cannot alter the balance of the code. Right here, the balance of the code is unsecured creditors cannot get paid out of estate assets until all senior creditors are paid in full. And if that makes it more difficult for a Committee to enter into an agreement with this fiction of a side deal, the fiction of non-estate assets, and forces them to comply with the Bankruptcy Code, that's what the Supreme Court said in Jevic.

As such, the settlement agreement here cannot be approved as it does skip higher priority claims, discriminates against disfavored unsecured creditors, and the fiction that it is all done by non-estate assets cannot be continued post Jevic.

However, even if your Honor determines that ICL does continue to have viability, it does not shield the settlement agreement in this case. And despite what the creditors' Committee stated in their argument today, there is a dispute as to whether the assets are estate assets. There are at least

four distinguishing factors. First, the Debtors and the Committee are providing mutual releases. The Debtor in ICL were not providing any releases. But here, as the DDTL parties already pointed out, these releases are broader than the releases that were contained -- or excuse me, than the stipulations and waivers contained in the final DIP order, and they are also the Committee's releases, as well, which of course they're releasing estate causes of action. This is clearly estate property, and anything received in exchange for the Debtors' releases, the Debtors' broader releases than the final DIP order, the Committee's broader releases than the final DIP order, are estate assets.

Second, the settlement releases the Committee's right to pursue claims against the secured lenders which claims are estate causes of action. The Committee hangs its hat now on the fact that the challenge periods set in the interim order expired, the final order had not been entered as of the date of this

settlement.

Third, the settlement provides an increased payment to the secured lender to pay professional fees. And in this respect, we need to look at the settlement agreement which specifically provides how those increased funds are going to come to the Committee. And that is the Committee's professional fees shall be paid solely through the wind-down budget and the applicable amount of seller retained third party professional fees, i.e. Debtor retained third party fees, included in the wind-down budget. And section 3.1 A-2 of the APA shall be amended to reflect the updated total amount of seller, i.e., Debtor retained third party professional fees or the wind-down budget. So this is being paid by the Debtor, according to the terms of the settlement sheet. In their papers, they argue that, well, final DIP order was already approved, the escrow was already funded, the fee applications have been approved, we've been paid, there's no Debtors' assets being transferred in this. But clearly that's not

true. At the time of the settlement, none of that had occurred, and the quid pro quo was the favor of the DIP objection to allow the DIP order to be entered, to allow that money to be funded, and therefore, at the time the settlement was entered into, it was clearly estate assets.

There's also an issue the Committee says, well, it's not priority skipping because we're admin creditors, we have to be paid. As your Honor indicated, you have to look at this case in its totality, and in the case in its totality, we are currently administratively an insolvent estate; we have the WARN act creditors establishing a record that there's a possibility that their admin claims have not been appropriately reserved for, and that they might not be paid in full. So therefore, you can't just say, well, because we are admin creditors, there's no priority skipping. There are other admin creditors here who are not being paid.

Finally, there is the transfer here of estate causes of action again

purportedly sold to the purchaser and then transferred to the GUC trust. ICL did not address whether this indirect transfer of estate assets could be deemed to be a transfer of non-estate assets, and it's clear it should not be. Again, at the time the settlement was entered into, not today, they were estate assets. The sale had not closed, the sale had not been approved. At the time that the Committee and the noteholders were negotiating over whether the Committee should be able to -- excuse me, the GUC trust should be able to get these causes of action, they were estate causes of action.

They became non-estate causes of action, arguably, when the Committee agreed to withdraw its objection and let the sale order be entered. But at the time of the settlement, they were clearly undeniably estate causes of action. They may come back and say, your Honor, we had testimony that the Debtor tried to get them to not be included in the APA and worked hard not to get them into the APA and they were into the APA. The APA

was not approved. At the time they entered into the settlement, the APA was subject to objection, had not been approved, the cause of action were clearly estate causes of action. Thus, even if ICL does remain good law, the assets transferred pursuant to the settlement cannot be deemed to be non-estate assets, and the settlement cannot be approved.

I do have one technical point. If your Honor were inclined to approve the settlement agreement, the settlement agreement provides that the Debtors and the Committee will not object to fee applications brought by any of the parties' professionals. There is a fiduciary out so that the Debtors and the Committee can meet their fiduciary obligations to review and object to fee statements of estate professionals. But, of course, the parties include the DIP lender and the purchaser, and therefore, their professionals, they're not estate professionals, and the fiduciary out in the settlement agreement does not extend to that. And if your Honor were to approve the settlement agreement , we do

object to the provision that says that the Committee and the Debtors agree not to object to the fee statements of the DIP lenders or the purchasers' agreements -- excuse me, professionals.

I do have specific objections to the procedures motion. I don't know if your Honor would like me to go through it now. I don't believe that that's where we are; I think we're waiting --

THE COURT: Yeah, let's wait on that.

MS. CASEY: If your Honor doesn't have any further questions, that's all.

THE COURT: I don't. Thank you.

We're going to take a short recess, then I'll hear the next set of objectors, so about five minutes.

(A brief recess was taken.)

THE COURT: Next? Mr. Raisner?

MR. RAISNER: Thank you, your Honor. Good afternoon. Jack Raisner on behalf of the WARN class.

Your Honor, the Jevic court did rule that in a case ending distribution by an estate, the priority code must be followed. It is true that the distinction between estate and non-estate assets were by that point a non-issue, and that's because the appellees rendered itself by not pursuing that argument rather early in the appeal process, recognizing it as a non-starter.

And Mr. Kaplan and Ms. Casey did an excellent job of showing how intertwined the distributed assets were to the estate that differentiated from ICL. The argument we did not attend that afternoon in the Third Circuit. So I'm not going to argue those differences.

But I would like to make one point that I think might have been lost and may not even have surfaced in the Jevic opinion, but is important here. And that is that when the assets are being used by the Debtor, they are not just serving as a messenger agent for the secured lender as a passive intermediary, taking the money from

the lender and giving it to the creditors in their pockets. They're using the money to settle claims against the estate which are claims against the Debtor itself. The Debtor is playing the role of a self-interested agent, in agency principles, being such an agent is liable personally. And when the Debtor is using the money as it does here, to extinguish claims against it from creditors, then it is liable to have to follow due process and the Bankruptcy Code. And that is a way to, again, differentiate ICL in which this didn't happen, but it's compelling I think in light of the procedures here that were proposed in the dismissal motion for the non-WARN CSC employee claimants. Their claims were supposedly going to be, are going to be sent to them in the form of a notice saying that they're allowed certain amount of money, and they will have 14 days from receipt in order to object to that with particularity and with documentation if they want to preserve their claim. And if they don't respond in the 14 days, in the event that the Debtors do not

receive a timely claim objection to the proposed disbursement notice, the Debtors may make the appropriate distribution from the CSC employee reserve in full and final satisfaction of the related non-WARN CSC employee claims.

So what they are doing is setting up a system to extinguish claims as they see fit with the amount of money that the Debtor sees fit. And that is the finality of taking away of someone's claim which is a due process issue that I do think that the Jevic decision does recognize. And you hear certain bankruptcy lawyers saying that after Jevic, they didn't realize that the Constitution played such a part under the Bankruptcy Code. So there is that, your Honor.

But I'd like to focus then on the other side of Jevic and what the Supreme Court did and what was supposed to be done, and that is to make priority skipping final distributions, of course, but with consent. And the motivation to reach consent is to have a dialog, to have some sort of settlement with

those priority claimants so that there's a basis for reaching consent. Here there was, I think, a purpose of putting certain amount of money into an escrow which was going to induce some kind of resolution of claims, both the Jevic -- I'm sorry, the WARN claim and also the non-WARN claims.

The problem here is that the procedures are hollow. Our concern at the outset was that we didn't have information. And so we lodged our first objection based on that alone, and then as we found it harder and harder to pull out any details or terms regarding this amount of four-and-a-half million dollars roughly, it turned out it was hard, because there was no there there. There are no terms. There is nothing to stake that money in the ground with certainty such that one can even talk about settling no less relinquishing an objection to the fact that the estate is trying to get out of bankruptcy with no provision to pay priority claims in full.

But there's an opportunity when

there is supposedly $4.6 million to reach a settlement, to reach a consensual resolution. And that's a missed opportunity here.

Our objections were raised and they were not responded to in the most recent reply by the Debtor and Committee, and the Debtor and Committee has put on no case whatsoever to show that there is any there there to this supposed $4.6 million. So to say they don't understand why we're here rebuffing us the way they have done from day one, what are you worrying about? There is this one here for you. That would be wonderful. And get to go a resolution and settlement includes, however, a proportionate responsibility on our part to kick the tires, do the due diligence, and keep litigating until we see there's been some there there, and there has been no case put on that there is any.

So it does seem as though there was an awareness that in order to, quote, get around Jevic in order to try to at least create the possibility or illusion of a

consensual settlement, something was done to put some rules, a few sentences down in some orders. But it unfortunately turns out to be a losery, that the 4.6 million would even used to pay employees is suspect, because the first sentence of the sale order of August 19th, the very first sentence leaves an open-ended, ambiguous clause as to what the money might even be used for. I'll just read it into the record. "The ad hoc notes and Creditors Committee, PE and CE, GSPEO, and the DIP lenders, the creditor parties, agree funds will be set aside (in an escrow or other acceptable manner) the employee funding escrow from the net proceeds from the sale in an amount sufficient to pay the estimated amount of all allowed security priority and administrative claims of the employees of CSC, whether they're working or not, or such other amounts as may be agreed upon." The money of the proceeds may be set aside to pay other amounts as may be agreed upon. That's completely open-ended.

And of course when we first read

it, we didn't know what that means, and we tried to fathom it. But as you can see from the testimony today, nobody knows what will ultimately be the agreed upon use of whatever money has been in some way segregated. And so there is a -- there was a sense in Jevic that the one plaintiffs were offered something and they didn't take it, and their recalcitrant or the step up artists or something, and unfortunately here, there's an idea that somehow we're looking a gift horse in the mouth. But if the result of whatever the Court's disposition is would be to have some certainty placed in the use of these funds that have been used in this settlement so that a constructive settlement can be talked about and perhaps reached, that should be the way cases end in a final distribution, not with terms thrown at creditors and then close the doors and ears and come into court and say we can't do anything else about this. That is not the best practice. Thank you, your Honor.

THE COURT: You're welcome. Mr. Benson?

MR. BENSON: Thank you, your Honor. Just a few brief points. I know we're not currently discussing objections to the mechanics motion as it's called, but I want to direct the Court's attention to two provisions of the liquidating trust agreement, because I think they're directly relevant to the issue of just jurisdiction over the settlement.

I first note in the liquidating trust agreement Section 2.2 H, which entitles the liquidating trustee to seek a determination of tax liability or refund under section 505 of the Bankruptcy Code. 10.6 entitles the trust to request an expedited determination of taxes and tax refunds, tax refund rights, excuse me, of the CE liquidating trust, including the disputed reserves under section 505 B of the Bankruptcy Code for all the terms or claims filed by the CE liquidating trust for all taxable periods through the determination of the CE liquidating trust.

Now, section 505, the broad granted jurisdiction to bankruptcy courts to

determine tax liability has been limited by the Third Circuit in the Qualcomm case to tax liabilities of the Debtor or the estate for the most part unless, very rare circumstances, it says, but generally 1334 says you have to have related jurisdiction. If the liability is not of the Debtor or the estate, it's unclear how that relates to administration of an estate, and therefore, as a general matter, there can be no jurisdiction for the liquidating trust, or no jurisdiction over tax liabilities of the liquidating trust unless it is, in fact, the estate. Same holds true for the expedited determination request under 505 B under the code. That procedure is only available to determine liabilities of the estate.

Now, exceptions are made sometimes when you have liquidating trust that is deemed to be a de facto successor to the estate. But that is only where you have a liquidating trust that is administering the estate assets. So here, in order for the Court to have the jurisdiction that is being

sought under the liquidating trust agreement, the liquidating trust must be a de facto successor to the estate, meaning it must be administering estate assets. If that's true, then there's a Jevic problem. If the liquidating trust has no estate assets, it is not a successor to the estate, then there's no jurisdiction, and we continue our objection to the liquidating trust.

Moving on, I'd just like to respond to Mr. Kinel's comment about how the United States and the IRS were not involved up until very recently. We weren't involved because as far as I know, no one at the tax division or the IRS was alerted that any of this was happening. We do not have the resources to have the DOJ attorney attend ever sale hearing and DIP hearing and hearing of any kind to make sure that there is no settlement put in place that affects us down the line and cuts out our priority claim. It's just totally unrealistic, it's unrealistic to all other priority claims, employee claims when not represented by class

counsel. And that also goes to what the Supreme Court was saying about the whole importance of priority, is it forces the insiders to the case to bring in the con congressionally preferred priority creditors. Because if the priority doesn't matter, then there's no reason to bring us in, we don't find out until it's essentially a fait accompli, or patricide, as Mr. Kaplan described it.

So for that reason, I think it's very important, however you want to talk about it, as ICL, Jevic, the priority claims need to be given their congressionally granted status if we're ever to be brought in and allowed to participate in these negotiations, which the Supreme Court highlighted as the crucial part of its Jevic decision.

THE COURT: Thank you, Mr. Benson. Reply?

MR. SHAPIRO: I'd like to respond to just a few points raised by the parties.

First, I'd like to address the

allegation that the Debtors did not exercise sound business judgment in agreeing to enter into a settlement. So I think, again, the context here is important in what was put in front of the Debtors. And specifically, what was put in front of the Debtors were the following terms. The purchaser would contribute causes of action that it purchased to a GUC trust. The purchaser would contribute its own cash to the GUC trust. Certain out of money creditors would be the beneficiaries of those assets, and the Committee would support the sales and the debt and drop any objections there to.

And importantly, that document on August 16th was subject to further documentation. And I have a couple -- in case that wasn't clear, I have a few quotes from the August 16th hearing from each of the parties. First was Mr. Rubin, counsel to the ad hoc Committee. And there Mr. Rubin said, "The Debtors are not today committing to these things. We know we have steps to take to get there. The Debtors are supportive of the

terms." Mr. Wehrer, counsel to the Committee: "There are certain elements regarding process that we need to work through." And finally, Mr. Rogoff, counsel to the Debtors: "The Debtors are prepared and committed to work in good faith with them, and the other parties memorialized this agreement.

And then if you wanted to look at what happened with the benefit of hindsight when determining whether the Debtors exercised sound business judgment, the Court did, in fact, approve the sales on August 16th and the DIP on September 9th. So in other words, the Debtors' key goals were achieved, and the Debtors gave up nothing in the process. And in the reasonable view of the Debtors, the Committee support helped achieve those goals.

And it can't simply be the case that in order to enter into a settlement, all parties must be treated fairly. That simply can't be right. Why? Most importantly because on August 16th and even on September 9th, there was a binding Third Circuit opinion that was binding on this court that allowed

for class skipping in the context of settlements. But at least in part what the DDTL parties are saying is that the Debtors couldn't have possibly signed on to the settlement the same day that it received it. That's just not enough time to digest the document and make a determination as to whether to enter into it subject to final documentation. To me that sounds like an argument that the Debtors breached some kind of duty of care.

But let's assume that underlying premise is true and a few hours isn't enough time to review and understand a six-page document. Fine. But what about three weeks? Because it was not until September 8, more than three weeks later, that the settlement term sheet was finalized, executed, and filed with this court. Three weeks is surely enough time to review and understand a six-page document.

Now, let's just talk about why it was important to have the sale go forward on August 16th and not adjourn it so that we

could get this settlement in a term that was more fair to all the parties. And I think the testimony there, uncontroverted, we needed an approved sale to show the market, the vendors, employees, et cetera, that we had a buyer and that this business would survive. That surely is a valid reason to move forward with a sale on August 16th, not where standing that the term sheet wasn't finalized and notwithstanding that the term sheet didn't make everybody happy.

And my next point speaks to the allegation by the objectors, and really the DDTL parties, that the settlement was some kind of a laundering scheme that was the result of some conspiracy between the Debtors and the Committee. We found this particular accusation offensive, especially given the use of the word laundering, and that connotes some kind of criminal conduct. But let's assume the DDTL parties are right, we used the purchaser to transfer state causes of action to the trust to get around Jevic. But how could that be laundering? How could that be

in any way criminal? As I noted, at the time the settlement was entered into, the Third Circuit's opinion in Jevic was binding. It permitted class skipping in limited circumstances. There could be nothing criminal about what was done.

But let's talk about why that allegation is nonsensical. From the outset of these cases, the purchaser contemplated acquiring what the settlement refers to as specified causes of action. In fact, just days after the petition date and before the Committee was even formed, the Debtors filed a term sheet on the Court's docket that provided such causes of action were proposed to be purchased assets. So in other words, this so-called conspiracy began before the Committee was even formed. Now, it's been a while since I've taken criminal law, but my recollection is much like the tango, a conspiracy requires at least two parties.

But let's assume there was a conspiracy. What would that conspiracy be? Well, the Debtors and the Committee, before

the Committee was even formed, conspired to to ensure that the purchaser acquire the specified causes of action. The Debtors and the Committee then conspired to get the purchaser to agree to contribute those causes of action to the GUC trust if and only if the summit was approved with knowledge and downright clairvoyance that the Supreme Court would overrule the Third Circuit in Jevic. In other words, we were really playing the long game, and we were really coy if I dent that this settlement would be approved. Because if it isn't approved, these causes of action will remain as they are today since November 28, 2016, with the purchaser. All criminal conduct is risky, but this experience just defies common sense.

In further support of their experience theory, the DDTL parties point to various drafts of the term sheet which they say demonstrate we were manipulating the term sheet to contravene Jevic. Let's assume that's correct. Well, isn't that our job? Isn't our job to comply with the law and to

structure transactions so they comply with the law? We tried to structure the transaction in such a way to remove any concern that to the extent Jevic was implicated wouldn't be an issue.

But getting past that, the only item that changed of any relevance to the issues before your Honor today was the precise mechanic of how assets would be contributed.

THE COURT: Which is the entire thrust of your current argument that Jevic doesn't apply. So you dismiss it and rely on it at the same time.

MR. SHAPIRO: So I only rely on it inasmuch as on August 16th when the Debtors made the determination to exercise sound business judgment, at that time, Third Circuit law permitted class skipping. That's the extent I rely on it.

THE COURT: On August 16th, the document your client approved had the causes of action coming back to the Debtor, and then you changed it.

MR. SHAPIRO: That's fair.

THE COURT: And you say it doesn't matter that you changed it, but of course it matters you changed it, because as we sit here today, if you hadn't changed it, you'd be DOA. That's my point.

MR. SHAPIRO: And that's a fair point. But I think the record makes clear both on August 16th at the transcript that when Mr. Wehrer said that the mechanic was to be worked out, and it was worked out. And on September 8th when we filed the executed term sheet, that was the mechanic that's before your Honor, that was the ultimate mechanic that was decided.

THE COURT: Who does Mr. Wehrer represent?

MR. SHAPIRO: The Committee.

So getting back to the term sheet, there was never a -- so before August 16th, we had an auction. And at that auction, we declared the winning bidder for the non-CSC assets. And the purchase agreement that we filed with the Court, the one that we declared the winning bid, provided that the CE Star

entity would acquire these specified causes of action.

So from our perspective, on August 15th up until the morning of August 16th, it was always our understanding that the purchaser was acquiring these causes of action, because that's what the APA that won the auction provided for.

So that morning when we were told that the APA was going to be amended so that these causes of action could be contributed to a trust, from our perspective, in sound exercise of our business judgment, we were never entitled to those causes of action to begin with. We had already declared them the winning bidder, and that bid contemplated the purchase of those assets.

And the other thing that's telling is --

THE COURT: But at that time, they were still your assets.

MR. SHAPIRO: That's correct. But the settlement that we entered no -- sorry. The settlement that we agreed in good

faith to pursue on August 16th was always subject to court approval. A Debtor just can't just enter into a settlement at that time and have it be binding on him. It's still not binding on him; it has to be approved by your Honor.

So what happened between then is the sale closed and the causes of action are owned by the purchaser. And if the settlement today is not approved, the causes of action will still be owned by the purchaser.

THE COURT: Look, the problem you have is that most of the arguments I'm hearing from you and from Mr. Kinel are the exact same arguments that Judge Shannon relied on when he did the lower court ruling in Jevic, okay? But that doesn't carry weight anymore. The Supreme Court has made it very clear that those kind of arguments and the kind of arguments you're making right now, that if I don't approve this transaction, this money will go away and everybody will be worse off. That was the exact rationale that was overturned by the Supreme Court, and they say

that has to fall to the wayside when you're talking about altering the priority scheme without some bankruptcy related purpose. Right?

MR. SHAPIRO: That's true, your Honor.

THE COURT: And that was the thrust of Mr. Kinel's closing at the very end was you can't do this to us. Well, I didn't do it to you, eight people in Washington, D.C. did it to you. Well six, I guess in washing done D.C. did it to you, I didn't do it to you.

MR. SHAPIRO: And I understand, your Honor; that wasn't my argument. The only point would make to that is what distinguishes this case from other cases and perhaps that case is right now what's being contributed if this settlement is approved is coming from a non-Debtor.

THE COURT: Yes and no, okay? Yes, they currently have it after the closing. No, it started off as a Debtor asset. This isn't -- is it ICL? I'm no good with

acronyms.

MR. SHAPIRO: That's right.

THE COURT: This isn't ICL. This isn't even Jevic to the extent we're talking about the CIT cash distribution or the lien contribution. In ICL, that was money that was never in the estate's coffers that was going from the purchaser to the creditor.

In this case, you start, the very proposition on as of the petition date, this was property of the estate. It's always property of the estate. So say it's not estate property that's being distributed is ignoring its origins. And doesn't that distinguish it from ICL because it started off as state property?

And importantly, at the time the settlement was reached on August 16th, and even on September 8th, it still was property of the estate.

MR. SHAPIRO: What I think distinguishes that is they're not co-dependent on one another. We're not saying that you can't approve the sale unless the settlement

is approved. They really truly are two independent things. Because right now, the sale has closed, the sale has been approved, and those assets belong with the buyer. They're with the buyer. The only string attached is if this settlement is approved, at that point, it's transferred. But they're not tied together. They're independent, and that's the way that we required them to be.

So I don't know that you can -- I think you need to distinguish it in that way. There has to be the sale. The sale is done, the sale has closed, the sale is a final order. This settlement is separate and apart from that. And if you don't approve the settlement, then this sale is unchanged and nothing happens to the sale. But if they were tied, and I could see that being a concern, because you would say, well, isn't this just some creative two-step process to get around Jevic? In some sense maybe it is, but it's a very risky one. Because at this point we have a sale that closed with the assets in the purchaser's pocket with no obligation to

contribute them whatsoever unless your Honor approves this settlement. And so if somebody wants to structure a deal that way, in such a risky way, I don't think that's a legitimate concern.

THE COURT: I'm speculating, but I don't see it as an attempt to get around a Supreme Court decision that hasn't come down yet as much as I see it as an attempt to fit into the ICL model, which was controlling law as of the settlement date. But that's sort of neither here nor there. It doesn't matter why it's being done this way. You're right that an independent sale order that's become final has transferred these assets, and that's separate from approval or disapproval of the settlement.

But that doesn't answer my fundamental point, which was to distinguish this from ICL. And I don't have the brief in front of me, but the quoted -- yeah, this is in Mr. Kaplan's depth from ICL, "And the Trustee presented no evidence that the settlement funds were otherwise intended for

the Debtors' estate. All are true here. The settlement sums paid by the purchaser were not proceeds from its liens, did not at any time belong to Life Care's estate, and will not become part of its estate even as a pass-through."

Did not at any time belong to life care's estate. This did at one time belong to this estate. There's no question there. So doesn't that distinguish ICL?

MR. SHAPIRO: You know, if you take that out of context, I suppose. And it's true, I mean, you could at one point trace assets to a lot of people and you could follow where they go.

THE COURT: I'm telling you you take it out of context, it's the whole thing --

MR. SHAPIRO: Well, let me --

THE COURT: -- of the case.

MR. SHAPIRO: Sorry. Let me rephrase. Yes, they were at one time owned by the Debtor, but they were sold, and a purchase price was negotiated, and that purchase price

was paid and the buyer bought them. They're theirs. The buyer owns those causes of action, no questions asked. And they're only obligated to contribute them to the trust if your Honor approves the settlement.

So yes, at one point the Debtor did own them, but the Debtor doesn't own them now. We have no claim to those causes of action. We can't ask the purchaser to return them, we can't ask the purchaser to do anything with them. For all we know, the purchaser brought them and started suing individuals on account of those -- we don't know. We have no control over that. And as far as, yes, we did at one time own the causes of action, but we don't anymore.

THE COURT: Well, I don't see how the purchaser can pursue Chapter 5 causes of action on its own behalf if it's not on behalf of the estate, they're simply not able to be pursued.

MR. SHAPIRO: That's fair, your Honor, but that was only one component of the specified causes of action. I was just using

it as an illustration, but that is a fair point.

THE COURT: Fair enough. I get it, I get it. You don't control the causes of action. I understand.

MR. SHAPIRO: And just a couple more points. I heard your Honor loud and clear, and I should probably keep my mouth shut. But I just wanted to make one point. We haven't yet made a final determination as to whether we're moving forward with dismissal or conversion, but I think in both Mr. LaForge's deposition testimony and other filings we made before the Court, including one in response to the dismissal motion, I think that, it's safe to say that conversion is the most likely outcome. I don't think that this is going to be a dismissal. There are causes of action that were not acquired by the buyer, specifically causes of action that belonged to the Columbus entities, and that was a separate sale, that was a liquidation sale, so they did not buy causes of action. So while we've not valued what those causes of

action are, we cannot, we don't think, dismiss those cases while they're there, because they have some value, we just don't know what they are.

THE COURT: I think that goes to the point does Jevic live and die on the fact that it has to be a structured dismissal. And I think Ms. Casey did a nice job of going through the concerns that the Supreme Court had, and I don't think it's necessarily tied to a dismissal, because there's certainly language in the opinion that allows intermediate settlements, like the Iridium case, or critical vendor motions, orders, wage orders that have this sort of bankruptcy purpose or reorganization purpose.

But I think, you know, you're right, I think this case is headed, if I deny the settlement -- or if I grant it, I'm sorry. If I grant the settlement, I think the case is headed to dismissal or conversion, and probably conversion. But where it's not headed is a plan. And when it's headed to dismissal or conversion, it's headed there

soon. So I think, you know, while I certainly understand your point about how the dismissal motion isn't necessarily tied to the settlement motion, I think, you know, the case is such, I don't have to ignore my common sense, this case is either approval or not approval of the settlement, is either headed to dismissal or conversion in short order. I may be wrong, I don't know. That's my feel.

MR. SHAPIRO: So a couple more points, your Honor. On the releases, it is true that we are providing, the Debtors are providing some releases. But it can't be that they are releases that makes this settlement, you know, prohibited by Jevic. Then every settlement would be prohibited by Jevic.

THE COURT: Why? Maybe every settlement is prohibited by Jevic.

MR. SHAPIRO: Okay.

THE COURT: Well, I don't know. Maybe every case ending priority skipping settlement is off the table. I think it was the Middle District of Tennessee, but Bankruptcy Court in Tennessee just issued an

opinion that one could argue broadly interpreted Jevic to deny a settlement. I don't know where we are.

MR. SHAPIRO: I'm glad we're in Delaware, I guess.

THE COURT: We'll see.

MR. SHAPIRO: Just one more point, and this addresses the WARN claimants' response. I want to be clear, the WARN claimants had a bunch of issues with the procedures in a dismissal motion. I informed your Honor we're not going forward with that dismissal motion. Even if by some miracle we do dismiss and not convert, we're not seeking approval of those procedures. So to the extent the WARN claimants has an issue with those procedures, that's certainly not relevant to the court's consideration of the settlement motion.

Finally, to the extent the WARN claimants have an issue with us providing them with information, they have an adversary proceeding, they can seek discovery in the context of that. Of course, we're trying, as

I think the WARN claimant's counsel said himself, we are trying to resolve that. But there is a mechanism for them to get the information that they want.

And I think that's it for me, your Honor.

THE COURT: Okay. Thank you. Mr. Kinel? You get the last word.

MR. KINEL: I hope it's a good one.

Your Honor, I'm just going to address a few points. I think it's pretty clear that the U.S. Trustee is asking your Honor to reverse the Third Circuit's ICL decision. I heard Your Honor's comments a few minutes ago, and I think the distinguishing factors have been pointing to don't distinguish the case at all. And I think that the only way this settlement doesn't get approved under ICL is to basically for this court to conclude that ICL is no longer good law.

The point made about -- well, actually Ms. Casey said Jevic leads the door

wide open for creative lawyers. Well, if that's the case, I don't know if it is or isn't, but the point, I think that's effectively a concession that Jevic doesn't deal with this case, and that the U.S. Trustee would like it to, but it simply doesn't. The idea that it's a fiction that there are non-estate causes of action when somebody buys something and returns them, and I heard your Honor say something similar a moment ago, number one, if I buy your house and I live in it, yeah, once upon a time, you owned it, but I owned it now, why does it matter? I don't understand, no one has articulated a rule of law as to why that was a distinguishing feature in any case --

THE COURT: Well, and I'm not saying you have the facts now, but if it's a sham transaction, you can ignore the fact that it was sold. I'm not saying these are the facts, but if it was part of the conspiracy to avoid Jevic and go back on what the documentation said on August 16th and change it to make sure that it stayed out of the

estate, I can collapse that transaction. I don't have to honor it. And there are plenty -- if those are the facts, you could do that -- you know, it's in effect a fraudulent conveyance. It's a transfer that's not a transfer.

So there are plenty of ways to avoid that kind of transaction if the Court deems that that's the appropriate based on the facts of the case.

MR. KINEL: Well, respectfully, those are not the facts of this case.

THE COURT: Fair enough.

MR. KINEL: There's not a shred of evidence that the economics of this transaction ever changed or that the noteholders would have paid an extra nickle for this estate for the assets. As a matter of fact, the noteholders kept their powder dry and didn't even fully credit bid what they could have in order to win that auction. The idea that they just would have written a check on top of -- if they had to increase their credit bid, which they could have, that they

instead would have just written a check is really just beyond credulity. It's not this case. It's not what happened here.

The idea that the assets were still the assets of the estate on the date the parties came before the Court on approval of the settlement, I don't see how that's relevant. Nobody objected. If the U.S. Trustee or some other party thinks that every one of these transactions is a sham and that you can't purchase estate causes of action, then why not object at that point? That's the point when somebody should have objected and, said a minute, why are these estate causes of action going through the noteholders? What business does the Debtor have selling those? What's the consideration for them? That entire unless shouldn't be done today, it should have been then. And nobody objected, and this court approved that transaction.

And I just wanted to address one of the apparently big distinguishing factors that people are relying on and arguing about the difference between ICL and this case is

the releases. And I think Mr. Shapiro touched on it. But the releases that are set forth on the term sheet, they released the noteholders and the officers and directors and all that. That was already done in the DIP. And that was done, and didn't need to be a final DIP order, that was gone in connection with the interim, first interim DIP order.

The only other release that the Debtor is giving is a release of the Committee. That's worth nothing, okay? And I'll represent to the Court that if that's the deciding factor in this deal, we'll take that out of the settlement, because that doesn't distinguish this case from ICL, the fact that the Debtors, just like every other settlement you see, the parties who sign off on it want mutual releases and exculpation. There's zero value that came out of the estate for that release. And that doesn't distinguish ICL.

The other factors -- I mean, sure , you can pick apart, and do they line up exactly? No. And the phrase that your Honor quoted, does that sort of imply that, it says

did not at any time belong to the estate. Yes, it says that. But I'm not sure that's the holding. If you look at the opinion, and actually, I read it again yesterday and thought I had lost a page, because it ends very strangely for a circuit court decision. It really has no conclusion.

The last paragraph of the decision is, "As noted, the Bankruptcy Code's creditor payment hierarchy only becomes an issue when distributing estate property. Thus, even assuming the rules for bidding equal ranked creditors from receiving unequal payouts and lower ranked creditors from being paid before higher ranking creditors apply. In the 363 context, neither was violated here."

So I guess we could debate what the actual holding of ICL is, but I don't think that that one phrase taken in isolation versus that phrase or others is enough to distinguish ICL from the facts of this case.

And yes, I apologize for appealing to perhaps the Court's equitable

considerations here, but, you know, I believe that you don't have to rely on that in order to approve the settlement. I believe that the burden has been met under the standards for a 9019 settlement. I don't believe any evidence of any conspiracy, breach of duties, lack of business judgment, I don't believe any of that has been proven. It's conjecture. Why things change and who changed them, the fact that an email came from one person and went to another doesn't mean that it was their idea. So we don't have a lot of those facts, and the reason we don't have them is our position has been since day one, and I told Mr. Kaplan this in our various discovery disputes. We don't think they're relevant. The Court indicated earlier today that it does think they're relevant.

But the intentions of the parties were to document a settlement whose economic terms were put on the record on August 16th, and nothing changed. There was never any contemplation that those assets would remain with the estate or that the

purchaser would have paid more had they not agreed to this arrangement with the Committee and the Debtors. Thank you, your Honor.

THE COURT: You're welcome.

All right, I'm going to take a recess and then I'll come out and give my ruling.

(A brief recess was taken.)

THE COURT: All right. Thank you very much for your paper submissions. Thank you very much for your arguments today and your professional presentation of the evidence and the argument. I really do appreciate it. One of the real pleasures of this job is the lawyers that appear in front of me are so good.

I'm ready to rule, and I am going to deny the settlement motion. And I do that with some reluctance because looking at the equities, as Mr. Kinel referenced in his reply, doing this takes money away from creditors and keeps it in the hands of the purchaser, both the potential loss proceeds of the avoidance actions as well as the cash that

was going to be paid. However, I am constrained to do so by the facts and by the law. And I'll talk about the law first.

As we all know and as we talked a lot about, the Supreme Court ruled recently in the Jevic case with regard to what the courts can and cannot do in priority skipping or class skipping settlements that don't have the consent of the affected class. And the argument that's primarily been made that Jevic doesn't apply in this case is really focused on the fact that the facts, and importantly, the causes of action are not property of the estate, they rest in the control and ownership of the purchaser. And since they're not property estate, ICL, the Third Circuit's opinion in ICL, specifically provides that they can be dealt with however the parties wish without regard to the priority scheme or the Bankruptcy Code, because it's simply not applicable, and that Jevic doesn't apply because of that.

So there are a couple of things going on there. One, there's a question about

whether ICL applies to the facts of this case. And I think it does not. I think the fact that thesis state causes of action were property of the estate on the petition date, they were property of the estate on the day of settlement, they were property of the estate when the settlement motion was filed. They are no longer property of the estate, but they were at some point property of the estate. And I don't think you can claim them for purposes of the ICL ruling by transferring them for some time to the purchaser with them just to be transferred back. And at the time of the closing of the transaction when they were transferred, it was contemplated that they would be transferred back hopefully very shortly; we had a hearing set for December 16th.

So I think you can't -- I think ICL is a narrow exception. I also think it's not applicable here. And I think that if it hasn't been overturned by Jevic altogether, and I'm not ruling that it has been overturned, I think it probably has been

significantly narrowed even further by the Supreme Court's ruling in Jevic.

But in any event, assuming ICL is still good law, assuming it has not been affected by Jevic, I find that this case is not controlled by ICL and doesn't fit ICL because the causes of action were property of the estate at one time. And the language that I quoted during argument made a point, the language from the opinion, makes a point in approving the transaction in ICL that it is important, among other things, that the transferred assets did not at any time belong to the Debtors' estate. So ICL is not applicable.

Is Jevic applicable? I think Jevic is applicable because even Jevic involved, in part, transfer of assets that were not property of the estate as part of the settlement. There was the $2 million from Citi, and the lien contributed by Sun, and neither of those were property of the estate. Nevertheless the Court didn't draw a distinction in its analysis in Jevic that was

focused one way or the other on whether the property of the estate issue mattered or not; it simply wasn't focused on by the Court. And counsel who was there and represented the WARN act plaintiffs represented to the Court, which is fine, I certainly accept it at face value, that it wasn't present in the Court's mind because the appellees pretty much abandoned the argument at some point during the appellate process. But one way or another, it wasn't on the mind of the Court.

So I don't think you can get too into, you know, Jevic doesn't apply to this because it's not property of the estate. That sort of falls away, because there were non-estate property elements of that settlement that were not, and it was not approved, and the Court really didn't delve into it one way or another, but a distinction that simply says Jevic doesn't apply because none of the property here is property of the estate, I think goes too far. I don't think we can say with certainty that's the distinguishing factor that would rule.

However, if I were faced with a true ICL situation post Jevic, I'd be in a tough spot. But I think I'd be constrained to follow or enforce ICL. But again, I find it's not applicable in this instance.

Also, the settlement here isn't just the cash and the estate asset or the causes of action. The Debtor is significantly involved in this settlement. We've talked a lot about the releases by the Debtors, the releases by the Committee. There's a continued, proposed continued involvement of the Debtors in the claims reconciliation process. We have the causes of action themselves which will stay in the court and arguably can only be brought by somehow affecting property of the estate, so I'm not even sure how that would work as a procedural or jurisdictional matter.

But in any event, the releases in particular, we're talking about actual property of the Debtors' estate beyond the causes of action. They're implicated by this settlement. So it's not a pure, just like

Jevic wasn't pure, estate property versus non-estate property, this settlement isn't pure estate property versus non-estate property.

So where does that leave us? I think that we're in a situation, when you think about Jevic here, is this more along the lines of a wage order or a critical vendor order or even a settlement order like in Iridium that happens sort of halfway through the case? The types of things the Court went out of its way to say, look, you know, these kinds of things may be okay as long as there's some Bankruptcy Code related objective that justifies violating the normal priority scheme. And there's a focus on things like does it promote a plan, does it promote reorganization of the business? None of that is going on here. It doesn't promote a plan, it doesn't promote saving the business. It promoted at the time a Code- related objective, which was the sale of the assets under 363. And it's a little awkward and unfair to the Debtors and the Committee here

that we're looking at this settlement nine months after it was reached and six months after the claim, you know, the case, the asset sales closed, so it kind of loses its immediacy.

But I don't see the exception that was talked about in Jevic applying under the facts of this case. And I think it's important, too, that we're not at the beginning, we're not in the middle, we're at the end of this case's Chapter 11 life. I assume the case is either going to dismiss or convert very shortly. I assume if I had approved it, it was going to dismiss or convert very shortly. The fact that this settlement wasn't tied specifically to the dismissal motion I don't think distinguishes Jevic, either.

I'm not going to get into the arguments about whether business judgment was satisfied, whether there was a breach of fiduciary duty by the Committee or by the Debtors. I'm going to rule based on the merits as I've described them. My alternative

ruling, though, is this -- or alternative comment, rather, not ruling. Is forget Jevic ever was written, and we were back where we were in August of 2016 where the Third Circuit had ruled on the Jevic opinion that they had ruled on, and ICL is still good law, and you can do structured dismissals in the Third Circuit and anywhere else. I'm still not at all convinced that I would have approved this even under the quote/unquote old rules. And that's because I don't believe the facts support freezing out the priority creditors in the way that the facts generally have supported that in other structured dismissal cases, for example, Judge Shannon's ruling in Jevic, and the fact that the WARN act claimants had to be frozen out because Sun didn't want to fund litigation against itself, so they weren't going to pay the WARN act claimants, and that's just the way it was.

We don't have any evidence here today that indicates why the priority creditors were cut out of the equation and why the deficiency claim creditors are being

treated differently. There's no evidence that said, look, this had to be done, this was a part of the deal. There was a lot of movement between August and September over the terms of the settlement. The economics may not have changed, but certainly the details changed, and I think the economics for priority creditors changed, and I think the economics for deficiency creditors changed, because the document that was alive in August was not the document that ultimately ended up controlling the transaction in September.

So I'm not ruling on this basis, but I just simply note that I think that even under the old rules of structured dismissals that are no longer applicable, I was still very troubled, and I think I had real concerns and may not have approved the settlement in that instance. But that's neither here nor there, because we live under the new rules and the new order, and in the first Jevic world, this just doesn't satisfy the law.

So sorry it's a rather lengthy ruling, but for those reasons, I am going to

deny the motion. The Court will enter an order. And I think that moots the procedures motion.

MR. RAMOS: Thank you, your Honor. Marcos Ramos. I think that's correct, and therefore, nothing further on the agenda. We thank your Honor very much for the time you scheduled today and for spending the day with us.

THE COURT: Of course; happy to do that. Thank you very much; we're adjourned.

(Hearing adjourned at 4:35 p.m.)

State of Delaware)
)
New Castle County)

CERTIFICATE OF REPORTER

I, Jennifer M. Guy, Registered Professional Reporter and Notary Public, do hereby certify that the foregoing record, pages 1 to 256 inclusive, is a true and accurate transcript of my stenographic notes.

Jennifer M. Guy, RPR

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2017 WL 1489822
United States Bankruptcy Court,
E.D. Tennessee, Southern Division.

IN RE: William Harry FRYAR, Debtor

No. 1:16–bk–13559–SDR
|
Signed 04/25/2017

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MEMORANDUM [1]

Shelley D. Rucker, UNITED STATES BANKRUPTCY JUDGE

***1** The Debtor filed a Notice of Proposed Use, Sale or Lease of Property Outside of the Normal Couse of Business combined with a Motion to Sell Property Free and Clear and Motion for Settlement and Compromise on February 24, 2017. The property to be sold was the Debtor's stock interests in two corporations whose value the Debtor listed as $900,000 on Schedule A/B, Question 19. The buyer of these interests is the other shareholder of the companies. The purchase price for these interests is $350,000 plus the conveyance by one of the companies of a piece of property which it owns. The interests are to be sold free and clear of the tax lien filed by the Internal Revenue Service and any other claim or interest. However, the settlement does not propose for the IRS lien to attach to the proceeds of the sale. Rather the lien will attach to two other properties which the Debtor owns individually on Highway 58, Chattanooga, Tennessee, and the property being conveyed to the Debtor in the settlement. Those Highway 58 properties are currently encumbered by a $531,000 mortgage in favor of Pinnacle Bank, the successor in interest to Cornerstone Bank. The settlement piece of the motion requires Pinnacle's lien to be satisfied by the payment to Pinnacle of the $350,000 in sales proceeds. This would be less controversial if Pinnacle's collateral were worth $350,000, but the Debtor contends that the property is worth only $200,000. The U.S. Trustee and creditors Sammie and Robert Gammenthaler, BBCO, LLC, and SmartBank appeared in opposition to the motion. The Gammenthalers, BBCO and SmartBank have filed unsecured claims totaling $436,000 (after deducting the secured portion of SmartBank's claim). The basis of their objections is that Pinnacle is being preferred and the priorities set for distribution under the bankruptcy code are being reordered to Pinnacle's benefit. As such, the court should not find the settlement to be fair and equitable.

The parties made oral arguments regarding the appropriateness of the settlement at the hearing but put on no evidence. Following the hearing, the parties filed Stipulations of Fact on which the court will rely for making its findings. (Doc. No. 73.) Those stipulations were supplemented with testimony from the Debtor at the hearing on April 13th before the court issued its opinion.

The court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (N). These are the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052 as made applicable to contested matters by Fed. R. Bankr. P. 9014.

A. Findings of Facts

The Debtor owns a 50% interest in two businesses: WLF Properties, Inc. and LF Properties, Inc. Stephen Long owns the other 50% of both businesses.

WLF owns a storage operation in Oak Ridge, Tennessee, and four rental houses in Murfreesboro, Tennessee. The storage operation has a value of approximately $2.4 million, and the rental houses have a value of approximately $325,000. WLF has debts of approximately $1.8 million. Based on these stipulations, the court calculates the Debtor's 50% interest to be worth approximately $467,500.

***2** LF owns property located at Belgrade Road, Oak Ridge, Tennessee, and 219 Yearwood Avenue, Murfreesboro, Tennessee. Those properties are worth approximately $265,000. LF has debts of $220,000. Based on these stipulations, the court calculates that the Debtor's equity in LF is worth approximately $22,500.

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The value of the Debtor's interest in the two businesses, after debt, is approximately $490,000.

In addition to these business interests, the Debtor individually owns properties at 6308 and 6310 Highway 58, Harrison, Tennessee. In his schedules, the Debtor valued these properties at $100,000 each. The Debtor owes Hamilton County and the City of Chattanooga property taxes on the Highway 58 properties totaling approximately $48,000 based on proofs of claim nos. 5–9 & 14–17. Pinnacle Bank has a mortgage of approximately $531,000 on these two properties based on the documents filed with claim 3. Its deeds of trust were recorded on October 20 and 31, 2008.

The IRS has a claim of approximately $90,000 based on proof of claim no. 4. Approximately $74,000 of this claim was asserted as secured. Notice of the federal tax lien was filed on July 5, 2016. An additional approximately $15,000 of the claim is asserted as priority. The priority of the liens on 6308 and 6310 Highway 58 appears to be: first, the property taxes owed to the City and County, then the mortgage to Pinnacle Bank, and finally the IRS lien to the extent that its claim is not satisfied by other property of the Debtor.

WLF owes Pinnacle Bank $1.1 million, secured by the storage operation and the rental houses owned by WLF. This debt was guaranteed by the Debtor and Mr. Long. Pinnacle Bank has assigned the debt to Mr. Long's company, S.J. Long, Inc. which is now the holder of that debt.

Excluding the claims of Pinnacle Bank and S.J. Long, Inc., there is approximately $700,000 of unsecured debt reflected in the claims filed in this case. No objection to any of these claims had been filed at the time of the hearing on the settlement.

As noted above, the settlement involves a series of transactions that breaks down as follows:

1. Mr. Long will pay $350,000 into the estate. In exchange, the estate will convey all stock interests of the Debtor in WLF Properties and LF Properties to Mr. Long. This is all subject to Mr. Long's obtaining financing from Pinnacle Bank for $350,000.

2. LF Properties will convey one of its properties, 219 Yearwood Ave., to the estate free and clear of liens. Debtor estimates the value of that property to be $150,000. The stipulations state that the property was purchased for $166,000 in 2004 and that the tax appraisal made by Rutherford County, Tennessee is $124,800. The Debtor testified that the property is regularly rented and believes that the property will provide value of that amount, although the Debtor also stated that there are repairs he would like to make to the property.

3. Mr. Long, WLF Properties, and LF Properties will release the Debtor from all claims they may have against him. At the hearing, Mr. Long's counsel clarified that there were debts that WLF Properties and LF Properties have asserted against the Debtor individually. Counsel for the Debtor agreed that these were amounts owed by the Debtor. [2]

***3** The settlement also provides that the Debtor will release Mr. Long, WLF Properties, and LF Properties from all claims he may have against them. No claims or causes of action were listed in Schedule B filed by the Debtor. (Schedule A/B, Questions 33–34.)

4. S.J. Long, Inc. will release the Debtor's guaranty on the obligation from the debt it purchased from Pinnacle Bank.

5. The estate will pay the sale proceeds of $350,000 to Pinnacle Bank on the $531,000 obligation. Pinnacle Bank will release the mortgage on 6308 and 6310 Highway 58, but will retain a claim for $181,000 for the deficiency which it will subordinate to the other unsecured creditors.

Pinnacle Bank acknowledges that if the $350,000 were paid to the estate, that the IRS lien on the stock and the IRS priority lien would be paid before its unsecured claim. It also acknowledges that if it were to foreclose on the two Highway 58 properties that the tax liens of the City and County would have to be paid, and that it is likely to only receive $140,000 from the sale of its collateral. [3]

Creditors BBCO, LLC (Claim no. 23 for $57,191), Robert Gammenthaler (Claim no. 22 for $34,360) and Smartbank (Claim no. 24 for $381,843 of which $37,100 is claimed as secured) have objected to the settlement.

The Debtor testified that he will reduce the claims through objections to filed claims and liquidation from other

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sources to $100,000. The unsecured claim for his school loans will stay in deferment because he intends to return to school to complete his doctorate degree.

B. Legal Analysis

The court can authorize the sale of assets when there is a sound business purpose for such action. *Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986). The stipulations do not specifically state the business purpose of the sale. However, in oral argument, the Debtor argued that this settlement resolves the issues between the two shareholders and provides a means for WLF to continue and avoid a foreclosure which would subject both shareholders to significant individual tax liability.

The Debtor testified at a hearing on a motion to dismiss, brought by Pinnacle Bank early in the case, that his relationship with Mr. Long had deteriorated and that he was not getting information from Mr. Long nor any income from the properties. At the initial hearing on this motion, the court asked the parties if this settlement was to facilitate a business divorce between two business associates. The parties acknowledged that this was the case. Given that situation, the Debtor faced either buying out his partner or selling to him to resolve these disputes. The court finds that the resolution of the claims arising from the two companies, the avoidance of the tax liability, and realization of value for the creditors from the stock interest provide a sufficient business purpose for the sale. However, because the business terms of the sale also involve a settlement and a payment of one unsecured creditor ahead of other prior parties and other unsecured creditors, the court must also review the standards for approval of a settlement.

***4** The involvement of the court in the approval of a settlement is based on Fed. R. Bankr. P. 9019(a) which provides that a court may approve a compromise or settlement on motion by the trustee after notice and a hearing. Notice is required to be given to creditors, the U.S. Trustee, the debtor, and indenture trustee as provided in Rule 2002 and to any other entity as the court may direct. Fed. R. Bankr. P. 9019.

> In bankruptcy proceedings, as distinguished from ordinary civil cases, any compromise between the debtor and his creditors must be approved by the court as fair and equitable. *Protective Committee for Independent Stockholders of TMT Trailer Ferry v. Anderson,* 390 U.S. 414, 424, 88 S.Ct. 1157, 1163, 20 L.Ed.2d 1 (1968); *In re A & C Properties,* 784 F.2d 1377, 1381 (9th Cir.), *cert. denied,* 479 U.S. 854, 107 S.Ct. 189, 93 L.Ed.2d 122 (1986). In considering a proposed compromise, the bankruptcy court is charged with an affirmative obligation to apprise itself of the underlying facts and to make an independent judgment as to whether the compromise is fair and equitable. *In re American Reserve Corp.,* 841 F.2d 159, 162–63 (7th Cir.1987). The court is not permitted to act as a mere rubber stamp or to rely on the trustee's word that the compromise is "reasonable." *Id.* at 162.
>
> The need for this safeguard is obvious. Any settlement between the debtor and one of his individual creditors necessarily affects the rights of other creditors by reducing the assets of the estate available to satisfy other creditors' claims.

Reynolds v. C.I.R., 861 F.2d 469, 473 (6th Cir. 1988); *see also In re Anderson*, 377 B.R. 865, 871 (B.A.P. 6th 2007) (abrogated on other grounds) (discussing unpublished opinions by Sixth Circuit and the 6th Cir. B.A.P. adhering to the "fair and equitable standard" for settlement approval).

To determine whether a compromise is fair and equitable, the court considers factors such as the probability of success on the merits, the complexity and expense of litigation, and the reasonable views of creditors. *Bauer v. Commerce Union Bank*, 859 F.2d 438, 441 (6th Cir. 1988). The debtor has the burden of persuading the court that the compromise is in the estate's best interest. *McGraw v. Yelverton (In re Bell & Beckwith)*, 87 B.R. 476, 478 (N.D. Ohio 1988).

The stipulations are short on exactly what is being compromised. At the hearing, the Debtor was able to clarify that it is a compromise of what he owes Pinnacle and what he owes WLF and LF and a compromise of the value of the stock interest being sold. The stipulations still do not clearly answer the question of why all of the cash should be paid to Pinnacle other than that Pinnacle is requiring it to be done that way. They do not offer facts from which the court could determine how this helps the Debtor move forward with a plan or how that plan will ultimately leave the Code's distribution priorities intact.

The issue of reordering the distribution priorities in a settlement has been the subject of controversy. The Fifth

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Circuit held that it would not approve a settlement that disregarded the priority system required by the Code in sections 726 and 1129. *U.S. v. Aweco, Inc.* 725 F.2d 293, 298 (5th Cir. 1984) ("[A] bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors.").

***5** The Second Circuit found that standard to be "too rigid a test." *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 464 (2nd Cir. 2007). It opted for a more flexible test where the facts of the case indicated that approval of a settlement reordering distribution from some assets was necessary to allow the estate to pursue its most significant assets and where the nature and extent of the estate and the priorities were not fully resolved. *Id.*

Nevertheless, it recognized that a more flexible rule created a greater risk that the parties to a settlement might engage in improper collusion. "Thus whether a particular settlement's distribution scheme complies with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is 'fair and equitable' under Rule 9019." *Id.* "The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code." *Id.*

The United States Supreme Court recently accepted certiorari on this issue, but opined on a more specific question involving the approval of a structured dismissal which did not follow the Code's priority distribution. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 985 (2017). The Supreme Court held that bankruptcy courts may not approve structured dismissals that provide for distributions that do not follow ordinary priority rules without the consent of affected creditors. *Id.* at 983.

In dicta, the Supreme Court acknowledged that there are instances where interim distributions that violate the ordinary priority rules have been approved.

> 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 (CA7 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).

Id.

The court now turns to the settlement before it. It finds that the settlement does in fact provide for a distribution that does not follow the ordinary priority rules. Based on the filed claims which are deemed allowed until objected to under 11 U.S.C. § 502(a), the proceeds from the sale of the stock should go first to the lien of the IRS. 26 U.S.C. §§ 6321, 6323(a). Then the proceeds would be paid into the estate for distribution to priority creditors and then to unsecured creditors on a pro rata basis. The amount of claims might be reduced and liens might be avoided or further negotiated, but, as the claims currently stand, Pinnacle Bank is moving to the head of the line.

***6** This might be acceptable if all of the creditors were consenting; however, three creditors and the U.S. Trustee have objected, so the court must consider whether there are Code-related objectives being served that are so significant that deviation is justified.

This settlement is not part of a "first day" order to ensure the Debtor's survival to get to a plan. This case has been here for eight months and was filed on the heels of prior chapter 11 which was dismissed for failure to propose a plan. At the initial hearing on the motion, the court asked counsel whether there were other properties which would provide an income stream to fund a plan and pay unsecured creditors, but the Debtor and the U.S. Trustee both contended there was very little income in the case and that funding would have to come from the liquidation of assets. The court is hard pressed to determine what

business remains to be revived or reorganized. This is an individual chapter 11 in which the Debtor sought settlement approval on the basis that he believes he can provide the same 53% dividend to all unsecured creditors. Under the law in the Sixth Circuit, an individual may not retain anything in a chapter 11 unless each class of creditors consent or are paid 100%. *Ice House Am., LLC v. Cardin*, 751 F.3d 734, 739 (6th Cir. 2014). The Debtor has not provided any proof that the objecting creditors would support a plan if they were paid 53%.

The court's review of the facts in this case leads it to conclude that this settlement is more of a preamble to a conversion or structured dismissal than it is to the situation in *Iridium*, where there was a reorganization anticipated. The Debtor has failed to prove that disregard of the priority scheme will promote "a significant Code-related objective." *Jevic*, 137 S. Ct. at 985. As with the situation in *Jevic*, this case more closely resembles the proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards. *Id.* at 986.

The court does not refuse to authorize the compromise lightly. The court realizes that the parties found themselves caught at a time when the settlement standards may have changed based on the *Jevic* case. The court understands the Debtor's desire to find a way to retain the two properties on Highway 58, one of which is where the Debtor originally testified he lives and leases a business location to a family member for the operation of his business. The court also understands that the Debtor wants to ensure that there will be no new tax liability arising from a foreclosure of WLF's holdings. Failing to approve this settlement may result in the unsecured creditors getting nothing, but that is their decision to make if they want to see if they can find a better deal for the Debtor's stock interests. The fact that this settlement disregards the priority scheme contained in the bankruptcy code entitles them to ask the court for close scrutiny of the proposed compromise and the prospects for reorganization.

In light of the Supreme Court's recent ruling in *Jevic,* parties who seek approval of settlements that provide for a distribution in a manner contrary to the Code's priority scheme should be prepared to prove that the settlement is not only "fair and equitable" based on the factors to be considered by the Sixth Circuit, *Bauer*, 859 F.2d at 441, but also that any deviation from the priority scheme for a portion of the assets is justified because it serves a significant Code-related objective. The proposed settlement should state that objective, such as enabling a successful reorganization or permitting a business debtor to reorganize and restructure its debt in order to revive the business and maximize the value of the estate. The proposed settlement should state how it furthers that objective and should demonstrate that it makes even the disfavored creditors better off.

***7** The proposed settlement in this case fails to meet this standard. To approve a settlement which is a *sub rosa* plan or a precursor for a conversion or dismissal in which the Code's priority scheme is ignored would be an abuse of the bankruptcy court's discretion.

For these reasons, the Debtor's motion to compromise is denied. Without the compromise the buyer is unwilling to go forward with the sale, therefore the motion to sell is denied as moot.

A separate order has been entered at docket number 79.

All Citations

Slip Copy, 2017 WL 1489822, 64 Bankr.Ct.Dec. 8

Footnotes

1 The court delivered this opinion orally on April 13, 2017. Due to its applicability to settlements proposed in a Chapter 11 case after the Supreme Court's decision in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), the court is filing a written opinion. Modifications and edits for citation, style and grammar have been made to enhance readability. To the extent that this memorandum differs from the opinion read in court, this memorandum shall control.

2 The stipulations do not indicate what types of claims are being settled. None of these parties have filed proofs of claim, so the court is relying on the stipulations made in court that these claims exist and are being released. Only Mr. Long was listed as a creditor in the Debtor's schedules. To the extent that Mr. Long and the Debtor are both guarantors of the debt of WLF to S.J. Long, Inc., there might be contribution claims but the parties' stipulations lead the court to believe that the WLF obligation is fully secured.

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3 The court calculates that rather than leaving it with a $391,000 deficiency claim, the current settlement proposal leaves it with only a $181,000 deficiency claim on which it will not receive any other funds until the other creditors have been paid.

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Jevic Applied to Ordinary Settlements in the Midst of a Chapter 11 Case

"Tennessee judge says Jevic tightened rules for approval of settlements."

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Bankruptcy Judge Shelley D. Rucker of Chattanooga, Tenn., wrote the first opinion pondering what *Czyzewski v. Jevic Holding Corp.* means when the court is called on to approve a settlement in mid-case that departs from the rules of priority.

Judge Rucker's April 25 opinion rejecting the settlement erects a high barrier for approval of priority-defying settlements and may provide guidance when other courts are confronted with so-called gift plans.

The facts in Judge Rucker's case were complex, but the basic pattern was simple. The individual chapter 11 debtor sought approval of a settlement with his secured bank lender. The deal would sell property to a business associate and bring $500,000 into the estate. In return for releasing the debtor, the bank would get about $350,000 applied to a debt of about $530,000. The bank would subordinate its remaining claims to the claims of unsecured creditors.

The bank, however, was undersecured in view of prior liens on the property being sold. Significantly, the bank would be receiving about $200,000 more on its deficiency claim than it would receive were the lender to foreclose.

Several unsecured creditors objected to the sale because the bank would receive a distribution on its unsecured deficiency claim ahead of creditors with the same priority.

The debtor argued that the settlement would avoid foreclosure and result in tax-recapture that would generate new claims, possibly obviating confirmation of a plan. With the settlement, the debtor said he could propose a plan paying 53% to all unsecured creditors. Were there foreclosure instead of settlement, unsecured creditors might be wiped out.

Judge Rucker noted that the Sixth Circuit has held that Congress did not abrogate the absolute priority rule in individual chapter 11 cases. Because the plan would not pay creditors in full, she said that creditor opposition could kill the plan.

Skeptical about how the case would end, Judge Rucker said the "settlement is more of a preamble to a conversion or structured dismissal than it is to the situation" in the Second Circuit's *Iridium* decision that approved a settlement deviating from the rules of priority.

Judge Rucker conceded that *Jevic*, 2017 BL 89680, 85 U.S.L.W. 4115 (Sup. Ct. March 22, 2017), was not precisely on point because her case did not entail a structured dismissal. She alluded to *dicta* in *Jevic* suggesting that priority-defying actions early in a chapter 11 case can be approved if they serve "significant Code-related objectives" like first-day wage or critical vendor orders.

Still, Judge Rucker said that "settlement standards may have changed based on *Jevic*." To approve a settlement not in accord with the rules of priority, she held that a debtor must satisfy not only traditional approval standards but must also serve a "significant Code-related objective," like enabling a debtor to reorganize and showing how "disfavored creditors are better off."

Judge Rucker said it would be an abuse of discretion to approve a settlement "which is a *sub rosa* plan or a precursor for a conversion or dismissal in which the Code's priority scheme is ignored."

It is unclear whether Judge Rucker would have disapproved were the debtor a corporation where the absolute priority rule did not apply.

Opinion Link: Opinion Link

Judge Name: Shelley D. Rucker

[+] Feedback

Case Citation: In re Fryar, 16-13559 (Bankr. E.D. Tenn. April 25, 2017)

Case Name: In re Fryar

Case Type: Business

Court: 6th Circuit
Tennessee
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United States Bankruptcy Court,
S.D. Mississippi.

IN RE: PIONEER HEALTH SERVICES, INC., et al., Debtors.

CASE NO. 16–01119–NPO
|
Signed April 4, 2017

Attorneys and Law Firms

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JOINTLY ADMINISTERED

MEMORANDUM OPINION AND ORDER DENYING IN PART MOTION TO ESTABLISH CERTAIN CLAIMANTS AS CRITICAL VENDORS AND TO APPROVE CRITICAL VENDOR PAYMENTS FOR EMERGENCY ROOM PHYSICIANS

Judge Neil P. Olack , United States Bankruptcy Judge

***1** This matter came before the Court for hearing on March 24, 2017 (the "Hearing"), on the Motion to Establish Certain Claimants as Critical Vendors and to Approve Critical Vendor Payments (the "Motion") (Dkt. 1725) filed by Pioneer Health Services, Inc. ("Pioneer Health") and the Objection to Debtors' Motion to Establish Certain Claimants as Critical Vendors and to Approve Critical Vendor Payments (the "Objection") (Dkt. 1780) filed by the Official Committee of the Unsecured Creditors (the "Committee") in the above-referenced bankruptcy case (the "Bankruptcy Case"). At the Hearing, Craig M. Geno represented Pioneer Health; Darryl Laddin represented the Committee; Brian I. Swett represented Capital One National Association; and David N. Usry and Robert E. Dozier represented the Internal Revenue Service.

In the Motion, Pioneer Health asked the Court for permission to pay in full the prepetition, unsecured claims of Grist Oil ("Grist") and three (3) emergency room physicians, Dr. Lamar Brand ("Dr. Brand"), Dr. Vincent Barker ("Dr. Barker"), and Dr. Kevin Hayes ("Dr. Hayes"), in the total amount of $116,259.73, on the ground that the goods and services they provide to its affiliate hospitals are critical to their continued viability. At the beginning of the Hearing, Pioneer Health announced that it had settled the Motion with respect to Grist and its supply of fuel oil. As a result of that settlement, the only issue presented at the Hearing was whether Dr. Brand, Dr. Barker, and Dr. Hayes qualified as "critical vendors." The Court denied the Motion from the bench as it pertained to the doctors. This Order memorializes and supplements that bench ruling. It does not address the settlement reached by Pioneer Health with Grist.

Jurisdiction

This Court has jurisdiction over the parties to and the subject matter of the Bankruptcy Case pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), and (O). Notice of the Motion was proper under the circumstances.

Facts

1. Pioneer Health is the parent company of several hospitals and other healthcare facilities located throughout the southeastern United States. Pioneer Health filed a voluntary chapter 11 petition for relief (the "Petition") (Dkt. 1) on March 30, 2016. On that same date, certain affiliates of Pioneer Health also filed voluntary chapter 11 petitions for relief, including Pioneer Health Services of Monroe County, Inc. (Case No. 16–01125–NPO, Dkt. 1). Another affiliate of Pioneer Health, Pioneer

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Health Services of Early County, LLC (Case No. 16–01243–NPO, Dkt. 1), filed for chapter 11 relief on April 8, 2016. The bankruptcy cases of these affiliates have been administratively consolidated into the lead Bankruptcy Case. (Dkt. 44 & 92).

2. Pioneer Health operates Pioneer Community Hospital of Aberdeen ("Aberdeen Hospital"), located in Monroe County, Aberdeen, Mississippi, through its affiliate Pioneer Health Services of Monroe County, Inc. and Pioneer Community Hospital of Early ("Early Hospital"), located in Early County, Georgia, through its affiliate Pioneer Health Services of Early County, LLC. (Mot. ¶ 3). Together, Aberdeen Hospital and Early Hospital are referred to in this Opinion as the "Hospitals." This is a liquidating chapter 11 Bankruptcy Case, and Pioneer Health is actively marketing substantially all of its assets for sale, including the Hospitals.

***2** 3. Pioneer Health entered into employment agreements with numerous physicians and other professionals to provide medical services and treatment for patients at the Hospitals and at other healthcare facilities. (Mot. ¶¶ 4, 7). It is undisputed that at the time the Petition was filed, Pioneer Health owed money to Dr. Brand, Dr. Barker, and Dr. Hayes pursuant to their respective employment agreements.[1] (*Id.* ¶ 5). Michael Morgan ("Morgan") of Healthcare Management Partners, LLC, Pioneer Health's chief restructuring officer, testified at the Hearing that Dr. Brand and Dr. Barker work in the emergency department at Early Hospital and Dr. Hayes, at Aberdeen Hospital.[2] Each of their employment agreements with Pioneer Health is purportedly subject to termination by either party for any reason upon prior written notice. Based on Morgan's testimony alone, Dr. Brand and Dr. Barker could terminate their employment upon thirty (30) days' prior written notice, and Dr. Hayes could terminate his employment upon ninety (90) days' prior written notice. In the Motion, Pioneer Health referred to the three (3) physicians as the "Affected Physicians," and the Court continues to refer to them as such in this Opinion.

4. According to Pioneer Health, the prepetition claims of the Affected Physicians are unsecured except that some portion may be entitled to priority under the Bankruptcy Code.[3] (Mot. ¶ 5).

5. Pioneer Health alleged in the Motion that the Affected Physicians have expressed "their concern about continuing employment in the absence of payment of their pre-petition claims prior to the time that priority claims are established." (Mot. ¶ 6). According to its counsel, Pioneer Health filed the Motion because it did not want to play a game of "chicken" with the Affected Physicians.[4] By paying their prepetition claims in full, Pioneer Health hopes to reduce the risk that the Affected Physicians will terminate their employment agreements and leave the Hospitals.

6. In support of elevating the status of the Affected Physicians to critical vendors, Pioneer Health alleged in the Motion that it cannot "obtain replacement physicians with the same level of competence, skill and, especially, the dedication that the[ ] Affected Physicians possess," and, moreover, their absence will hinder its ability to market and sell the Hospitals. (Mot. ¶¶ 8–9). At the Hearing, however, Pioneer Health articulated an additional reason for designating the Affected Physicians as critical vendors. In Morgan's opinion, if they leave, Early Hospital would close within one (1) month, and Aberdeen Hospital would straggle financially. In that regard, Morgan testified that Dr. Brand and Dr. Barker together are responsible for admitting ninety-five percent (95%) of the total number of patients admitted to Early Hospital, and that Dr. Hayes is responsible for admitting forty percent (40%) of the total number of patients admitted to Aberdeen Hospital.

***3** 7. Pioneer Health proposed to make the following payments to the Affected Physicians:

Hospital	Physician	Proposed Payment
Aberdeen Hospital	Dr. Hayes	$42,260.78
Early Hospital	Dr. Brand	$38,726.46
	Dr. Barker	$17,203.29

(Mot. ¶ 11). To assist with cash flow, Pioneer Health proposed to make these critical vendor payments in three (3) equal payments over a three (3)–week period. (*Id.*).

8. According to Pioneer Health, the employment agreements may be executory contracts under 11 U.S.C. § 365, but it chose to classify the Affected Physicians as critical vendors rather than to assume the contracts because of the personal nature of the services rendered by the Affected Physicians.[5] (Mot. ¶ 12).

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9. The Committee opposed the Motion. In the Objection, the Committee pointed out that the Motion was not filed early in the Bankruptcy Case, as is customary with critical vendor motions, but almost ten (10) months after the date of the Petition. If granted, the Motion could encourage other creditors to demand critical vendor status. (Obj. ¶ 2 & n.2). Indeed, according to Morgan, there are approximately two hundred forty (240) employees at the Hospitals, many of whom have threatened to leave Pioneer Health. The Committee also pointed out that Pioneer Health failed to allege in the Motion that the Affected Physicians, notwithstanding their employment agreements, have actually refused or could realistically refuse to provide services if the critical vendor payments are not made. (*Id.* ¶¶ 4, 8). Finally, the Committee argued that Pioneer Health failed to address how other unsecured creditors will be treated if the proposed payments are made. (*Id.* ¶ 10).

Discussion

A chapter 11 debtor generally may not make any payments or other distributions on account of prepetition claims except through a confirmed plan of reorganization or court-authorized liquidation. *See* 11 U.S.C. § 1129(b)(1). On occasion, a creditor that provides goods or services that are essential to the continued viability of a business declines to have any further dealings with the debtor unless its prepetition debt is paid in full or in part. *In re United Am., Inc.,* 327 B.R. 776, 781 (Bankr. E.D. Va. 2005). Under those circumstances, some courts have permitted a chapter 11 debtor to settle and pay the creditors their prepetition, unsecured claims prior to confirmation of a plan. *See, e.g., In re Ionosphere Clubs, Inc.,* 98 B.R. 174, 175–77 (Bankr. S.D.N.Y. 1989). Generally, a chapter 11 debtor that seeks authorization to pay a prepetition claim of a vendor that the debtor believes is "necessary" to its continued business operations, the so-called "critical" vendor does so within the first days of a chapter 11 bankruptcy case. *See, e.g., In re Mirant Corp.,* 296 B.R. 427, 428–29 (Bankr. N.D. Tex. 2003).

Courts have struggled to find authority in the Bankruptcy Code for violating the priority scheme established in 11 U.S.C. § 507[6] to elevate the prepetition claims of critical vendors. Historically, courts that have granted critical vendor motions have based their decisions on 11 U.S.C. § 105[7] and the equitable "doctrine of necessity," also known as the "necessity of payment rule."[8] *See, e.g., In re Just for Feet, Inc.,* 242 B.R. 821, 824–25 (D. Del. 1999). These courts have reasoned that departing from the Bankruptcy Code's principal tenets of equality of treatment is necessary for the debtor to reach its goal of reorganization. *Id.*

***4** Pioneer Health's Motion assumes that this Court has the authority to overrule the priority scheme and allow payment of general, unsecured prepetition claims under certain circumstances. As noted by the bankruptcy court in *In re CoServ, L.L.C.,* 273 B.R. 487 (Bankr. N.D. Tex. 2002), however, the Fifth Circuit Court of Appeals in *Chiasson v. J. Louis Matherne & Associates* (*In re Oxford Management, Inc.*), 4 F.3d 1329 (5th Cir. 1993), "has come perilously close to the view ... that a prepetition unsecured claim cannot be elevated to an administrative expense." *CoServ,* 273 B.R. at 495 (citation & quotation omitted). In support of this proposition, *CoServ* quoted the following language from *Oxford Management:*

> Section 105(a) authorizes a bankruptcy court to fashion such orders as are necessary to further the substantive provisions of the Bankruptcy Code .... But, the powers granted by that statute must be exercised in a manner that is consistent with the Bankruptcy Code.
>
> Neither the appellees nor the bankruptcy court cited a specific provision of the Code that would allow payment of post-petition funds to satisfy prepetition claims. By commanding payment, the bankruptcy court elevated the status of the appellees above that of the other general unsecured creditors .... This order effectuated an unpermissible alteration of the Code's provisions.

Id. at 495 (quoting *Oxford Mgmt.,* 4 F.3d at 1333–34). "[P]referring 'critical vendors' ... has the smell of a[n] ... inappropriate adjustment of congressionally established priorities ...." *Id.* at 496.

Recognizing that 11 U.S.C. § 105(a) on its face may be invoked only within the confines of the Bankruptcy Code,[9] the bankruptcy court in *CoServ* reasoned that "[t]o get from section 105(a) to the Doctrine of Necessity, the Court must find a bridge that makes application of the Doctrine of Necessity 'necessary or appropriate to carry out the provisions of' the Bankruptcy Code." *Id.* at 496–97. The *CoServ* Court constructed this "bridge" from 11 U.S.C. § 1107(a), which places a fiduciary duty on a

debtor in possession to protect and preserve the debtor's estate, including the going-concern value of an operating business. *CoServ, 273 B.R.* at 497. "There are occasions when this duty can only be fulfilled by the preplan satisfaction of a prepetition claim" of a critical vendor. *Id.* at 497. Thus, CoServ recognized the necessity of critical vendor payments but only in narrow circumstances.

The bankruptcy court in *CoServ* articulated the following test for determining whether a creditor falls within the definition of a critical vendor:

> First, it must be critical that the debtor deal with the claimant. Second, unless it deals with the claimant the debtor risk the probability of harm, or, alternatively, loss of economic advantage to the estate or the debtor's going concern value, which is disproportionate to the amount of the claimant's prepetition claim. Third, there is no practical or legal alternative by which the debtor can deal with the claimant other than by payment of the claim.

Id. at 498; *see also In re Mirant,* 296 B.R. at 429 (reaffirming same three (3)–part test). To satisfy the first element of the test, the creditor must be "indispensable to profitable operations or preservation of the estate." *CoServ,* 273 B.R. at 498. The second element requires that a debtor show "that meaningful economic gain to the estate or the going concern value of the business will result or that serious economic harm will be avoided through payment of the prepetition claim, which itself is materially less than the potential loss to the estate or business." *Id.* at 498–99. The third element recognizes that payment of the prepetition claim may not be the only avenue of relief. *Id.* at 499. For example, a vendor's concerns may be met by practical means, such as paying a deposit. *Id.* Additionally, the debtor may have legal remedies. *Id.* In some instances, the automatic stay may afford an alternative relief. *Id.* "[T]he irreplaceable supplier which uses its leverage to extort payment of a pre-petition debt may violate 11 U.S.C. § 362(a)(6)." *CoServ,* 273 B.R. at 499.

***5** After applying the three (3)–part test, the *CoServ* Court granted the debtor's motion with respect to only one of the alleged critical vendors. *Id.* at 500. That vendor provided the debtor, "at cost," the services of an information technology professional formerly employed by the debtor, who was intimately familiar with the debtor's information systems. The vendor testified that it would be unable to continue this arrangement without payment of its prepetition claim. The bankruptcy court allowed payment of the vendor's prepetition claim on the condition that the vendor continue making the professional available to the debtor under the existing arrangement. *Id.* at 500.

In a widely discussed opinion, *In re Kmart Corp.,* 359 F.3d 866 (7th Cir. 2004), the Seventh Circuit Court of Appeals curtailed the commonplace practice in some courts of allowing critical vendor payments with little supporting evidence. Citing the doctrine of necessity and § 105(a), the bankruptcy court designated more than half of Kmart Corporations' vendors as "critical" based solely on the testimony of its chief executive officer. *Id.* at 871. Addressing the legal authority cited by the bankruptcy court, the Seventh Circuit concluded that "Section 105(a) allows a bankruptcy court to 'issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of' the Code. This does not create discretion to set aside the Code's rules about priority and distribution; the power conferred by § 105(a) is one to implement rather than override." *Id.* at 871 (citations & quotations omitted). Moreover, the Seventh Circuit rejected the doctrine of necessity as justification for the critical vendor payments, calling it "just a fancy name for a power to depart from the Code." *Id.* The Seventh Circuit, however, suggested that § 363(b)(1) might operate as a possible bridge (using *CoServ's* analogy) justifying the payment of prepetition claims under limited circumstances. *Id.* at 872. Those circumstances would exist if there was sufficient evidence that: (1) the payments are necessary for a successful reorganization, (2) the disfavored unsecured creditors will be as well off with reorganization as with liquidation, and (3) the critical vendors would cease doing business with the debtor if the payments are not made. *Id.* at 872–74. Because the critical vendor orders at issue did not come close to satisfying this test, the Seventh Circuit declined to decide whether they are ever permissible. *Id.* at 872.

Recently, in *Czyzewski v. Jevic Holding Corp.,* No. 15–649, 2017 WL 1066259 (Mar. 22, 2017), the U.S. Supreme Court mentioned *Kmart.* There, the Supreme Court held that bankruptcy courts may not approve non-

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consensual structured dismissals that vary the priority scheme established by the Code. *Id.,* at *10. In reaching this conclusion, the Supreme Court distinguished critical vendor orders from structured dismissals on the ground that unlike the former, the latter served no "significant offsetting bankruptcy-related justification." *Id.,* at *12.

> [I]t 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.

Id. Jevic suggests that *CoServ's* and *Kmart's* restrictive view of critical vendor payments is the correct approach.

Mindful of the increased scrutiny required by *Oxford Management*, *CoServ,* and *Kmart*, and, apparently, by *Jevic*, the Court finds that the evidence presented at the Hearing by Pioneer Health was insufficient to show that the Affected Physicians fall within any definition of critical vendors to the extent that such payments are authorized. First, Pioneer Health has not shown that it is critical that Pioneer Health deal with the Affected Physicians. *See CoServ,* 273 B.R. at 498. Although Pioneer Health alleged in the Motion that the Affected Physicians are irreplaceable, there was no testimony at the Hearing about their education, skills, training, or licensing that would support such a conclusion. That the Affected Physicians are well-liked in their respective communities does not render them critical, as opposed to important or preferred. Moreover, no evidence was presented at the Hearing as to the efforts, if any, made by Pioneer Health to find replacements for the Affected Physicians.

***6** Second, Pioneer Health has not shown that unless the payments are made, the Affected Physicians will actually leave the Hospitals. *See id.* In the Motion and at the Hearing, Pioneer Health expressed a preference to avoid the risk that the Affected Physicians will leave, but it failed to provide any admissible evidence that they actually intend to leave. The Affected Physicians did not submit affidavits in support of the Motion, did not testify at the Hearing, and were not physically present in the courtroom. The Court is not persuaded by Pioneer Health's speculations, especially given that the Motion was filed almost one (1) year after the Bankruptcy Case was commenced.

Third, there is a legal alternative by which Pioneer Health can deal with the Affected Physicians other than by full payment of their unsecured claims. *See id.* From Pioneer Health's allegations, it appears that the Affected Physicians may be stay violators. *See* 11 U.S.C. § 362(a)(6).[10] If the Affected Physicians are impermissibly threatening to leave the Hospital in order to force Pioneer Health to pay their prepetition claims, despite being obligated to provide services under their employment agreements, the Court will authorize the Committee to bring actions against them for violations of the automatic stay, assuming Pioneer Health declines to do so. *See* 11 U.S.C. § 362(k) (providing for the recovery of actual damages, including costs and attorneys' fees, and, in appropriate circumstances, punitive damages for any willful violation of a stay).

Moreover, the Court questions whether a sound business purpose justifies the critical vendor payments. Pioneer Health proposed to pay the Affected Physicians their prepetition, unsecured claims in full without obtaining from them any commitment to continue providing medical services to patients at the Hospitals. Theoretically, the Affected Physicians could terminate their employment agreements the same day they receive payment of their prepetition claims and then leave the Hospitals only thirty (30) to ninety (90) days later. Unlike traditional critical vendor motions, Pioneer Health failed to negotiate any benefit for the estate.

Finally, the Committee expressed concerns as to whether allowing the critical vendor payments would open a floodgate of requests by the Hospitals' other creditors for immediate payment of prepetition claims such as the prepetition wages of two hundred forty (240) employees. The Court shares the Committee's concern, not only for the Bankruptcy Case but also for the precedent of approving "critical vendor" payments that are so far outside the norm.

Conclusion

The Fifth Circuit, at best, takes a dim view of critical vendor orders. The Supreme Court recently rejected non-consensual structured dismissals as violating priority rules. Here, the Courts finds no "significant offsetting bankruptcy-related justification" for classifying

the Affected Physicians as critical vendors. Counsel for Pioneer Health mentioned playing a game of "chicken" with the Affected Physicians, but the Court notes that "Chicken Little" arguments that the sky is falling make bad law. *See, e.g., United States v. Clark,* 96 U.S. 37, 49 (1877) (Harlan J., dissenting) ("[I]t is the duty of all courts of justice to take care ... that hard cases do not make bad law."). Accordingly, the Court finds that the Motion should be denied with respect to the relief sought as to the Affected Physicians. In reaching this finding, the Court does not address any other issue, such as whether the Affected Physicians have a wage priority claim or have violated the automatic stay.

***7** IT IS, THEREFORE, ORDERED that the Motion with respect to the Affected Physicians is hereby denied.

SO ORDERED.

All Citations

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Footnotes

1 Copies of their employment agreements were not introduced into evidence. From the bankruptcy schedules, it appears that the employment agreements were not entered into with the individual physicians but with business entities in which they hold an interest, including: Brand Professional Services (Case No. 16–01243–NPO, Dkt. 76–1 at 6) on behalf of Dr. Brand; Elite Physicians (Case No. 16–01243–NPO, Dkt. 76–1 at 10) on behalf of Dr. Barker; and Diversified Physicians (Case No. 16–01125–NPO, Dkt. 83–1 at 8) on behalf of Dr. Hayes. The Committee introduced copies of the bankruptcy schedules into evidence as "Committee Ex. 1" and "Committee Ex. 2."

2 Morgan testified that Dr. Brand and Dr. Barker also treat patients in a medical clinic operated by Pioneer Health.

3 Section 507(a)(4) of the Bankruptcy Code gives priority in distribution to claims of employees for prepetition wages, salaries, and commissions earned within one hundred eighty (180) days before the earlier of the date of the filing of the petition or the date the debtor ceased business. 11 U.S.C. § 507(a)(4)(A). For each individual, there is a statutory cap of $12,475.00 for cases commenced during the three (3) year period beginning April 1, 2013, and $12,850.00 for cases commenced on or after April 1, 2016. *Id.* At the Hearing, Pioneer Health argued that the immediate payment of the prepetition claims of the Affected Physicians, up to the statutory cap, would not disrupt the priority scheme, and, thus, only approximately $60,000.00 was actually at issue. It was undisputed at the Hearing, however, that the Affected Physicians are independent contractors, not employees, and, thus, their claims do not appear to fall within 11 U.S.C. § 507(a)(4), although that issue is not before the Court. *See* 4 COLLIER ON BANKRUPTCY ¶ 507.06[3][a] (16th ed. 2016). A further complication is that the priority is available, with one exception, only to individuals. *Id.*; *see supra* note 1.

4 In the game of "chicken," two (2) drivers speed towards each other from opposite ends of a long, straight road, and in a contest of nerves, the first driver to swerve is the "chicken," meaning a coward. *See, e.g.,* REBEL WITHOUT A CAUSE (Warner Bros. 1955).

5 *See* 11 U.S.C. § 365(c) (precluding assumption of an executory contract if applicable nonbankruptcy law would excuse the other party from rendering performance to an entity other than the debtor).

6 Section 507 fixes the priority order of claims and expenses against the bankruptcy estate and does not carve out a priority status for prepetition, general unsecured claims based on the "critical" status of the creditor. 11 U.S.C. § 507.

7 Section 105 allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Code. 11 U.S.C. § 105(a). Under 11 U.S.C. § 1107, a debtor in possession has the same rights of a trustee, including the right to operate the business as provided by 11 U.S.C. § 1108. Thus, critical vendor payments arguably assist the debtor in implementing 11 U.S.C. § 1108.

8 The "doctrine of necessity" evolved from the "necessity of payment rule," which was first developed and used in railroad organizations. *See Miltenberger v. Logansport, C. & S.W.R Co.,* 106 U.S. 286 (1882).

9 *United States v. Sutton,* 786 F.2d 1305, 1308 (5th Cir. 1986) ("the powers granted by [§ 105] may be exercised only in a manner consistent with the provisions of the Bankruptcy Code" and does not "constitute a roving commission to do equity.").

10 Section 362(a)(6) provides that "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the [bankruptcy] case" is a violation of the automatic stay. 11 U.S.C. § 362(a)(6).

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United States Bankruptcy Court,
D. Connecticut,
NEW HAVEN DIVISION.

IN RE: ETERNAL ENTERPRISE, INC., Debtor.

Case No.: 14–20292 (AMN)
|
Signed April 13, 2017

Attorneys and Law Firms

Irene Costello, Shipkevich PLLC, New York, NY, for Debtor

Re: ECF Nos. 709, 966, 967

MEMORANDUM AND RULING CONFIRMING HARTFORD HOLDINGS, LLC'S SECOND MODIFIED FIFTH AMENDED CHAPTER 11 PLAN

BUT STAYING THE CONFIRMATION ORDER TO NOT LATER THAN JULY 31, 2017

Ann M. Nevins, United States Bankruptcy Judge

Introduction

***1** What is the value of the debtor's real property? The answer—and the key to the resolution of this three-year old chapter 11 case—is unknown with estimates varying between $14,240,000 and $4,360,000. When, as here, a plan is proposed that will divest an unwilling debtor of its ownership without an auction the bankruptcy court is required to value a chapter 11 estate's property to determine compliance with 11 U.S.C. § 1129(b)(1).

Any judicial determination of fair market value of real estate is, at most, a fixing of a hypothetical price "at which [the real estate] would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." *World Trade Center Props. LLC v. American Airlines, Inc. (In re September 11 Litig.)*, 802 F.3d 314, 335 (2d Cir. 2015) (*citing United States v. Cartwright*, 411 U.S. 546 (1973)). In light of the recognized subjectivity inherent in evaluating real estate, "courts have wide latitude in determining value." *In re Barbieri*, 2009 WL 5216963, Docket No. 00–22274–478, 2009 Bankr. LEXIS 4095, at *29 (Bankr. E.D.N.Y. Dec. 29, 2009). "The Court is not bound by the experts' appraisals and may form its own opinion of a property's value." *Menorah Congregation & Religious Ctr. v. Feldman (In re Menorah Congregation & Religious Ctr.)*, 554 B.R. 675, 692 (Bankr. S.D.N.Y. 2016).

Here, a creditor proposes to take title to the debtor's real property and certain other assets constituting its collateral in satisfaction of the debtor's obligation on multiple notes and mortgages. Having presented evidence that the real property is worth far less than its debt to support its claim that its plan is fair and equitable pursuant to 11 U.S.C. § 1129(b)(1), the creditor awaits the court's ruling on confirmation of its chapter 11 plan. The debtor, in a change in strategy and somewhat late in the case, now presents two offers to purchase the property for a sum that would render the estate solvent leaving a surplus for equity.

In the interim between the creditor's proposal of the chapter 11 plan and the debtor's proposed sales, much has happened, including the mid-stream disbarment of debtor's counsel and the debtor's recent receipt of fire insurance proceeds totaling $3,000,000. *See,* ECF No. 881.

For the reasons that follow, the court will confirm the plan with the condition that the debtor first be provided a period of time to sell the real property pursuant to further order of the court.

Procedural History and the Nature of the Proceedings

The debtor here, Eternal Enterprise, LLC ("EE"), filed a voluntary chapter 11 bankruptcy proceeding in early 2014 with Peter Ressler representing the debtor as bankruptcy counsel. Mr. Ressler resigned from the state and federal bars without leave to reapply in March 2016. The debtor obtained the present chapter 11 counsel in April 2016. Additional, relevant procedural history is detailed in ECF No. 881, and was discussed with counsel for the debtor EE and with counsel for the largest creditor participating in the administration of this case, Hartford Holdings,

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LLC ("HH"), during a hearing held on February 15, 2017. Both counsel indicated substantial agreement with the procedural history recited in ECF No. 881. The court notes that no committee of unsecured creditors was appointed in this case; the secured creditor's claim is estimated at approximately $9,569,593.70 [1]; and the unsecured creditor pool totals at most approximately $76,000. As a result, this case is best viewed as a two party dispute between EE and HH.

***2** Presently pending before the court are three matters that are addressed in this Memorandum and Ruling: (1) HH's Second Modified Fifth Amended Chapter 11 Plan, ECF No. 709 (the "Plan"); (2) EE's objection to HH's proofs of claim, ECF No. 966 [2]; and (3) EE's motion to sell real property pursuant to 11 U.S.C. § 363 (the "363 Motion"), ECF No. 967. [3]

Various Estimates of Value and HH's Secured Claims

According to the debtor EE, its Real Property [4] is now worth approximately $11,240,000 based on recent, contingent offers to purchase it. In addition, EE alleged that it now holds $3,000,000 [5] of fire insurance proceeds relating to 270 Laurel Street, Hartford, Connecticut in an escrow account. [6] HH asserts liens on the Real Property, all accounts, proceeds, cash, receivables and the fire insurance proceeds ("HH's Collateral") to secure its claim of approximately $9,569,593.70. *See*, footnote 1. Based on these values, EE argues that HH's Collateral is worth substantially more than HH's claims if EE is able to sell the Real Property for $11,240,000. *See* Proofs of Claim 14 through 21, as amended; footnote 1.

***3** If the Real Property is not sold through a § 363 sale, and HH's Plan is considered, there is vastly differing valuation information before the court. EE argued during a Confirmation Hearing (defined below) in early 2016 that the value of its real property was $9,800,000. On April 7, 2017, at the request of EE, the court approved a revised valuation of $6,681,040 for the Real Property with the City of Hartford for the 2015 Grand List (which EE argues is based on a 2011 City of Hartford revaluation). ECF No. 984. According to the City of Hartford's revaluation appraisals for its October 2016 Grand List, the Real Property is worth $8,872,500. And, according to HH's evidence presented during the Confirmation Hearing (defined below), the Real Property is worth a mere $4,360,000. [7] Some of the valuation estimates contemplate the $3,000,000 fire insurance proceeds; others do not.

The Confirmation Hearing

A fully contested, evidentiary confirmation hearing—in effect a trial on the value of the EE Property—was held over three days in January and February 2016 (the "Confirmation Hearing"). Peter Ressler represented the debtor EE during the Confirmation Hearing. For many reasons, the ruling on the Plan has been delayed and familiarity is assumed with the procedural and factual history of this chapter 11 case as set forth in the court's Scheduling Order, ECF No. 881. [8]

During the Confirmation Hearing, both EE and HH presented evidence of the fair market values of the Real Property. HH met its burden to establish that the Plan was fair and equitable under § 1129(b)(1) by presenting testimony from Norman Benedict, [9] a licensed real estate appraiser, and offered into evidence appraisal reports for the Real Property. [10] Norman Benedict's appraisals, taken cumulatively, provide a fair market value of the Real Property, totaling $4,360,000.00. See, Exhibits C–J. Mr. Benedict's appraisals comported with well-established practices for valuing real estate for purposes of chapter 11 reorganization plans. For example, each appraisal included comparison of the subject property to similar properties, replacement costs and capitalized income as bases for evaluation. *See* Collier on Bankruptcy ¶ 1129.05 [3][a][v].

In response, EE offered the testimony of Michael McDonald, PhD, an assistant professor of finance but Mr. McDonald's testimony failed to establish that the value of the Real Property would be sufficient to pay all allowed claims and leave a surplus for equity. Michael McDonald testified, as an expert in finance and business valuation, that it was his opinion that the Real Property should be valued, in the aggregate, closer to $9,800,000.00. ECF No. 348 at 01:01:40–01:02:30. Mr. McDonald's valuation approach did not follow well-established practices for valuing real estate when considering a chapter 11 plan and the court gives little weight to his opinion for this reason.

***4** The debtor's two recent fires—one at 270 Laurel Street and one at 21 Evergreen Avenue—occurred after the Confirmation Hearing and so neither Mr. Benedict nor Mr. McDonald took the effect of the fires into account.

The court notes that in late 2015, represented by former attorney Peter Ressler, EE proposed a plan that was not confirmable because no impaired class voted in favor of the plan. *See*, 11 U.S.C. § 1129(a)(10); ECF Nos. 343; 344. Since April 2016, when debtor's present counsel first sought admission to represent EE, the debtor has failed to file a plan of reorganization and disclosure statement meeting the requirements of the Bankruptcy Code and Federal Rules of Procedure.

The Proposed § 363 Sale

Instead of pursuing reorganization through a chapter 11 plan the debtor EE recently filed the 363 Motion seeking authority to sell portions of the debtor's Real Property to two different buyers as follows:

- **Offer One: $9,240,000**
  - o Aria Legacy Group, LLC proposes to purchase 243–255 Laurel Street, 252 Laurel Street, 154–160A Collins Street, 21 Evergreen Avenue, 117–145 South Marshall Street, and 56 Webster Street, Hartford, Connecticut (the "Offer One Property") for $9,240,000.
- **Offer Two: $2,000,000**
  - o Onyx Investments, LLC proposes to purchase 270 Laurel Street and 360 Laurel Street, Hartford, Connecticut (the "Offer Two Property) for $2,000,000.
  - o Offer Two excludes $3,000,000 of fire insurance proceeds the debtor alleges it holds relating to 270 Laurel Street. This brings the value of Offer Two to $5,000,000, net of any commission allowed to a public insurance adjuster.

Neither Offer One or Offer Two is without contingencies. It is presently unknown whether the proposed transactions, or any higher competing bid, if approved by the court after notice and a hearing, will close.

Discussion

The Second Circuit has noted that, "[c]onfirmation of a plan over the vote of a dissenting class requires that the plan be 'fair and equitable, with respect to each class of claims or interest that is impaired under, and has not accepted, the plan.' 11 U.S.C. § 1129(b)(1)." *Ahuja v. LightSquared Inc.*, 644 Fed.Appx. 24, 29 (2d Cir. 2016), cert. denied sub nom. *Sanjiv Ahuja v. LightSquared Inc.*, 137 S. Ct. 335, 196 L.Ed. 2d 262 (2016). The fair and equitable requirement "protects the Equity as a dissenting class. It's undisputed that the 'fair and equitable' requirement encompasses a rule that a senior class cannot receive more than full compensation for its claims. Courts will deny confirmation if a plan undervalues a debtor and therefore would have resulted in paying senior creditors more than full compensation for their allowed claims." *In re Chemtura Corp.*, 439 B.R. 561, 592 (Bankr. S.D.N.Y. 2010); *see also LightSquared Inc.* at 29 (concluding that bankruptcy court had properly valued the debtor, therefore senior creditors had not been overpaid). "The reason for this rule is obvious, and goes back to the basic understanding between debt and equity. Holders of debt traditionally contract for repayment of principal and interest, but no more; after that, the residual goes to equity. ... This component of the fair and equitable rule will require valuation of the debtor in every case in which the plan proposes to eliminate equity or any junior class of creditors. Eliminated classes may then insist on compliance with the fair and equitable requirement, which will necessitate an evidentiary showing that there is insufficient reorganization value for the eliminated class after payment to the senior classes." Collier on Bankruptcy, ¶ 1129.03 (16th ed. 2017).

***5** To credit EE's estimate of value of approximately $14,240,000 in considering the application of 11 U.S.C. § 1129(b) to HH's Plan, the court must consider whether the purchase prices proposed in Offer One and Offer Two are indicative of an accurate value of the real estate. If the Offers are never consummated, the proposed purchase prices are irrelevant. The court recognizes that "[v]aluation outside the actual market place is inherently inexact." *Wright v. Chase (In re Wright)*, 460 B.R. 581, 584 (Bankr. E.D.N.Y. 2011) (citing *Rushton v. Commissioner*, 498 F.2d 88, 95 (5th Cir. 1974)).

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The parties are in rare agreement, through counsel, that a reasonable course in this unusual case would be to provide a limited period of time for EE to seek court approval for the 363 Motion and then to attempt to consummate sales of all of the Property, followed by immediate consummation of HH's Plan if the sales effort is unsuccessful. [11]

The court notes that this is a single asset real estate case as defined in 11 U.S.C. § 101. Pursuant to 11 U.S.C. § 362(d)(3), a single asset real estate debtor must file a plan that has a reasonable possibility of being confirmed within a reasonable time, or commence monthly adequate protection payments, within thirty (30) days after the petition date. If it does not, the court must grant relief from stay if requested by a secured creditor. The debtor commenced monthly adequate protection payments during the case, but the payments substantially ceased in July 2016 following the fire at 270 Laurel Street. The necessity of resolving single asset real estate cases in chapter 11 with celerity, embodied by Congress's enactment of § 362(d)(3) in 2005, provides further justification for the court's decision to proceed with the case on dual tracks thereby ensuring that either a § 363 sale or confirmation of the Plan occurs on or before July 31, 2017.

Findings Regarding Valuation

The court must value the Real Property in case there is no sale that can be consummated. After carefully considering the sources of valuation information before it, including the Norman Benedict appraisals and testimony, testimony from Michael McDonald, municipal tax assessor valuations and the $3,000,000 fire insurance proceeds relating to the 270 Laurel Street property, the court finds that the municipal tax assessor valuations from the City of Hartford's 2016 revaluation are the most probative.

With regard to the evidence and testimony submitted during the Confirmation Hearing more than a year ago, the court finds that Norman Benedict and his appraisal reports provide a more credible estimation of fair market value based upon recognized valuation methodologies than the evidence and testimony provided by Michael McDonald. *See, See* Collier on Bankruptcy ¶ 1129.05[3][a][v]. However, the court notes that recent events including Offer Two and the City of Hartford's 2016 property revaluation appraisals indicated the weight to be given to Norman Benedict's appraised values must be tempered by subsequent events. For example, Offer Two proposes to purchase two properties—270 Laurel Street and 360 Laurel Street—for $2,000,000 in as is condition, leaving the debtor EE with $3,000,000 of insurance proceeds, for a total value of $5,000,000 to EE, subject to HH's liens. According to Norman Benedict's appraisals, the value of these two buildings is just $1,200,000; according to the City of Hartford's 2016 appraisals the value is $2,530,000. [12] The court therefore concludes that the $4,360,000 valuation for all of the Real Property urged by HH during the Evidentiary Hearing, while based on more sound methodologies when compared to Mr. McDonald's economic analysis of a hypothetical market, is entitled to reduced weight based on these other factors.

***6** The court has also considered matters of public record regarding EE's Real Property. The State of Connecticut provides guidelines for periodic revaluation of real property in a municipality in its general statutes, including Gen. Stat. § 12–63b(a). Regarding income producing property similar to EE's Real Property, section 12–63b(a) provides that, "[t]he [tax] assessor or board of assessors in any town, at any time, when determining the present true and actual value of real property as provided in section 12–63, which property is used primarily for the purpose of producing rental income ... shall determine such value on the basis of an appraisal which shall include to the extent applicable with respect to such property, consideration of each of the following methods of appraisal: (1) Replacement cost less depreciation, plus the market value of the land, (2) capitalization of net income based on market rent for similar property, and (3) a sales comparison approach based on current bona fide sales of comparable property." Conn. Gen. Stat. § 12–63b(a). This three-pronged approach to valuation is identical to the generally accepted analysis for valuation of rental-producing real estate in the context of chapter 11 plans of reorganization. *See* Collier on Bankruptcy ¶ 1129.05[3] [a][v]. Moreover, the City of Hartford assessor undertook a city-wide revaluation within the past 12 months that was not performed in anticipation of litigation between the two parties here.

After careful consideration the court adopts the City of Hartford's 2016 valuation appraisals as the fair market value of the Real Property for purposes of confirmation

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of HH's Plan with the following values for each of the properties:

Property Address	2016 FMV City of Hartford Reevaluation [13]
21 Evergreen Avenue Hartford, CT	$894,500.00
156 Collins Street Hartford, CT	$703,200.00
160 Collins Street Hartford, CT	$679,600.00
243 Laurel Street Hartford, CT	$636,200.00
255 Laurel Street Hartford, CT	$596,400.00
252 Laurel Street Hartford, CT	$710,900.00
270 Laurel Street Hartford, CT	$2,274,800.00
360 Laurel Street Hartford, CT	$255,200.00
115 South Marshall Street Hartford, CT	$1,626,000.00
56 Webster Street Hartford, CT	$495,700.00
TOTAL	**$8,872,500.00**

Neither the evidence presented during the Confirmation Hearing nor the City of Hartford's 2016 valuation appraisals adopted as the fair market value by the court demonstrates with requisite certainty that there is enough value in the Real Property to provide a recovery to EE's equity holder. This is because even assuming the Real Property could be sold for the highest of the values before the court—EE's $9,800,000 estimate of value during the Confirmation Hearing—this sum would be insufficient to pay HH's claims totaling approximately $9,569,593.70, plus a capital gains tax [14], plus all allowed administrative and unsecured claims. Without such certainty, HH's Plan cannot be determined to violate 11 U.S.C. § 1129(b)(1) as EE urges [15] and should be confirmed.

The potential for greater recovery embodied by the Offers, however, requires the delayed confirmation of HH's Plan.

A § 363 Sale and In re: Lionel

Before the court may approve a sale of the Real Property pursuant to 11 U.S.C. § 363 rather than through a chapter 11 plan with the substantive and procedural due process protections inherent in that process, the sale proponent must demonstrate that all costs of sale, as well as allowed administrative claims, secured claims and unsecured claims will be paid at least as much as they would be paid under a chapter 11 plan. Pursuant to the Second Circuit's seminal *Lionel* decision, "a debtor applying under § 363(b) carries the burden of demonstrating that a use, sale or lease out of the ordinary course of business will aid the debtor's reorganization, [while] an objectant ... is required to produce some evidence respecting its objections." *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983). A bankruptcy judge considering a sale under § 363 must consider "all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike." *Id.*

***7** More recently, the Second Circuit has articulated its "concern ... that a quick, plenary sale of assets outside the ordinary course of business risked circumventing key features of the Chapter 11 process, which afford

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debt and equity holders the opportunity to vote on a proposed plan of reorganization after receiving meaningful information. ... Pushed by a bullying [party in interest], a § 363(b) sale might evade such requirements as disclosure, solicitation, acceptance, and confirmation of a plan." *In re Chrysler LLC*, 576 F.3d 108, 114 (2d Cir. 2009), *cert. granted, judgment vacated as moot sub nom. Indiana State Police Pension Trust v. Chrysler LLC*, 558 U.S. 1087, 130 S. Ct. 1015, 175 L.Ed. 2d 614 (2009). In its recent decision in *Czyzewski v. Jevic Holding Corp.*, the United States Supreme Court compared the structured dismissal it disapproved with "transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards" citing, among others, the *Lionel* decision. *Czyzewski v. Jevic Holding Corp.*, —— U.S. ——, 137 S.Ct. 973, 986, 63 Bankr.Ct.Dec. 242 (2017).

In this case, among the salient factors the bankruptcy court must consider are the fact that HH's Plan proposes to pay all allowed claims but takes away equity's potential recovery, the proposed Offers One and Two, and the possibility that the proposed Offers may not close even if approved by the court. The court must also consider that the § 363 sale proponent must demonstrate that a sale will pay the costs and expenses of the sale, including the secured claims of HH, the cost of a realtor commission, a capital gains tax, and other administrative and pre-petition claims as summarized in the table below, at a minimum.

Debt, Cost or Expense	Amount	Source in Record
Secured Claim: Hartford Holdings, LLC	$8,794,365.34	Proofs of Claim 14–21 as amended
Administrative Claim: Capital Gains Tax (State and Federal)	$1,743,056.00	ECF Nos. 934; 938
Administrative Claim: Real estate taxes now due (City of Hartford)	$476,871.53	See footnote. [16]
Real Estate Commission: (if property sold pursuant to realtor's work)	$337,200.00	ECF No. 979
Administrative Claim: Debtor's Attorney	$263,440.00	ECF No. 979
Administrative Claim and Secured Claim: Water and Sewer Liens/Taxes advanced by HH	$130,728.40	ECF 944, 1:01:20–30
Administrative Claim and Secured Claim: Water and Sewer Liens/Taxes advanced by HH	$130,728.40	ECF 944, 1:01:20–30

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Unsecured Claims	$76,682.27	Proofs of Claim Nos. 2–1; 13–1; 22–1; and ECF No. 86 [17]
TOTAL:	$12,465,161.27	

Even if the court adopts the EE evidence of a $9,800,000 value submitted during the Confirmation Hearing and adds the $3,000,000 in cash from the fire insurance proceeds, the estimate of value does not provide the requisite certainty that all claims would be paid and a surplus would then be available for the the equity holder Vera Mladen. Among other considerations, the property at 270 Laurel Street sustained substantial fire damage after Mr. McDonald's testimony and that certainly would have impacted his estimate of $9,800,000. The court therefore concludes that the value of the property that would be transferred to HH under its Plan is not worth more than the sum of the items summarized in the table above.

Next Steps

***8** Because the court believes the most efficient and fair resolution under the circumstances here is to provide the debtor, EE, with the opportunity to satisfy the *Lionel* criteria and to sell the Real Property—if it can—to the highest bidder, the court will confirm HH's Second Modified Fifth Amended Chapter 11 Plan (the "Plan"), ECF No. 709, with a stay of the implementation of the confirmation order (which will enter separately) that will automatically terminate not later than July 31, 2017. During the interim period of time, the debtor EE will have an opportunity to sell its Real Property pursuant to 11 U.S.C. §§ 363(b) and (f).

If EE is unable to obtain an order authorizing a sale of the Real Property pursuant to 11 U.S.C. §§ 363(b) and 363(f) on or before July 14, 2017, or if an approved buyer(s) is unable to consummate a purchase on or before July 28, 2017, then the stay of the confirmation order will terminate. To monitor the progress of any potential sale process, the court will hold hearings on July 14, 2017, and July 28, 2017, at 10:00 a.m. If it is demonstrated that there is cause to terminate the stay of the confirmation order during either of those hearings, the court will immediately do so.

If only one of either the Offer One Property or the Offer Two Property is sold pursuant to a possible, future court order, then the court shall schedule a status conference to address whether all or any portion of the HH Plan should proceed to be implemented.

Other than the question of value of EE's Real Property, the court finds and concludes that HH's Plan satisfies the requirements of 11 U.S.C. §§ 1129(a) and (b) based on the record of the Confirmation Hearing and the record of the case since that time. If the debtor is unable to sell the Real Property on or before July 28, 2017—a date that is more than the 90 days requested by debtor's counsel during the hearing on April 5, 2017—the record will support a conclusion that HH's Plan is not unfair or inequitable.

ACCORDINGLY, it is hereby

ORDERED, that the Second Modified Fifth Amended Plan, ECF No. 709, of Hartford Holdings, LLC shall be confirmed (and a separate order shall enter); and it is further

ORDERED, that the confirmation order shall be stayed pursuant to the terms and conditions set forth in this Memorandum and Ruling, subject to further order of this court, or until July 31, 2017; and it is further

ORDERED, that a scheduling conference to address the 363 Motion and the debtor's objection to HH's claims shall be held on Monday, April 17, 2017, at 4:00 p.m. (unless otherwise ordered due to counsel's schedules, if necessary); and it is further

ORDERED, that further hearings consistent with this Memorandum and Ruling shall be held on July 14, 2017 at 10:00 a.m. and on July 28, 2017 at 10:00 a.m.

All Citations

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Footnotes

1 Hartford Holdings, LLC claims prepetition debt of $8,794,365.34 (Proofs of Claim 14–21, as amended) plus attorneys fees of approximately $644,500.00, ECF No. 930, plus reimbursement of advanced water and sewer payments of $130,728.40, ECF 944, 1:01:20–30, totaling approximately $9,569,593.70. This sum is exclusive of post-petition interest and the effect, if any, of post-petition adequate protection payments.

2 While EE has acknowledged the perfection of HH's liens in numerous cash collateral orders, including in a proposed order filed by EE as recently as April 10, 2017 (ECF No. 993), EE nonetheless objected to the perfection of HH's liens on all of its cash and to the calculation of post-default interest, among other things. ECF No. 966. A hearing to consider the objection will be scheduled. The court assumes in this Memorandum and Ruling that HH's claim is valid and enforceable as EE has stipulated to these facts in numerous hearings and in several cash collateral orders submitted by both EE and HH jointly over the past three years. If HH's claim is disallowed in whole or in part the court will address at that time whether any modifications to this Memorandum and Ruling may be required.

3 Counsel for EE and its shareholder Vera Mladen, Attorney Irene Costello and Attorney John Gale, respectively, repeatedly articulate surprise at the procedural requirements of the chapter 11 process and preface many statements by referring to what the judge supposedly told them to do or asking that the judge tell them what to do. This court considers it the responsibility of attorneys practicing before it to be familiar with the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. For purposes of clarity, the court notes that while the 363 Motion and the objection to HH's claims will be scheduled for hearing, this scheduling by the court is in no way an assurance that the relief sought has been adequately noticed or that any procedural or substantive prerequisites to the entry of the relief being sought have been met.

4 The debtor's real properties, as the "Real Property" is comprised of: 243–255 Laurel Street, 252 Laurel Street, 154–160A Collins Street, 21 Evergreen Avenue, 117–145 South Marshall Street, 56 Webster Street, 270 Laurel Street and 360 Laurel Street, all in Hartford, Connecticut.

5 The court notes that a public adjuster is entitled to a commission of 10% on insurance proceeds pursuant to a prior order of the court, so the amount available to the debtor or the secured creditor is perhaps only $2,700,000. ECF No. 579. No application for allowance and payment of the commission has been filed by the debtor at this time.

6 During a hearing held on April 5, 2017, the court directed counsel for the debtor to file information confirming the debtor's receipt of the $3,000,000 fire insurance proceeds and evidence of the balance of the escrow account. To date nothing has been filed.

7 These figures oversimplify the valuation issue as each potential value has attendant costs that are described in more detail later in this Memorandum and Ruling. These differing figures illustrate, however, the vastly differing views of value presented by the debtor EE and the creditor HH. One consequence of EE's valuation, if it is correct, is that HH is entitled to postpetition interest, costs and attorneys fees relating to its allowed secured claims.

8 *See, e.g.,* ECF No. 481. The court concludes that Mr. Ressler was acting under a conflict of interest during the Confirmation Hearing.

9 Norman Benedict was originally retained by EE and conducted appraisals on EE's behalf in June 2015. EE relied upon the June 2015 appraisals in its Fourth Amended Disclosure Statement. See, Order Authorizing Employment, ECF No. 137 and Fourth Amended Disclosure Statement, p. 6, ECF No. 283.

10 The appraisal reports were admitted as exhibits C (Appraisal of 21 Evergreen Avenue), D (Appraisal of 56 Webster Street), E (Appraisal of 115 South Marshall Street), F (Appraisal of 156 Collins Street), G (Appraisal of 243 and 255 Laurel Street), H (Appraisal of 252 Laurel Street) and I (Appraisal of 270 Laurel Street), and J (Appraisal of 360 Laurel Street).

11 During the April 5, 2017 hearing, HH's attorney conceded that it would be satisfied if sales of the Real Property resulted in $14,000,000 in combined sales and insurance proceeds in a timely manner. ECF No. 978, 00:58:25–00:58:40. Also during the April 5, 2017 hearing, EE's attorney stated that a ninety-day stay of the effectiveness of the HH Plan would be sufficient. ECF No. 978, 01:17:40–01:18:00.

12 It is unknown whether the City of Hartford's 2016 valuation of 270 Laurel Street is based on its post-fire, pre-repair status.

13 *See,* http://assessor1.hartford.gov/Default.asp?br=exp&yr=6

14 A capital gains tax would be potentially allowed as an administrative claim under 11 U.S.C. § 503(b). *See* ECF No. 934 and 938 (debtor's alleged basis in portions of Real Property); *see also,* HH's Plan, ECF No. 709, pp. 7–9. "In a non-individual [chapter 7 or 11] case, all of the assets and income become part of the bankruptcy estate and all taxes incurred during the administration of the case, except those treated as unsecured priority claims under section 507(a)(8), are treated as administrative expenses." Collier on Bankruptcy ¶ 503.07 (16th 2017).

15 The court notes that EE's arguments regarding 11 U.S.C. § 1129(b)(1) have not been clearly and directly made by counsel. First, while former attorney Mr. Ressler did seek to introduce appraisal evidence showing the value of the Real Property was higher than Mr. Benedict's appraised values, he did not clearly articulate an objection grounded in § 1129(b)(1). Similarly, Attorneys Costello (for EE) and Gale (for Vera Mladen), have asserted (during oral argument on other matters) alleged facts that, when considered in the light most favorable to the debtor, amount to an objection to the HH Plan grounded in § 1129(b)(1).

16 The amount of the outstanding real estate taxes owed was obtained from the publically available records of the City of Hartford. https://www.mytaxbill.org/inet/bill/search.do The amount consists of the following amounts: as to 21 Evergreen Avenue for the grand list of 2015—$34,202.32; as to 360 Laurel Street for the grand list of 2015—$5,110.07; as to 115–141 South Marshall Street for the grand list of 2014—$45,751.55; as to 115–141 South Marshall Street for the grand list of 2015—$86,194.98; as to 243 Laurel Street for the grand list of 2015—$28,961.52; as to 270 Laurel Street for the grand list of 2014—$42,223.76; as to 270 Laurel Street for the grand list of 2015—$100,560.81; as to 252 Laurel Street for the grand list of 2015—$27,996.13; as to 160 Collins Street for the grand list of 2015—$27,582.39; as to 156 Collins Street for the grand list of 2015—$31,857.65; and as to 56 Webster Street for the grand list of 2015—$20,686.79.

17 The claims of Vera Mladen and Dusan Mladen scheduled in ECF No. 86 (an amended Schedule F, list of unsecured creditors) were recharacterized as equity in Adversary Proceeding No. 15–2034; the claim of Goran Mladen was disallowed in Adversary Proceeding No. 15–2035.

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	Chapter 11
DB HOLDINGS LIQUIDATION, INC. (f/k/a DIRECTBUY HOLDINGS, INC.), *et al.*,[1]	:	Case No. 16-12435 (CSS)
	:	Jointly Administered
Debtors.	:	**Related to Docket No. 662**

ORDER DISMISSING THE DEBTORS' CHAPTER 11 CASES AND GRANTING RELATED RELIEF

Upon the motion (the "Motion")[2] of the Debtors for entry of an order, pursuant to sections 105(a), 305, 349 and 1112(b) of title 11 of the United States Code (as amended, the "Bankruptcy Code"), rules 1017 and 2002 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and rule 1017-2 of the Local Rules of Bankruptcy Procedure (the "Local Rules") dismissing the Debtors' Chapter 11 cases and granting related relief; and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. § 1334; and consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper in this district pursuant to 28 U.S.C. § § 1408 and 1409; and due and sufficient notice of the Motion having been given under the particular circumstances; and it appearing that no other or further notice is necessary; and the Court having determined that the legal and factual bases set forth in the Motion establish just

[1] The Debtors in these cases, along with the last four digits of each Debtor's federal tax identification number, are: DB Holdings Liquidation, Inc. (3621); Consumer Liquidation, Inc. (6335); DB Liquidation, Inc. (5059); BF Liquidation, Inc. (8776); UDB Liquidation, Inc. (6010); Trading Liquidation, Inc. (4388); NMC Liquidation, Inc. (8765); and Canada DB Liquidation, Inc. (6435).

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Motion.

cause for the relief granted herein; and upon all the proceedings heretofore had before the Court; and after due deliberation thereof; and good and sufficient cause appearing therefor;

IT IS HEREBY ORDERED THAT:

1. The Motion is granted as set forth herein.

2. All objections to the Motion or the relief requested therein that have not been withdrawn, waived, or settled, and all reservations of rights included therein, are overruled on the merits and denied with prejudice.

3. Each of the Chapter 11 Cases shall be dismissed upon a certification (the "Certification") filed by the Debtors' counsel certifying that (a) all quarterly fees due and owing to the Office of the U. S. Trustee pursuant to 28 U.S.C. § 1930 (the "U.S. Trustee Fees") including those for the quarter in which the case is dismissed attributable to the Debtors have been paid in full, (b) the Court has entered orders with respect to final fee applications for estate professionals and the Debtors have paid all outstanding amounts approved by such orders, unless otherwise agreed to by the applicable professional, and (c) any excess funds in the Debtors' estates have been paid to MasterBrand in accordance with the MasterBrand Stipulation.

4. The Certification shall indicate that it was provided to the Office of the U.S. Trustee before its filing, and further shall indicate whether the Office of the U.S. Trustee concurs that all U.S. Trustee Fees have been paid.

5. The Certification and this Order may be served on the general service list established in the Chapter 11 Cases, including the UST, and the Debtors need not send the Certification to the Debtors' entire matrix of creditors and parties-in-interest, as such parties received reasonable notice of the proposed dismissal through notice of the hearing on the Motion.

6. Notwithstanding any Order to the contrary, a final omnibus fee hearing will be held on 9/6, 2017 at 12:00 p.m. (prevailing Eastern Time) (the "Final Fee Hearing"). Not later than ~~twenty-one (21) days before the Final Fee Hearing~~ 8/7/17, all professionals retained in the Chapter 11 Cases shall file final requests for allowance and payment of all fees and expenses incurred during the Chapter 11 Cases (the "Final Fee Applications") in accordance with the Bankruptcy Code, the Bankruptcy Rules and the Local Rules and otherwise in accordance with the *Order Establishing Procedures for Interim Compensation and Reimbursement of Expenses of Professionals* so as to be heard at the Final Fee Hearing. Any objections to the Final Fee Applications shall be filed and served on counsel for the Debtors and the firm submitting the application to which an objection is being filed by 4:00 p.m. (prevailing Eastern Time) on 9/29, 2017.

7. Notwithstanding section 349 of the Bankruptcy Code, all prior orders, stipulations, settlements, rulings, orders and judgments of this Court made during the course of the Chapter 11 Cases shall remain in full force and effect and shall survive the dismissal of the Chapter 11 Cases.

8. Upon dismissal of the Chapter 11 Cases, Cole Schotz P.C. ("Cole Schotz") shall be discharged as Debtors' counsel. Upon dismissal, absent an objection received within 30 days, the Debtors are authorized but not directed, to abandon and destroy, or cause to be abandoned and destroyed, any and all Books and Records; provided, however, the Debtors shall maintain any electronic records that are stored on hard drives until final adjudication of the Komodo Appeals. Also upon dismissal of the Chapter 11 Cases, the Committee shall be disbanded and Saul Ewing LLP shall be discharged as Committee counsel.

9. Upon dismissal of the Chapter 11 Cases, Prime Clerk LLC ("Prime Clerk"), the Debtors' claims and noticing agent, shall be relieved of its responsibilities as the Debtors' claims and noticing agent in these cases. In accordance with Local Rule 2002-1(f)(ix), within fourteen (14) days of the dismissal of the Chapter 11 Cases, Prime Clerk shall forward to the Clerk of the Court an electronic version of all imaged claims, (b) upload the creditor mailing list into CM/ECF, (c) docket a combined final claims register containing claims against each Debtor, and (d) box and transport all original claims to the Philadelphia Federal Records Center, 14700 Townsend Road, Philadelphia, Pennsylvania 19154 and docket a completed SF 135 Form indicting the accession and location numbers of the archived claims.

10. Notwithstanding any applicability of any Bankruptcy Rules, the terms and conditions of the Order shall be effective and enforceable immediately upon its entry, and the Debtors shall be, and hereby are, authorized to take such actions as are necessary and appropriate to effectuate the terms of this Order.

11. The Court retains jurisdiction with respect to all matters arising from or related to the implementation of this Order and any other order entered in the Chapter 11 Cases.

Dated: July 19, 2017
Wilmington, Delaware

CHRISTOPHER S. SONTCHI
UNITED STATES BANKRUPTCY JUDGE

US Supreme Court confirms priority rules apply to a structured dismissal of a chapter 11 bankruptcy case

RESTRUCTURING E-NEWSLETTER - GLOBAL INSIGHT SERIES

Restructuring e-Newsletter - Global Insight
7 JUL 2017
By: Maris J. Kandestin I Joe Riches

In its recent decision *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), the United States Supreme Court held that a bankruptcy court may not approve a structured dismissal of a chapter 11 case that provides for distributions that fail to follow the standard priority rules, unless the affected creditors consent to such treatment.

A structured dismissal is one of three typical ways in which a chapter 11 case can come to an end. The first way is through a chapter 11 plan of reorganization or liquidation. The chapter 11 plan governs how to treat the debtor's debt and distribute the estate's assets. The second way a chapter 11 case can conclude is through a conversion to chapter 7. Upon conversion, a chapter 7 trustee will be appointed to liquidate and distribute the debtor's assets. The third way the case can end is by dismissal. A bankruptcy court may dismiss a chapter 11 case under section 349(b) of the Bankruptcy Code. Dismissal of the case would restore the parties' positions to those that existed before the bankruptcy. If perfect restoration is difficult or impossible, as was the case in Jevic, then the court may "for cause" alter the dismissal's normal restorative consequences; ie it may order a "structured dismissal."

The Supreme Court's ruling in *Jevic* preserves the Bankruptcy Code's priority system, which ensures that a debtor's assets are distributed in order of statutory priority − typically, senior creditors must be paid in full before junior creditors receive any distribution. Although the Bankruptcy Code does not expressly apply these rules to a structured dismissal, the Supreme Court clarified that courts should do so.

Background

In 2006, Sun Capital Partners, a private equity firm, acquired Jevic Transportation Corporation with money borrowed from CIT Group in a leveraged buyout. Just two years after the buyout, Jevic (and certain of its affiliates) filed for chapter 11. At the time of filing, Jevic owed US$53 million to its senior secured creditors and US$20 million to general unsecured creditors.

A group of former Jevic truck drivers filed suit in bankruptcy court against Jevic and Sun alleging WARN Act

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violations (the WARN Act litigation). The Bankruptcy Court granted summary judgment against Jevic in that action; US$8.3 million of that judgment was considered to fall into the bucket of "priority wage claims" that were entitled to payment before general unsecured claims but behind secured claims, under the Bankruptcy Code.

A second lawsuit was brought by the official committee of unsecured creditors against Sun and CIT. The committee alleged that the leveraged buyout hastened Jevic's bankruptcy by saddling it with debt that it was unable to service. In 2011, the Bankruptcy Court held that the committee had adequately pleaded claims of preferential and fraudulent transfer. In *re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011).

Thereafter, the committee, Sun, CIT and Jevic reached a settlement agreement that, among other things, called for a structured dismissal of Jevic's chapter 11 cases. Under the proposed structured dismissal, the WARN Act petitioners would receive no distribution, but lower-priority general unsecured creditors would receive a distribution.

The proposed settlement therefore called for a structured dismissal involving distributions that did not follow ordinary priority rules.

Approach of the Bankruptcy Court, District Court and Third Circuit Court of Appeals

Sun, CIT, Jevic and the committee asked the Bankruptcy Court to approve the settlement and dismiss the cases. The Warn Act petitioners and the Office of the United States Trustee objected, arguing that the structured dismissal violated the Bankruptcy Code's priority scheme by skipping the petitioners who had claims ranking higher than the low-priority general unsecured creditors who were to receive a distribution.

The Bankruptcy Court held that as the proposed settlement's distribution would occur through a structured dismissal (as opposed to through a chapter 11 plan where the Bankruptcy Code expressly provides that the ordinary priority rules apply), the distributions were not prohibited under applicable law. The Bankruptcy Court approved the settlement given the "dire circumstances" of the cases – namely, that there was "no realistic prospect" of a meaningful distribution to anyone other than the secured creditors; a plan of reorganization was unattainable; and there were not enough funds to operate a chapter 7 proceeding. In *re Jevic Holding Corp.*, 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011).

On appeal, the District Court affirmed the Bankruptcy Court's decision, holding that the Bankruptcy Code's priority rules were "not a bar to the approval of the settlement as [a settlement] is not a reorganization plan." In *re Jevic Holding Corp.*, 2014 WL 268613, *3 (D. Del. Jan. 24, 2014).

On further appeal, the Third Circuit affirmed by a vote of 2 to 1, providing that when Congress codified the absolute priority rule, it did so in the specific context of plan confirmation and neither Congress nor the Supreme Court has ever held that the absolute priority rule applies to settlements in bankruptcy. The Third Circuit agreed with the Second Circuit's approach in In *re Iridium Operating LLC* that there should be some flexibility for bankruptcy courts to approve settlements. 478 F.3d 452 (2d Cir. 2007). The Third Circuit agreed that although the Bankruptcy Code and the Bankruptcy Rules do not extend the absolute priority rule to settlements in bankruptcy, the underlying policy – ensuring the predictable and fair treatment of creditors – applies in a settlement context. The Court therefore held that bankruptcy courts may approve settlements deviating from the Bankruptcy Code's priority rules only if they have "specific and credible grounds to justify [the] deviation." Id at 466.

The Third Circuit concluded that the Bankruptcy Court had sufficient reason to approve the structured dismissal in *Jevic*, because the settlement "remained the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to chapter 7 would have resulted in the secured creditors taking all that remained of the estate." The core issue was whether a settlement served the best interests of the estates. The Third Circuit opined that the Bankruptcy Court chose between approving a settlement that deviated from the priority scheme or rejecting it so a lawsuit could proceed that would deplete the estate, and that the second option would have served neither the interests of creditors or the estate.

The Supreme Court reverses

The Supreme Court reversed the Third Circuit and held that "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."

The Supreme Court conceded that, insofar as the dismissal of chapter 11 cases seek restoration of the prepetition status quo under section 349(b) of the Bankruptcy Code, a bankruptcy judge may "for cause, orde[r] otherwise.[1]" But

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this exception does not authorize a bankruptcy court to violate priority without the consent of the impaired creditors. Although there are instances where courts had approved interim settlements violating ordinary priority rules, those cases involved significant Bankruptcy Code-related objectives that the priority-violating distributions served to make disfavored creditors better off. By contrast, in *Jevic* there was no significant bankruptcy-related justification to violate ordinary priority rules.

The Supreme Court also disagreed with the Third Circuit's "rare case" exception for approving a priority-violating structured dismissal. Such an exception threatened to become a more general rule and could result in potentially serious consequences of departing from protections granted to particular classes of creditors. The Court opined that Congress did not authorize a "rare case" exception and courts should not diverge from procedures in the Bankruptcy Code. Lastly, the Supreme Court seemed to be particularly interested in the reasoning behind why the WARN Act petitioners were excluded from the settlement – because Sun did not want to fund litigation against itself – a reasoning that was perhaps not a significant bankruptcy-related justification to violate ordinary priority rules. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 983 (2017).

Impact of *Jevic*: no payment out of turn?

Bankruptcy courts will now closely scrutinize settlement agreements that seek to deviate from the basic priority rules under the Bankruptcy Code. *Jevic* has recently been applied in *In re Fryar* where the Bankruptcy Court for the Eastern District of Tennessee rejected a proposed settlement agreement (that did not include a specific request for a structured dismissal) because the deal would pay some unsecured creditors out of turn without "serv[ing] a significant Code-related objective." *In re Fryar*, Case No. 16-13559 (SR) (Bankr. E.D. Tenn. Apr. 25, 2017).

As another example, in the Constellation bankruptcy case pending in Delaware, the bankruptcy court recently denied a settlement motion that ran afoul of *Jevic*. See Order Denying Joint Motion Approving Settlement, *In re Constellation Enterprises LLC*, et al., Case No. 16-11213 (CSS) (Bankr. D. Del. May 16, 2017), ECF No. 963. The proposed settlement transferred cash and lawsuit rights from the debtor to an unsecured creditor's trust. The trust was structured in a way that cut some priority creditors out of the distribution equation. The proposed settlement provided that the chapter 11 cases would be "(a) dismissed by structured dismissal on terms that are consistent with this Term Sheet and/or the Settlement and are otherwise acceptable to the Debtors, Creditors' Committee and Ad Hoc Noteholder Group, or (b) resolved by such other process as may be agreed to by the Parties and approved by the Bankruptcy Court." *Id.*

In response to objections, the debtors argued that the settlement did not involve the distribution of the estates' assets, was in the best interests of the estates, and would provide a distribution to unsecured creditors that otherwise would be impossible absent the settlement agreement. The hearing on the initial settlement motion was adjourned pending the Supreme Court's ruling in *Jevic*.

After the Supreme Court issued its decision in *Jevic*, the objecting parties argued that if the Bankruptcy Court approved the settlement, then this would provide a means to circumvent *Jevic* by permitting debtors to move assets out of the estates temporarily and then distribute them in violation of the standard priority rules. See The DDTL Parties Supplemental Objection, In *re Constellation Enterprises LLC*, et al., Case No. 16-11213 (Bankr. D. Del. May 5, 2017), ECF No. 948.

On May 16, 2017, Judge Cristopher S. Sontchi denied the settlement motion because there was no evidence before the court as to why priority creditors were not involved in the settlement agreement or why deficiency claim creditors were treated differently. The facts and the law constrained the judge to this decision, despite him noting that it may come at a cost to creditors.

The impact of the *Jevic* ruling appears to be trending in a clear direction. Bankruptcy courts, upholding the ruling in *Jevic*, appear unwilling to approve settlement agreements (even where a structured dismissal is not contemplated or is contemplated as an option) or structured dismissals that violate ordinary priority rules. The Supreme Court's ruling in *Jevic* will make it more difficult to effect creative solutions in cases where creditors are severely out of the money, and may result in more conversions from chapter 11 to chapter 7. *Jevic* has taken some of the teeth out of structured dismissals and has potentially eliminated a tool to negotiate creative solutions in difficult cases. Going forward, practitioners should be mindful of how they present settlements to the bankruptcy court where there is any deviation from the ordinary priority rules.

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[1] The Supreme Court did not "express a view on the legality of structured dismissals in general." *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 985 (2017).

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