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Recent Confirmation Developments

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ABI-NYC SPRING CONFERENCE 2019

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TOPICS

1. Cram-Ups/Reinstatements since *Momentive*, including the *Momentive* remand trial
2. Excising third-party releases from a confirmed plan (*In re Thru Inc.*)
3. Nonconsensual releases (*Seaside Engineering*)
4. Vote-designation (*Fagerdala*, *LightSquared*)
5. Classification (*Novinda*)
6. Per plan vs. per debtor (*Transwest*, *Charter*, *Tribune*)
7. Whether all similarly situated creditors should have the right to participate in rights offerings, financings, etc. (*PacDrilling*).

TOPIC 1: *MOMENTIVE* AND POST-*MOMENTIVE* DEVELOPMENTS[1]

The Second Circuit's decision in *In re MPM Silicones, L.L.C.*[2] ("Momentive") will likely keep alive one of the more contentious debates in bankruptcy law in recent years. At issue before the court was the appropriate method for calculating the interest rate to apply where a debtor seeks to "cramdown" a class of secured creditors under Bankruptcy Code section 1129(b)(2)(A)(i).[3] That section allows a debtor to confirm a plan over the dissent of a secured creditor class if each holder receives on account of its claim deferred cash payments having a present value equal to the allowed amount of its claim.[4] At the heart of this statutory requirement is the applicable discount rate for determining the present value of such claim. In order to ensure that a secured creditor receives the present value of its secured claim under a plan, the proposed deferred payments must carry an appropriate interest rate. In *Momentive*, the court held that this interest rate must be a market rate if an "efficient market" exists, but if such a market does not exist, then the formula rate should be applied.[5] Before delving into the *Momentive* decision, some background on *Till v. SCS Credit Corp.*[6] is in order.

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[1] Adapted from "*Momentive and the 'Efficient Market': The Cramdown Saga Continues*" published in Norton Annual Survey of Bankruptcy Law, 2018 Ed., with permission of Thomson Reuters. Copyright © 2018. Further use without the permission of Thomson Reuters is prohibited. For further information about this publication, please visit https://store.legal.thomsonreuters.com/law-products/law-books/legal-publishers/norton, or call 800.328.9352.

[2] 874 F.3d 787 (2d Cir. 2017).

[3] All section references herein are to title 11 of chapter 11 of the United States Code (the "Code").

[4] § 1129(b)(2)(A)(i)(II) (requiring that "each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property").

[5] *In re MPM*, 874 F.3d at 800 ("'[T]he market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality.'" (quoting *In re Am. HomePatient, Inc.*, 420 F.3d 559, 568 (6th Cir. 2005))).

[6] 541 U.S. 465 (2004).

I. *Till v. SCS Credit Corp*

The issue before the Court in *Till* was the appropriate method for calculating the cramdown interest rate under section 1325(a)(5)(B)(ii).[7] In *Till*, the chapter 13 debtors had purchased a used truck from Instant Auto Finance for $6,395.[8] The debtors had financed the purchase price by entering into a retail installment contract with Instant Auto Finance at a 21% interest rate, which was immediately assigned to SCS Credit Corporation ("SCS"). SCS retained a purchase money security interest in the truck that gave SCS the right to repossess the truck if the debtors defaulted.[9] Eventually, the debtors defaulted on this contract, filed for relief under chapter 13, and sought to cramdown SCS.

In a plurality decision, the Court held that the formula rate approach is the appropriate cramdown method in chapter 13.[10] At the outset of its analysis, the Court observed that the Code offers little guidance as to the proper method for calculating this interest rate, but acknowledged that the cramdown interest rate must account for the fact that the "creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays" and the risk of nonpayment.[11] The Court stated that the bankruptcy court's job is to choose an interest rate that compensates the creditor for these concerns.[12]

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[7] As with chapter 11, chapter 13 allows a debtor to provide a secured creditor with deferred cash payments whose total "value, as of the effective date of the plan, . . . is not less than the allowed amount of such claim." § 1325(a)(5)(B)(ii).

[8] *Till*, 541 U.S. at 469.

[9] *Id.* at 470.

[10] *Id.* at 478-80. Under the formula rate approach, the bankruptcy court first looks to the daily press to find the current national prime rate. *Id.* Next, the court takes this rate and augments it for the greater risk of nonpayment presented by the debtor, resulting in a "prime-plus" rate. *Id.* at 479. The appropriate amount of adjustment is to be determined based on evidence presented at the confirmation hearing. *Id.*

[11] *Id.* at 474.

[12] *Id.*

In making this determination, the Court concluded that three considerations should govern. First, the Code includes many provisions that require a court to discount deferred payments to their present value. The Court noted that Congress "likely" intended bankruptcy courts "to follow essentially the same approach" when determining an appropriate "interest rate under any of these provisions."[13] In support of this inference, the Court mentioned, as it did at many places in its decision, that the preferred approach is one that "minimizes the need for expensive evidentiary proceedings."[14]

Second, the Court noted that chapter 13 allows a bankruptcy court to modify the rights of a secured creditor's claim. Under section 1322(b)(2), a court has clear authority to modify the timing, number, or amount of the payments in an installment contract. Indeed, there may be a need to make such changes because of a change in the debtor's circumstances – a debtor that was forced to file for bankruptcy because of its debt burden is now under court supervision with a risk of default that is somewhat reduced.[15]

Third, the cramdown interest rate approach requires an objective rather than subjective inquiry. The Court explained that section 1325(a)(5)(B) does not require that a creditor be "subjectively indifferent between present foreclosure and future payment."[16] By definition, a creditor that is crammed down is forced to accept a loan instead of foreclosing or receiving immediate payment. Instead, the focus should be on treating similarly situated creditors

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[13] *Id.*

[14] *Id.* at 474-75.

[15] *Id.* at 475.

[16] *Id.* at 476.

similarly and on an "objective economic analysis" that the debtor's deferred payments "will adequately compensate . . . creditors for the time value of their money and risk of default."[17]

Based on these considerations, the Court adopted the formula approach because it was the only method that best aligned with these considerations and the purposes of the Code.[18] The formula approach "entails a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary proceedings."[19] In contrast, the coerced loan, presumptive contract rate, and cost of funds approaches violate these considerations because each of them is "complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value."[20]

In the aftermath of *Till*, courts have split over its application in chapter 11.[21] The confusion primarily stems from the decision's internal inconsistencies. In discussing how a creditor subject to cramdown would prefer to foreclose rather than receive future payments, the Court included one of the most written about footnotes in bankruptcy law. In footnote 14, the Court stated, in relevant part:

> Because every cramdown loan is imposed by a court [in chapter 13] over the objection of the secured creditor, there is no free market of willing cramdown lenders. Interestingly, the same is ***not*** true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. ***Thus, when picking a cram down rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce.*** In the

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[17] *Id.* at 476-77.

[18] *Id.* at 478-80.

[19] *Id.* at 479.

[20] *Id.* at 477.

[21] *See generally* Thomas R. Fawkes & Steven M. Hartmann, *Revisiting* Till*: Has a Consensus Emerged in Chapter 11s*, AM. BANKR. INST. J., July/Aug. 2008, at 28, 28-29 (noting that post-*Till* courts inconsistently applied various cramdown interest rate approaches).

> Chapter 13 context, by contrast, the absence of any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure.[22]

This footnote is difficult to reconcile with the rest of the *Till* decision. The Court concluded that the formula approach applied in the chapter 13 case before it and stated that Congress "likely" intended courts to "follow essentially the same approach when choosing an appropriate interest rate under any of these [present value] provisions,"[23] including section 1129(b)(2)(A)(i)(II). At the same time, footnote 14 suggests incongruently that a different cramdown interest approach may be better suited in chapter 11, where an "efficient market" may exist.

Relying on footnote 14, some courts have held that a market rate of interest is required in chapter 11 if an efficient market exists,[24] while others have determined that footnote 14 is too slim of a reed on which to require a market-based approach given the rest of the Court's opinion.[25] Recently, in *Momentive*, the Second Circuit weighed in on the applicability of *Till* in chapter 11.

II. *Momentive*

Momentive Performance Materials Inc.'s ("MPM") financial troubles began in 2006 soon after it was acquired in a leveraged buyout.[26] In the years that followed, MPM became substantially over-levered and ultimately filed for relief under chapter 11 in April 2014. MPM's

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[22] *Till*, 541 U.S. at 476 n.14 (emphasis added, in part).

[23] *Id.* at 474 (internal citations omitted).

[24] *See, e.g.*, *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re Am. HomePatient, Inc.)*, 420 F.3d 559, 568 (6th Cir. 2005); *In re Prussia Assocs.*, 322 B.R. 572, 588-89 (Bankr. E.D. Pa. 2005); *Mercury Capital Corp. v. Milford Conn. Assoc., L.P.*, 354 B.R. 1, 11 (D. Conn. 2006).

[25] *See, e.g.*, *In re MPM Silicones, LLC*, No. 14-22503-RDD, 2014 WL 4436335, at *28 (Bankr. S.D.N.Y. Sept. 9, 2014) ("I conclude that such a two-step method, generally speaking, misinterprets *Till* and *Valenti* and the purpose of section 1129(b)(2)(A)(i)(II) of the Code based on the clear guidance of those precedents."), *aff'd*, 531 B.R. 321 (S.D.N.Y. 2015), *aff'd in part, rev'd in part and remanded sub nom. In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017); *In re Mirant Corp.*, 334 B.R. 800, 821 (Bankr. N.D. Tex. 2005).

[26] *In re MPM*, 874 F.3d at 791.

plan had three classes of notes: (1) $1.1 billion of first-lien secured notes and $250 million of 1.5-lien secured notes (together, the "Senior-Lien Notes"); (2) approximately $1 billion in springing second-lien notes (the "Second-Lien Notes"); and (3) $500 million in subordinated unsecured notes (the "Subordinated Notes").[27] Under MPM's plan, the Senior-Lien Notes could choose between (a) accepting the plan and receiving full payment in cash, but without any make-whole claim, and (b) rejecting the plan, preserving their right to litigate the make-whole claim, and "receiving replacement notes with a present value equal to the Allowed amount of such holder's Claim."[28] The Senior-Lien Notes overwhelmingly voted to reject the plan, thereby invoking the latter option. Consequently, MPM moved under section 1129(b)(2)(A)(i) to confirm its plan by cramdown of the non-accepting Senior-Lien Notes class.

At confirmation, the Senior-Lien Notes argued that MPM's use of the formula rate to set the discount rate was improper because, among other things, the resulting cramdown interest rate failed to comply with section 1129(b)(2)(A)(i). The Senior-Lien Notes argued that fair and equitable treatment under section 1129(b)(2) required the application of ascertainable market rates for similar debt obligations.[29] The bankruptcy court disagreed, holding that the formula rate was the appropriate cramdown methodology under section 1129(b)(2)(A)(i).[30] After the

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[27] *Id.* at 791-92.

[28] *Id.* at 792 (alteration in original). In the parlance of bankruptcy practitioners, this sort of option is colloquially referred to as a "death trap."

[29] *Id.* at 793.

[30] The factual and legal recitation herein is tailored to focus only on the cramdown interest rate issue. The other two principal issues before the bankruptcy court were whether the Subordinated Notes were subordinated to the Second-Lien Notes and whether the Senior-Lien Notes were entitled to a make-whole premium. *See In re MPM Silicones*, 2014 WL 4436335, at *2-19. The court concluded that the Subordinated Notes were subordinate to the Second-Lien Notes under the applicable indentures and that the Senior-Lien Notes were not entitled to a make-whole premium. *Id.* Both of these conclusions of law were affirmed by the district court and Second Circuit. *In re MPM Silicones, LLC*, 531 B.R. 321, 326-31, 335-38 (S.D.N.Y. 2015), *aff'd,* 874 F.3d at 794-97, 801-05.

district court affirmed the bankruptcy court,[31] the Subordinated Notes and Senior-Lien Notes appealed.

In a matter of first impression, the issue before the Second Circuit was the appropriate methodology for determining the appropriate interest rate to apply to MPM's deferred payments so that the present value of those payments would equal the allowed amount of the Secured-Lien Notes' claims.[32] The parties' arguments focused on the interpretation of *Till*. Likewise, the Second Circuit's decision rested on its interpretation of *Till*. Relying heavily on footnote 14 of *Till*, the court held that where an "efficient market exists" that generates an interest rate "acceptable to sophisticated parties dealing at arm's length[,]" that market rate should be used instead of a formula-based rate.[33] In calculating the appropriate cramdown interest rate, the *Momentive* court adopted the two-step process for selecting an interest rate in a chapter 11 cramdown under section 1129(b)(2)(A)(i) set forth in the Sixth Circuit decision in *In re American HomePatient, Inc.*[34] (the "HomePatient Standard"): "'The market rate should be applied in Chapter 11 cases, where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the *Till* plurality.'"[35] The Second Circuit briefly discussed why the HomePatient Standard complies with *Till* and the dictates of section 1129(b)(2)(A)(i) and why this approach "'best aligns with the Code and relevant precedent.'"[36] The court reasoned that ignoring efficient market rates would depart from long-standing precedent that teaches that "the

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[31] *In re MPM Silicones*, 531 B.R. at 324, 338.

[32] *In re MPM*, 874 F.3d at 794, 798-800.

[33] *Id.* at 801.

[34] 420 F.3d 559 (6th Cir. 2005).

[35] *In re MPM*, 874 F.3d at 800 (quoting *In re Am. HomePatient, Inc.*, 420 F.3d 559, 568 (6th Cir. 2005)).

[36] *Id.*

best way to determine value is exposure to a market."[37] Relying on *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*,[38] the court explained that the Supreme Court expressed "disfavor for decisions untested by competitive choice . . . when some form of market valuation may be available."[39]

The HomePatient Standard that the Second Circuit adopted in *Momentive* is easy enough to apply in theory: a market rate applies if an efficient market exists; if not, then the formula approach applies. Under this standard, the presence of an efficient market obviously plays a pivotal role. But *Momentive* offers little guidance as to what constitutes an "efficient market," other than briefly observing that "courts have held" markets are efficient where "'they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan'"[40] and if they "generate[] an interest rate that is . . . acceptable to sophisticated parties dealing at arms-length."[41]

III. *Momentive* Remand Trial

On remand, the bankruptcy court was tasked with applying the Second Circuit's newly adopted two-step approach in calculating the cramdown interest rate on the replacement first-lien notes and 1.5 lien notes. In August 2018, the bankruptcy court conducted a three-day evidentiary hearing to determine (1) whether an efficient market existed, and assuming one existed, (2) what should be the market rate of interest on the replacement notes. The remand trial

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[37] *Id.* (quoting *Bank of Am.*, 526 U.S. at 457-58); *United States v. 50 Acres of Land,* 469 U.S. 24, 25 & n.1 (1984)).

[38] 526 U.S. 434 (1999).

[39] *In re MPM*, 874 F.3d at 800.

[40] *Id.* (quoting *In re Tex. Grand Prairie Hotel Realty*, 420 F.3d at 568).

[41] *Id.* at 801.

consisted of a classic battle of the experts over how to assess market efficiency. Below is a high-level overview of the positions the parties took at the remand trial:

- **Market Efficiency**

    - **Debtors:** Relying on the Efficient Capital Market Hypothesis and *Till*, the debtors argued that an efficient market is one in which "prices at any time 'fully reflect' all available information."[42] The central tenant of market efficiency is that there is sufficient interaction among market participants such that the price of an instrument reflects publicly available information.[43] The debtors contended that the relevant market for determining "efficiency" should be on the replacement notes themselves, not some other debt financing. Applying this approach, the debtors concluded that no efficient market existed because, among other things, none of the key features of the replacement notes could be identified based on the debtors' expert review of the 19,494 U.S. corporate bonds issued on October 24, 2012.[44]

    - **First Liens:** Relying heavily on the Second Circuit's characterization of an "efficient market," the first liens argued that the market for the replacement notes was efficient because the debtor secured exit financing commitments at arm's length with three large competitors that had a term, size, and collateral comparable to the first lien notes. The first liens further contended that, even without such commitments, the market for this type of financing was highly active when the debtor emerged and therefore efficient.[45]

    - **1.5 Liens:** Similar to the first-lien noteholders, the 1.5 lien noteholders relied on the Second Circuit's description of an "efficient market." In the cramdown context, the relevant test for market efficiency was specifically set forth by the Second Circuit: markets for financing are efficient, where, for example, they offer a loan with a term, size, and collateral comparable to the forced loan contemplated under the cramdown plan. Under this standard, the 1.5 lien noteholders argued an efficient market existed because the new notes to be issued to refinance the 1.5 lien notes were substantially similar to the 1.5 lien cramdown replacement notes: (i) they had the same size; (ii) substantially similar terms; and (iii) the same collateral.[46]

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[42] *Debtors' Pre-Trial Brief*, Case No. 14-22503, Doc. No. 1666, at 7 (Bankr. S.D.N.Y.).

[43] *Id.* at 11.

[44] *Id*. at 23.

[45] *Trial Brief for BOKF, N.A.*, Case No. 14-22503, Doc. No. 1667, at 1 (Bankr. S.D.N.Y.).

[46] *Trial Brief of Wilmington Trust*, Case No. 14-22503, Doc. No. 1668, at 4 (Bankr. S.D.N.Y.).

- **Market Rate**

  - **Debtors:** Alternatively, if the bankruptcy court found that an efficient market existed, the debtors urged the court to adopt a floating rate of interest. Unlike debt instruments with call protections that are typically paired with fixed interest rates, the replacement notes had no call protections, which supports the use of a floating rate. The debtors contended that the appropriate range for the floating rate should be between LIBOR + 400 basis points and LIBOR + 425 basis points. The debtors defended these ranges on grounds that their expert arrived at these ranges after considering the specific characteristics of the notes and interest rates of the debt instruments issued by similar companies.[47]

  - **First Liens:** The first liens argued that a fixed rate should be applied because that is consistent with market practice and the debtors' plan which specifically provided that the first lien notes would be set at a fixed rate. As far as the rate, the best evidence of the market rate for the replacement first-lien notes is the interest rate for the exit term loan because it was an actual market transaction with the debtors seeking first lien financing.[48] Such a competitive process provides assurances that the resulting interest rate was a competitive market rate. The first liens urged a fixed rate between 6.47% and 6.99%.

  - **1.5 Liens:** The 1.5 lien noteholders argued that a fixed interest rate should be applied because the market standard for high-yield notes is a fixed rate and the chapter 11 plan used a fixed rate. As the appropriate market rate of interest, the range for the replacement notes should be between 7.75% and 8.25%. The 1.5 lien noteholders looked to the debtor's own contemporaneous valuations used in its SEC filing which it was required to do in connection with its fresh-start accounting. Based on that valuation, the fair value of the 1.5 replacement notes was 81%, which reflects a market rate of interest of 8.12%.[49]

Although the bankruptcy court has not yet ruled, the court remarked at trial that courts applying a market-based approach have done so primarily based on what has happened in the case, as opposed to extensive expert testimony on debt markets, and whether the parties were sophisticated and dealing at arm's-length. He further observed that it was "fairer to have a

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[47] *Debtors' Pre-Trial Brief*, Case No. 14-22503, Doc. No. 1666, at 23 (Bankr. S.D.N.Y.).

[48] *Trial Brief for BOKF, N.A.*, Case No. 14-22503, Doc. No. 1667, at 16 (Bankr. S.D.N.Y.).

[49] *Trial Brief of Wilmington Trust*, Case No. 14-22503, Doc. No. 1668, at 1-2 (Bankr. S.D.N.Y.).

floating rate . . . truer to life" given how an efficient market does not have fixed prices and how the parties themselves appeared to be thinking about a floating rate.

TOPIC 2: EXERCISING THIRD-PARTY RELEASES FROM A CONFIRMED PLAN

Pursuant to Section 524(e),[50] debtors have attempted to extend releases to certain affiliated non-debtor parties whose participation in or impact on the chapter 11 process will allegedly affect the debtor's ability to reorganize — the "non-debtor" or "third-party" release. Some circuits have flatly rejected third-party releases on the grounds that they are contrary to a provision in the Bankruptcy Code providing that a discharge of a debtor's debt has no effect on the liability of third parties.[51] Other courts, however, permit non-consensual third-parity releases when there is a showing that the releases are necessary to an effective reorganization.[52]

Although the permissibility of non-debtor releases for prepetition conduct has been the subject of debate among the courts for years, exculpation of non-debtors for post-petition conduct has not been as greatly debated by the courts. Relying on the Fifth Circuit decision in *In re Pacific Lumber Co.*,[53] the District Court for the Northern District of Texas's in *In re Thru*[54]

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50 Section 524(e) provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e).

51 *See, e.g., Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (finding that third-party releases are impermissible); *Landsing Diversified Properties-II v. First Nat'l Bank and Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 601-02 (10th Cir. 1990) (holding that permanent injunctions that release non-debtors of their own liability to third parties are impermissible); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592, 601-02 (10th Cir. 1990) (holding that Bankruptcy Code section 524(e) prohibits a discharge of a non-debtor for liability owed to a creditor).

52 *See, e.g.*, *In re Specialty Equip.Cos., Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993) (holding that third-party releases that apply only to those creditors who vote in favor of the plan are permissible); *Gillman v. Cont'lAirlines (In re Cont'l Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000) (noting that the hallmarks of permissible non-consensual third-party releases are fairness, necessity to the reorganization, and specific findings to support these conclusions); *Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142-43 (2d Cir. 2005) (noting that third-party releases may be allowed in unique circumstances, but noting that such unique circumstances may exist where, for example, the estate receives substantial consideration for the release, or where the plan provides for payment in full of the enjoined claims); *In re Am. Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) ("Section 524(e), therefore, limits the court's equitable power under section 105 to order the discharge of the liabilities of nondebtors . . . .").

53 584 F.3d 229, 252 (5th Cir. 2009).

54 *In re Thru, Inc.*, Civil Action No. 3:17-CV-1958-G, 2018 WL 5113124 (N.D. Tex. Oct. 19, 2018)

extended the debate on whether a confirmed plan can be reversed based on non-debtor third-party releases for post-petition conduct.[55] The District Court's decision in *In re Thru* will likely start a new contentious debate in bankruptcy law regarding whether third-party releases for post-petition conduct should be granted.

I. *In re Thru, Inc.*

a. Facts

Dropbox Inc. ("Appellant"), an online file management and collaboration company that provides services to businesses and consumers, sued Thru, Inc. (the "debtor") for trademark infringement over the use of the mark "dropbox." Appellant was granted summary judgement and $2.3 million in attorney fees. However, the debtor was unable to pay the attorney fee award, and on March 22, 2017, filed for chapter 11. The debtor's plan subordinated the right of repayment of the debtor's secured creditors to Appellant, requiring that the debtor's $1 million exit facility loan be *pari passu* in right of repayment to Appellant's $2.3 million dollar fee award. The plan also removed all provisions of the plan requiring that all payments to Appellant be put in escrow while the appeal of the $2.3 million award was before the Ninth Circuit. The bankruptcy court ultimately confirmed the debtor's plan.

Because the debtor's appeal was pending while its plan was before the bankruptcy court, the bankruptcy court was unable to incorporate the Ninth Circuit's determination into its decision. Nevertheless, during the pendency of the bankruptcy appeal, the Ninth Circuit issued its opinion on the appeal. In the opinion, the Ninth Circuit affirmed all of the findings of the

55 *In re Pacific Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009) (holding that the chapter 11 plan could not be confirmed based on the third-party releases);

district court, determining that Appellant had senior rights in the trademark, that the district court did not abuse its discretion in finding that laches barred the debtor's counterclaims, and that the district court did not abuse its discretion in granting the $2.3 million fee award.

Appellant appealed the bankruptcy court's confirmation order, seeking that the court reverse the confirmation order and appoint a Chapter 11 trustee, or reverse the order with instructions to take testimony from Appellant's witness who was not allowed to testify. Appellant contended that the bankruptcy court erred in finding that the plan did not contain any impermissible third-party releases. Appellant maintained that because the exculpation and release provisions in the plan were broad enough to include Thru Limited Liability Company and the debtor's officers and directors, the plan ran afoul of Fifth Circuit precedent[56] foreclosing non-consensual non-debtor releases and permanent injunctions. In response, the debtors claimed that the District Court could not review either provision because the Appellant did not raise objections concerning these provisions to the bankruptcy court.

b. Holding & Analysis

The court held that the language contained in this exculpation provision was similar to the exculpation language struck down by the Fifth Circuit in *In re The Pacific Lumber Company*, and thus it was clearly erroneous for the bankruptcy court to approve this provision and confirm the plan.[57] In coming to this holding, the court analyzed paragraph 9.5[58], 9.7[59], and the term

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56 *In re The Pacific Lumber Company*, 584 F. 3d 299 (5th Cir. 2009).

57 *In re Thru, Inc.*, Civil Action No. 3:17-CV-1958-G, 2018 WL 5113124, at *20-22 (N.D. Tex. Oct. 19, 2018).

58 Paragraph 9.5, the injunction provision, provides that:

> Except as otherwise expressly provided in this Plan or in the Confirmation Order and except in connection with the enforcement of the terms of this Plan (including the payment of Distributions hereunder) or any documents provided for or contemplated in this Plan, all entities who have held, hold or may hold

(cont'd)

"Protected Party" in the Plan.[60] First, the court addressed whether the third-party release claims were equitably moot. Relying on Fifth Circuit precedent, the court held because partial relief on the third-party release claim was available, the claim was not equitably moot.[61]

Next, the court turned to whether the bankruptcy court should have approved the third-party and exculpatory releases. The court first analyzed the plan, holding that the broad

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> Claims against or Interests in the Debtor or the Estate that arose prior to the Effective Date are permanently enjoined from: (a) commencing or continuing in any manner, directly or indirectly, any action or other proceeding of any kind against any Protected Party or any property of any Protected Party with respect to any such Claim or Interest; (b) the enforcement, attachment, collection or recovery by any manner or means, directly or indirectly, of any judgment, award, decree or order against any Protected Party or any property of any Protected Party with respect to any such Claim or Interest; (c) creating, perfecting or enforcing, directly or indirectly, any lien or encumbrance of any kind against any Protected Party or any property of any Protected Party with respect to any such Claim or Interest; (d) effecting, directly or indirectly, any setoff or recoupment of any kind against any obligation due to any Protected Party or any property of any Protected Party with respect to any such Claim or Interest, unless approved by the Bankruptcy Court; and (e) any act, in any manner, in any place whatsoever, that does not conform to or comply with the provisions of this Plan with respect to such Claim or Interest. *Id*. at *21.

59 Paragraph 9.7, the exculpation provision, provides that:

> Neither the Debtor nor any of its present officers, directors, employees, agents, advisors, or affiliates, nor any of its Professionals (collectively, the "*Exculpated Persons*"), shall have or incur any liability to any Entity for any act taken or omission made in good faith in connection with or related to formulating, negotiating, implementing, confirming or consummating the Plan, the Disclosure Statement or any Plan Document. The Exculpated Persons shall have no liability to the Debtor, any Creditor, Interest holder, any other party in interest in the Chapter 11 Case or any other Entity for actions taken or not taken under the Plan, in connection herewith or with respect thereto, or arising out of their administration of the Plan or the property to be distributed under the Plan, in good faith, including failure to obtain Confirmation or to satisfy any condition or conditions, or refusal to waive any condition or conditions, to the occurrence of the Effective Date, and in all respects such Exculpated Persons shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the Plan. *Id*. at *22.

60 The plan defines the term "Protected Party" to include the debtor, Thru, as well as Thru's officers, directors, employees, shareholders, advisors, attorneys, representatives and other agents. *Id*. at *21.

61 *Id*. at *20 (*citing In re Pacific Lumber Company*, 584 F.3d at 252 (concluding that impermissible third party releases were not shielded from review by equitable mootness)).

language of Paragraph 9.5 would effectively discharge numerous non-debtor third parties, "such as Thru Limited Liability Company and Thru's officers and directors, by barring creditors from collecting pre-petition debts from non-debtor third parties who may be co-liable."[62] Next, the court compared this case to *In re Pacific Lumber Company*, finding that the language contained in this exculpation provision was similar to the exculpation language struck down in *In re Pacific Lumber Company*.[63]

The court disagreed with the debtor assertion, that the plan in *In re Pacific Lumber Company* contained additional insulation for the debtor and non-debtor third parties because there the plan precluded liability from "any act or omission relating to (i) the management and operation of the debtors, (ii) the implementation of any of the transactions described in the plan, and (iii) any action taken in connection with the enforcement of the debtors' rights or the defense of any claims against third parties."[64] The court concluded that the broad language contained in the debtors' exculpation provision would also provide the same insulation as the provision in *In re Pacific Lumber Company*. The court noted that even though the debtor's plan contained tolled claims, a number of contingencies would need to occur for a creditor to effectively pursue a tolled claim. Thus, the court reversed the bankruptcy court's decision concerning the plan's injunction and exculpation provisions, and remanded the case to the bankruptcy court with instructions to strike aspects of paragraphs 9.5 and 9.7 concerning improper releases of non-debtor third parties.

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[62] *Id*. at *22. The court stated that reading Paragraph 9.5 and the term Protected Party together with Paragraph 9.5 of the plan bars the debtor's creditors from pursuing causes of actions against a number of non-debtor third parties, if those causes of action relate to the creditors' claims against the debtor. *Id*. at *21.

[63] *Id*. at *21-22.

[64] *Id*.

TOPIC 3: NONCONSENSUAL RELEASES UNDER *IN RE SEASIDE ENGINEERING & SURVEYING, INC.*

Federal Circuit Courts of Appeal are split as to whether a bankruptcy court may release non-debtors from liability and/or enjoin third parties from asserting their direct claims against such non-debtors without the releasing parties' consent. Relying on the bankruptcy court's broad equitable powers under Bankruptcy Code section 105(a) and the lack of any express restriction in Bankruptcy Code section 524(e), the majority of circuits – specifically, the Second, Third, Fourth, Sixth, and Seventh – hold that nonconsensual releases are permissible in certain limited circumstances.[65] The Fifth, Ninth, and Tenth Circuits, on the other hand, interpret Bankruptcy Code section 524(e) as a prohibition against the bankruptcy court's ability to issue nonconsensual releases of third-party claims against non-debtors.[66] Recently, the Eleventh Circuit, in *In re Seaside Engineering & Surveying, Inc.*, 780 F.3d 1070 (11th Cir. 2015), joined the majority of circuits.

I. *In re Seaside Engineering & Surveying, Inc.*

a. Facts

Seaside Engineering & Surveying, Inc. ("Seaside"), was a closely-held engineering firm owned and operated by five principals (the "Principals"), all of whom were engineers. Before Seaside filed for relief under Chapter 11, the Principals formed two wholly separate real estate development entities. These entities borrowed money from Vision-Park Properties, LLC and SE

[65] *In re Metromedia Fiber Network Inc.*, 416 F.3d 136 (2d Cir. 2005); *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000); *Behrmann v. Nat'l Heritage Found. Inc.*, 663 F.3d 704 (4th Cir. 2011); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); *In re Ingersoll Inc.*, 562 F.3d 856 (7th Cir. 2009); *In re Airadigm Commc'ns. Inc.*, 519 F.3d 640 (7th Cir. 2008); *In re Munford Inc.*, 97 F.3d 449 (11th Cir. 1996); *In re AOV Indus. Inc.*, 792 F.2d 1140 (D.C. Cir. 1986).

[66] *In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *In re W. Real Estate Fund Inc.*, 922 F.2d 592 (10th Cir. 1990).

Property Holdings, LLC (collectively, "Vision"). To secure these funds, each of the Principals executed personal guaranties in favor of Vision. The real estate entities defaulted, and ultimately, Vision obtained an approximately $4.5 million judgment against the Principals. Soon thereafter, three of the five Principals filed for Chapter 7. After an acrimonious sale process, a Chapter 7 trustee in one of those individual bankruptcy cases sold the principal's equity in Seaside to Vision. Shortly thereafter, Seaside file for Chapter 11.

Seaside proposed a Chapter 11 plan that would assign all of its interest to Gulf Atlantic Engineering & Surveying LLC ("Gulf Atlantic"), a newly created company formed by four of the Principals. Seaside contemplated funding the plan from Gulf Atlantic's revenues. The plan proposed to pay all creditors in full, and in exchange for Vision's ownership interest in Seaside, Vision would receive a promissory note equal to the court-determined value of its equity interests in Seaside. The plan also included the following release provision:

> [N]one of the Debtor, ... Reorganized Debtor, Gulf Atlantic ... (and any officer or directors or members of the aforementioned [entities]) and any of their respective Representatives (the "Releasees") shall have or incur any liability to any Holder of a Claim against or Interest in Debtor, or any other party-in-interest ... for any act, omission, transaction or other occurrence in connection with, relating to, or arising out of the Chapter 11 Case, the pursuit of confirmation of the Amended Plan as modified by the Technical Amendment, or the consummation of the Amended Plan as modified by this Technical Amendment, except and solely to the extent such liability is based on fraud, gross negligence or willful misconduct.

Vision, which was not a creditor of Seaside, objected to Seaside's plan. Vision opposed the plan on numerous grounds, including that the releases contained in the plan were improper. The bankruptcy court overruled Vision's objection and confirmed the plan. The district court affirmed, and Vision appealed to the Eleventh Circuit.

b. Holding & Analysis

The Eleventh Circuit opened its discussion by observing that it had not yet approved the type of releases being requested. While in *In re Munford Inc.*,[67] the Eleventh Circuit approved release of claims against a non-debtor, that was in a settlement context within an adversary proceeding; whereas in Seaside the releases would "prevent claims against non-debtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity, Gulf [Atlantic]."[68] With no direct precedent on point, the Eleventh Circuit surveyed the circuit split on non-debtor releases, and determined that its decision in *In re Munford* placed it most closely with the majority of circuits that hold that non-debtor releases are permissible.[69] The court rejected the minority of circuits' interpretation of Bankruptcy Code section 524(e) as a barrier to issuing non-debtor releases because the discharge of a debtor's debt does not itself affect the liability of a third party.[70]

In siding with the majority of circuits, the Eleventh Circuit made clear that just because non-debtor releases are permissible that does not mean they should be granted as a matter of course. Non-debtor releases should be "reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances."[71] In assessing whether such releases should be granted, the bankruptcy court should apply the seven-factor test set forth in the Sixth Circuit's decision in *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002) (hereinafter, the

[67] 97 F.3d 449 (11th Cir. 1996).

[68] *In re Seaside*, 780 F.3d at 1076.

[69] *Id.* at 1078.

[70] *Id.*

[71] *Id.*

"Dow Corning Factors"). Under the Dow Corning Factors, the bankruptcy court may issue third-party non-consensual releases when the following seven factors are present:

> (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions.[72]

The Eleventh Circuit emphasized that the Dow Corning Factors are only a nonexclusive list of factors for the bankruptcy court to consider, which should be applied flexibly and with an eye towards whether the non-debtor releases are "essential, fair, and equitable."[73] After applying each one of the Dow Corning Factors, the Eleventh Circuit held that Seaside's releases were fair and equitable and warranted under the circumstances.

II. Takeaways

In re Seaside Engineering will probably be most remembered and cited for its application of the Dow Corning Factors, not that it sided with the majority of the circuits on the issue of non-consensual third-party releases. Notably, the Eleventh Circuit's application of the first three Dow Corning Factors seems inconsistent with its admonition that non-consensual third-party

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[72] *In re Dow Corning Corp.*, 280 F.3d at 658.

[73] *In re Seaside*, 780 F.3d at 1079.

releases should be granted “cautiously and infrequently.”[74] Regarding the identity of interests between the debtor and the third party, the court agreed with the bankruptcy court that Gulf Atlantic would deplete assets continuing to defend Vision’s lawsuits. Interestingly, however, there is no reference to any indemnity obligation, let alone an indemnity obligation that would require Gulf Atlantic to pay the Principals for litigation unrelated to Gulf Atlantic’s business. Turning next to possibly the most important Dow Corning Factor, the Eleventh Circuit observed that Principals were not contributing “any new value” to the reorganized debtor, but found that their labor was the “life blood of the reorganized debtor.”[75] In other words and contrary to many other decisions holding otherwise, labor alone is sufficient to satisfy this second factor. Regarding the third Dow Corning Factor, the Eleventh Circuit found that it favored issuing the release because Vision’s litigation against the Principals would result in them expending “their time in defense as opposed to focusing on their professional duties for the reorganized entity.”[76]

The *In re Seaside* facts seem inconsistent with the way in which the Eleventh Circuit described the circumstances upon which non-consensual third-party releases should be granted. The Eleventh Circuit repeatedly stressed that the continued professional services of the Principals were essential such that distracting them with litigation would imperil the reorganized debtor. Yet the same argument could be made for directors and officers – often the parties that seek, and benefit from, non-consensual third-party releases – that will remain with the reorganized debtor.

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[74] *Id.*

[75] *Id.* at 1080.

[76] *Id.*

III. Other Recent Developments Regarding Releases

To avoid application of the stringent standard set forth under *In re Metromedia Fiber Network, Inc.*,[77] debtor's counsel in the Second Circuit often contend that non-voting creditors are deemed to consent to third-party releases. Such deemed consent contexts often arise with those creditor who do not respond to a voting ballot or are left unimpaired under the plan. Bankruptcy courts in the Southern District of New York are divided on this issue.

- **Rejecting "Deemed Consent"; Creditors Must Affirmatively Consent to Release**
  - *In re Chassix Holdings, Inc.*:[78] Judge Wiles concluded that those creditors entitled to vote and who took no action did not consent to the third party releases.[79] The court also found that unimpaired creditors are not deemed to have consented to the third party releases.[80] The court questioned whether a creditor that must release a claim against a third party under a plan should be considered "unimpaired" under the Bankruptcy Code.[81]
  - *In re SunEdison, Inc.*:[82] The court rejected the debtors' argument that those creditors that did not object to the non-debtor releases conspicuously noted in the debtors' disclosure statement were deemed to consent to such releases. Resorting to New York contract law, the court reasoned that a creditors' mere silence in not voting was insufficient to charge them with consent.[83] The one applicable exception to this general rule – the offeror has given the offeree reason to understand that silence will constitute acceptance (i.e., a duty to speak) – did not apply because there could have been many other reasons for the creditors' silence.[84]

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[77] 416 F.3d 136 (2d Cir. 2005) ("Metromedia").

[78] 533 B.R. 64, 81 (Bankr. S.D.N.Y. 2015).

[79] *Id.* at 80.

[80] *Id.* at 81.

[81] *Id.* at 81.

[82] 576 B.R. 453, 459 (Bankr. S.D.N.Y. 2017).

[83] *Id.* at 460.

[84] *Id.* at 461 ("The Debtors have failed, however, to show that the Non-Voting Releasors' silence was misleading or that it signified their consent to the Release. There are other plausible inferences that support the opposite inference. For example, the meager recoveries (here, less than 3% for the unsecured creditors) may explain their inaction without regard to the Release.").

- **Accepting "Deemed Consent"**
    - Although *In re Frontier Insurance Group, Inc.*,[85] does not address third party releases, the bankruptcy court addressed the binding effects of a plan. Judge Drain held that a "confirmed plan binds, among others, the debtor and its creditors to its terms and vests all property of the debtor's estate in the reorganized debtor unless otherwise provided in the plan, and, moreover, can vest the property that is dealt with by the plan free and clear of all claims and interests of creditors and interest holders even if it was not necessarily property of the estate pre-confirmation."[86] The court explained that claims to property of the estate are reviewed for res judicata purposes in determining whether the claims were or could have been raised pre-confirmation, and thus, this may include claims asserting that an asset is not property of the debtor's estate.

Another significant decision issued recently regarding third party releases concerns a bankruptcy court's constitutional and statutory authority to approve of third party releases in a chapter 11 plan. Addressing an issue of apparent first impression for the court and recognizing a split of authority, Chief District Judge McMahon in *In re Kirwan Offices S.à.r.l.*,[87] held that non-consensual releases of non-debtor, third-party claims contained in proposed Chapter 11 plan of reorganization were within the bankruptcy court's "core" jurisdiction. Thus, the bankruptcy court had subject-matter jurisdiction to consider and subsequently enjoin, by way of the plan's exculpation and injunction provisions, claims under the debtor's non-debtor shareholders' prepetition shareholder agreement. The bankruptcy court found that resolving the shareholder's claims under the agreement was not merely related to the matters encompassed within the confirmed reorganization plan, but was necessary to the plan's operation. Furthermore, the fact that the bankruptcy court's decision may have had a preclusive, incidental effect on claims

[85] 585 B.R. 685 (Bankr. S.D. N.Y. 2018) aff'd, No. 18-CV-3211 (CS), 2019 WL 1236301 (S.D.N.Y. Mar. 18, 2019)

[86] *Id*. at 696.

[87] 592 B.R. 489 (S.D.N.Y. 2018).

beyond the scope of the immediate bankruptcy proceeding did not render the court's jurisdiction non-core.

TOPIC 4: VOTE-DESIGNATION

Under Section 1126(e) of the Bankruptcy Code, on the request of a party-in-interest and after notice and a hearing, the court may "designate any entity whose acceptance or rejection of [a chapter 11] plan was not in good faith or was not solicited or procured in good faith or in accordance" with the requirements of chapter 11 of the Bankruptcy Code. [88] In other words, the court may disqualify votes that were not made in good faith; however, the requesting party has a heavy burden of proof.

Notably, the leading case regarding vote-designation was *In re DBSD North America, Inc.* [89] In *DBSD*, the Second Circuit designated the vote of a late-on-the-scene claims buyer who bought an entire class of claims with the intention of blocking any plan that did not provide it a strategic interest in the reorganized debtor and disregarded that class for purposes of Section 1129(a)(8). *DBSD* provides a good summary of Section 1126(e):

> The Code provides no guidance about what constitutes a bad faith vote to accept or reject a plan. Rather, § 1126(e)'s "good faith" test effectively delegates to the courts the task of deciding when a party steps over the boundary. . . . Bankruptcy courts should employ § 1126(e) designation sparingly, as "the exception, not the rule….Merely purchasing claims in bankruptcy "for the purpose of securing the approval or rejection of a plan does not of itself amount to 'bad faith.'" Nor will selfishness alone defeat a creditor's good faith; the Code assumes that parties will act in their own self interest and allows them to do so . . . . Section 1126(e) comes into play when voters venture beyond mere self-interested promotion of their claims. "[T]he section was intended to apply to those who were not attempting to protect their own proper interests, but who were, instead, attempting to obtain some benefit to which they were not entitled." A bankruptcy court may, therefore, designate the vote of a party who votes "in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets," or one who votes with

88 11 U.S.C. § 1126(e).

89 634 F.3d 79 (2d Cir. 2011).

> an "ulterior motive," that is, with "an interest other than an interest as a creditor."[90]

DBSD suggested that extra scrutiny is warranted for those who buy claims during a chapter 11 case, especially after a plan has been proposed and especially if the party bought the claims *above* par.[91] Recently, the Southern District of New York addressed Section 1126(e) and *DBSD* in *In re LightSquared Inc.*[92] In addition, the Ninth Circuit recently addressed section 1126(e) in *Pacific Western Bank v. Fagerdala USA-Lompoc, Inc*. (*In re Fagerdala USA-Lompoc, Inc*.)[93] in determining whether a creditor acted in bad faith when it purchased only enough unsecured debt in a Chapter 11 case to block confirmation of the debtor's plan of reorganization.

I. *In re LightSquared Inc.*

(a) Facts

LightSquared Inc. and its affiliates (collectively, the "debtors") provided wholesale mobile satellite communications and broadband services throughout North America. On May 14, 2012, the debtors filed for chapter 11 bankruptcy. SP Special Opportunities LLC ("SPSO"), an entity that was wholly owned by the chairman and was controlling shareholder of a competitor of the debtors, DISH, held approximately $844 million face amount of the outstanding debtor pre-petition secured debt (the "SPSO Claim").

The debtors proposed their Third Amended Joint Plan Pursuant To Chapter 11 (the "Plan"), which provided for the separate classification of claims and equity interests into sixteen

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[90] 634 F.3d at 101-102.

[91] *Id*. at 104.

[92] 513 B.R. 56 (Bankr. S.D.N.Y. Jul. 11, 2014).

[93] 891 F.3d 848 (9th Cir. 2018).

distinct classes.[94] Pursuant to the Plan, holders of prepetition LP Facility Claims were divided into two classes, Class 7A and Class 7B. Holders of claims in Class 7A would receive Plan consideration in the form of cash payment equal to the amount of their allowed claims, while SPSO, the sole claimant in Class 7B, would receive Plan consideration in the form of the SPSO Note. The debtors obtained the support of every significant party in interest except SPSO.[95]

The debtor filed numerous motions in connection with the confirmation of the Plan, including a vote designation motion (the "Vote Designation Motion") seeking to designate the vote of SPSO pursuant to Section 1126(e) of the Bankruptcy Code. The debtor alleged that SPSO attempted to gain control of a company in distress by buying claims and manipulating the chapter 11 process for their non-creditor interests. SPSO filed several objections, including objections to the Plan and the Vote Designation Motion.

(b) Holding & Analysis

The court held that SPSO's vote to reject the Plan cannot be designated because SPSO did not act in bad faith. The bankruptcy court first discussed the Second Circuit's decision in *DBSD*,[96] acknowledging that "votes cast by parties who purchase claims in a competitor's bankruptcy case are viewed by courts as being particularly worth of scrutiny."[97] However, the

[94] Each class of Claims and Equity Interests contained only Claims or Equity Interest that were substantially similar to the other Claims or Equity Interests within that class. 513 B.R. at 64.

[95] The Plan was deemed to have been accepted because the debtors obtained the consent of the unimpaired classes, Classes 1, 2, 3, 4, 5, and 13. *Id*. at 66.

[96] 634 F.3d 79 (2d Cir. 2011).

[97] *Id*. at 89 (*citing In re DBSD N. Am. Inc.*, 634 F.3d at 105, n.12).

court found that SPSO did not buy the "claims with the intent of voting against any plan that did not give it a strategic interest in the reorganized company."[98]

In declining to extend the holding of *DBSD*, the court relied on two distinguishing factors. First, the court noted that unlike *DBSD*, SPSO purchased the debt below par and acquired all of the debt prior to the filing of the plan.[99] Second, there were valid reasons for SPSO's rejection of the Plan outside of its position as a competitor. The court noted that where a "creditor votes to reject a plan for an admixture of reasons, some of which can be characterized as being consistent with the interests of a creditor acting to protect its legitimate creditor interest, its vote cannot be designated."[100] Here, the Plan deprived SPSO of its first lien security interest and gave consideration that was virtually indistinguishable from equity interest. The court noted that "SPSO's good faith in rejecting the plan would be highly questionable if SPSO voted to reject a plan that proposed to pay it in full in cash or a Plan proposing that SPSO receive some other treatment that was accepted by the non-SPSO holders of LP Debt."[101] Thus, the court concluded that although SPSO had non-creditor interests, its vote to reject the Plan could not be designated.

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98 *Id*. at 90. In addition, the court declined to review the acts of SPSO outside of the voting process, holding that a section 1126(e) designation should only take into consideration the voting conduct of the creditor. *Id*.

99 *Id*. In *DBSD*, the Second Circuit was particularly focused on the timing of DISH's debt purchases, which were made after the plan had been filed. 634 F.3d at 104. The Second Circuit's decision relied on the fact that DISH, the competitor of DBSD, bought the claims above par and after the plan had been proposed by DBSD. *DBSD*, 634 F.3d at 104.

100 513 B.R. at 90.

101 513 B.R. at 92.

II. *In re Fagerdala USA-Lompoc, Inc.*

(a) Facts

Fagerdala USA – Lompoc, Inc. (the "debtor") was a California corporation that owned real estate worth approximately $6 million. Pacific Western Bank ("Pacific Western") held a senior secured claim worth approximately $4 million, secured on Fagerdala's real estate. On August 14, 2014, the debtor filed for chapter 11 in the United States Bankruptcy Court for the District of Oregon. The debtor filed an initial reorganization plan on November 14, 2014 and a first amended plan on April 27, 2015. Both plans placed Pacific Western's secured claim in Class 1 and the general unsecured claims in Class 4.[102] To cram down the Plan, the debtor "needed the approval of at least one impaired class" under § 1129(a)(10).[103]

In order to block the proposed plan, Pacific Western purchased certain some, but not all, of the general unsecured claims from Class 4. Pacific Western acquired 50% in number of the allowed general unsecured claims, representing less than 10% in value of all allowed general unsecured claims from Class 4. Because the Pacific Wester's budget was not sufficient to purchase all the unsecured claims, the Bank did not offer to buy claims: (1) valued at $0; (2) disputed by the debtor; or (3) held by entities that might alert the debtor to Pacific Western's purchases.

The debtor filed a second amended plan on June 2, 2015. Pacific Western then voted all of its claims − both secured and unsecured − against the debtor's chapter 11 plan. The debtor moved to designate Pacific Western's votes of the Purchased Claims under Section 1126(e),

[102] The debtor's plan of reorganization sought to impair Pacific Western's claim by using an interest rate lower than the penalty interest rate for its loan, and modifying the length of the term and other loan provisions. *In re Fagerdala*, 891 F.3d at 852.

[103] *Id*.

arguing that the claims were not acquired in good faith because Pacific Western did not offer to purchase of all the claims in Class 4.

The bankruptcy court granted the debtor's motion, concluding that designation is appropriate because "(1) Pacific Western did not make an offer to all unsecured creditors and (2) [Pacific Western] will have an unfair advantage over the unsecured creditors who did not receive a purchase offer and who hold the largest percentage of claims . . . in terms of amount."[104] Because of the perceived highly prejudicial effect of Pacific Western's purchase of Class 4 claims, the bankruptcy court removed the purchased claims from voting and confirmed the debtor's fourth amended plan.[105] The bankruptcy court stated that as a matter of law it was not going to consider Pacific Western's subjective motivation for not offering to purchase all general unsecured claims.[106]

(b) Holding and Analysis

The Ninth Circuit held that pursuant to Section 1126(e), a bankruptcy court may not designate claims for bad faith simply because (1) a creditor offers to purchase only a subset of available claims in order to block a plan of reorganization, and (2) blocking the plan will adversely impact the remaining creditors.[107] The Ninth Circuit rejected the bankruptcy court's analysis because it "incorrectly examined the negative effect of the action, not the motivation of

[104] *In re Fagerdala*, 891 F.3d at 853.

[105] With the purchased claims removed from the voting there were sufficient votes for approval under § 1126(c). *Id.*

[106] At the outset of the hearing, the bankruptcy court asked Pacific Western "whether or not the bank offered to buy all the claims, or did they just buy a few." *Id*. at 853. Pacific Western stated that they did not attempt to buy every claim and that "with respect to any claim that it did not attempt to buy, there were specific reasons not to buy it." *Id*.

[107] *In re Fagerdala*, 891 F.3d at 854.

the creditor, and failed to establish whether Pacific Western had acted to secure some untoward advantage over other creditors for some ulterior motive."[108]

The Ninth Circuit first noted that "good faith" is a fluid concept under the Bankruptcy Code, and "bad faith" does not include "enlightened self-interest, even if it appears selfish to those who do not benefit from it."[109] In overturning the bankruptcy court's decision, the Ninth Circuit relied on the principle that creditors are permitted to utilize the Bankruptcy Code for their own strategic advantage, and this use, unless evidence on an ulterior motive exits, is not bad faith. Creditors need not vote on a reorganization plan "'with a high degree of altruism and with a desire to help the debtor and their fellow creditors. Far from it."[110] "'[I]f [the creditor] acted out of enlightened self-interest, it is not to be condemned simply because it frustrated [the debtor's] desires.'"[111] Thus, bad faith is evidenced by a creditor attempting to obtain a benefit to which it was not entitled, and that such action was distinguishable from when and where a creditor took an action to protect its own proper interests.

Relying on case law, the court enumerated several clear examples of bad faith: (i) a non-preexisting creditor purchasing a claim for the purpose of blocking an action against it, (ii) competitors purchasing claims to destroy the debtor's business in order to further their own, and (iii) a debtor arranging to have an insider purchase claims.[112] In short, simply "protecting a

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[108] *Id*. at 855, quoting *Figter Ltd. v. Teachers Ins. & Annuity Ass'n of Am.* (*In re Figter*), 118 F.3d 635, 639 (9th Cir. 1997) (emphasis in original)

[109] *Id*.

[110] *Id*., quoting *Figter*, 118 F.3d at 639.

[111] *Id*., quoting *Figter,* 118 F.3d at 639 (emphasis added).

[112] *Id*. at 856-57, quoting *Figter,* 118 F.3d at 639 (emphasis added).

claim to its fullest extent cannot be evidence of bad faith."[113] Thus, the court held that the "bankruptcy court erred both by considering the effect on other creditors, without additional evidence of bad faith, and not making actual findings on [Lender's] motivations." [114]

III. Afterthoughts

In contrast to the Second Circuit's *DBSD* decision, the Ninth Circuit did not condemn an "acquisitive motive alone, without specific findings of bad behavior . . ." Rather, *Fagerdala'*s decision confirms that a creditor may purchase and vote claims that it cares little about, for the purpose of maximizing its return on an entirely *different* class of claim against the same debtor, and that such motivation is sufficiently intrinsic to the case so as not to constitute an "ulterior" one that would render the associated claim designable under section 1126(e). While the Ninth Circuit's decision was consistent with its prior decision in *Figte*r and those of other courts that have held that a creditor must have an "ulterior motive," exactly when a creditor's motive crosses the line and becomes the kind of ulterior motive justifying a finding of bad faith and designation of the vote under Section 1126(e) is not always clear. *Fagerdala* provides three examples of when a creditor's motive crosses the line: (i) a non-preexisting creditor purchasing a claim for the purpose of blocking an action against it, (ii) competitors purchasing claims to destroy the debtor's business in order to further their own, and (iii) a debtor arranging to have an insider purchase claims.[115]

In re LightSquared Inc. tests the limits of *DBSD,* clarifying that Section 1126(e) is vote- and plan-specific (*i.e.*, intent must be linked to the vote itself), and also warns against

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113 *Id*. at 857.

114 *Id*. at 854.

115 *Id*. at 856-57, quoting *Figter,* 118 F.3d at 639 (emphasis added).

"conflating" the bad faith required under Section 1126(e) with the inequitable conduct required under Section 510. The court in *In re LightSquared* explains two reasons why vote designation should not be ordered: (1) "where a creditor can articulate a valid business reason for rejecting a plan even if such rejection may also be consistent with such creditor's non-creditor interests" and (2) where a creditor purchased the debt below par and acquired all of the debt prior to the filing of the plan. Thus, *LightSquared Inc.'s* decision makes it even more difficult for debtors to prove that the court should designate an entity's vote pursuant to Section 1126(e).

TOPIC 5: CLASSIFICATION

Initially, the bankruptcy and district courts disagreed on the proper interpretation of the classification rules governing reorganization under Chapter 11 of the Bankruptcy Code. Section 1122(a) provides: "Except as provided in subsection (b) of this section a plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." In other words, Section 1122(a) restricts the inclusion within a class to substantially similar claims or interests, but does not mandate such inclusion.

Recently in *Minerals Techs., Inc. v. Novinda Corp*. (*In re Novinda Corp*.),[116] the Tenth Circuit Bankruptcy Appellate Panel upheld the separate classification of creditor claims in a chapter 11 plan on the basis that, among other things, such claims possessed certain attributes (described as "non-creditor interests") that distinguished them from other similarly situated claims. Despite the attendant cost and delay that may result from a debtor's decision to separately classify certain claims, the *Novinda* decision reinforces the flexibility that a debtor has in developing classification schemes that will preserve valuable options for its estate.

I. *In re Novinda Corp.*

a. Facts

Novinda Corp. (the "debtor"), an advanced air quality technology company, commenced its chapter 11 case after Colloid, the exclusive manufacturer of its product, imposed on it a significant increase in manufacturing costs and a change in its payment terms. Prior to filing for chapter 11, the debtor had financed the development and production of its product through venture capital funding, secured loans, and unsecured loans. Appellants (including Colloid, "Appellants") were creditors of, and 18% equity holders in, the debtor. As a condition to the

[116] 585 B.R. 145 (10th Cir. B.A.P. 2018)

debtor receiving additional funding from Appellants prior to filing for chapter 11, Colloid became the exclusive manufacturer of the debtor's product. The debtor also received substantial equity infusions from certain third-party investment firms (the "Funds"). Following its chapter 11 filing, the debtor alleged that Colloid fabricated a manufacturing cost increase to drive the debtor out of business and, thus, maintained that it had breach of contract and fraud claims, and could potentially equitably subordinate their claims for distribution purposes.

The debtor structured its chapter 11 liquidating plan into 12 classes of claims. In structuring its chapter 11 plan, the debtor was reasonably certain that it would have an impaired accepting class of priority wage claims from Class 1. The claims in Class 1 were deemed "impaired" because they would not receive interest on the deferred payment of their claims. Following the chapter 11 plan waterfall, if any proceeds from the debtor's estate remained after the payment of claims in Class 1 and Class 2, all claims in Class 3 and Class 4 would receive a pro rata share of the remainder (with certain exceptions not relevant here). The debtor's chapter 11 plan also provided that the Funds would contribute $400,000 to the debtor's estate.

Appellants objected to confirmation of the plan, arguing that (1) the Plan was biased in favor of the Funds; (2) the Plan was not feasible, as creditor recovery was based on the outcome of speculative litigation; (3) Classes 3, 4, and 5 were unfairly discriminatory and were improperly classified for purposes of gerrymandering; and (4) the Plan was not proposed in good faith. Appellants contended that the debtor was first required to classify their claims with other unsecured creditors and then separately move to designate their votes in order to equitably subordinate them. The bankruptcy court confirmed the Plan and Appellants appealed both the Order Overruling Objections and the Confirmation Order.

b. Holding & Analysis

The Tenth Circuit upheld the debtor's separate classification of Appellants' claims, finding that the debtor did not separately classify claims in order to gerrymander votes. The Tenth Circuit addressed three major confirmation issues: (1) whether the classification of claims was reasonable under Section 1122; (2) whether the Plan unfairly discriminated against the objecting creditor's claims; and (3) whether the Plan was feasible. The court held the classification of claims was reasonable under the "one clear rule" that none of the classes were used to gerrymander the vote on plan confirmation.[117] The court explained that when a debtor is reasonably certain that one impaired class of claims — standing alone — will vote in favor of the plan, "any claims of gerrymandered voting have little relevance."[118]

With regard to the administrative convenience class, Appellants argued that notwithstanding that Section 1122(b) expressly permits such a class, in this case Class 5 was established for vote manipulation. The court ruled that there was a reasonable basis for the classification of claims in Class 3 and Class 4. The court found no error in the bankruptcy court's finding that the Appellants: 1) sought to force the debtor into a position where it would fold and they could usurp its business; and 2) later attempted to thwart the reorganization in order to avoid becoming a litigation target. Another reason why there was a reasonable basis for the classification of claims in Class 3 and Class 4 was that the debtor was legitimately concerned that placing Appellants in Class 3 might inadvertently waive any claim the debtor had for equitable subordination of Appellants' claims. Under Section 1123(a)(4), a plan shall provide for the same treatment for each claim of a class unless the holder of a particular claim (here, the

[117] 585 B.R. 145, 155-56 (10th Cir. B.A.P. 2018).

[118] 585 B.R. at 155.

Funds), agrees to a less favorable treatment. Accordingly, the Court held that the debtor had a reasonable basis for separately classifying Appellants' claims from trade claims.

Rejecting Appellants' assertion that the Plan unfairly discriminated against their claims, the BAP stated, "The Code does not define unfair discrimination, and the 10th Circuit has not spoken on what constitutes unfair discrimination, but the Code dictates that unfair discrimination is more than simply making a distinction between claims."[119] The court clarified that a creditor's agreement to less favorable treatment is permitted by Section 1123(a)(4), and does not necessarily implicate analysis under Section 1129(b)(1)'s discrimination provision.

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[119] 585 B.R. at 158.

TOPIC 6: PER-DEBTOR VS. PER-PLAN

Pursuant to Section 1129(a)(10) of the Bankruptcy Code, a plan may be confirmed if, among other things, "at least one class of claims that is impaired under the plan has accepted the plan."[120] Once there is an impaired accepting class, and assuming certain requirements are met, the plan may then be "crammed down" on all other classes of impaired creditors that reject the plan, and those creditors will be bound by the terms of a plan they rejected. The application of this requirement, set forth in Section 1129(a)(10), is straightforward when applied to a single debtor. In multi-debtor cases, however, the courts have offered conflicting interpretations of what is required under Section 1129(a)(10). The "per-debtor" approach interprets Section 1129 (a)(10) as requiring an accepting impaired class for each debtor, while the "per-plan" approach requires only one accepting impaired class across all debtors. While courts in the Southern District of New York and District of Delaware remain split on the "per-plan" versus "per-debtor" issue, the Ninth Circuit in *Transwest*[121] is the first court of appeals to weigh-in on the issue. Consequently, *Transwes*t will likely reignite the debate as to the proper interpretation of Section 1129(a)(10), one that has been dormant for more than five years.

I. *In re Transwest Resort Properties, Inc.*

a. Facts

The Transwest Resort Properties Inc.'s corporate structure consisted of one holding company (the "HoldCo debtor"), two intermediate holding companies (the "Mezzanine debtors") and two operating companies (the "OpCo debtors," together with the HoldCo debtor and Mezzanine debtors, the "debtors"). In 2008, Ashford Hospitality Financing, LP provided financing to the

[120] 11 U.S.C. § 1129(a)(10).

[121] *JMPCC 2007-C1 Grasslawn Lodging LLC v. Transwest Resort Props. Inc., et al.* (*In re Transwest Resort Props.*), 881 F.3d 724 (9th Cir. 2018).

Mezzanine debtors, and JPMCC 2007- C1 Grasslawn Lodging LLC provided financing to the OpCo debtors (the "Lenders"), to finance the purchase of two hotels located in Hilton Head, S.C., and Tucson, Ariz. The Mezzanine debtors' loan was secured by the Mezzanine debtors' 100 percent ownership interests in the OpCo debtors, and the OpCo debtors' loan was secured by the two hotels.

In 2010, the five debtors filed for chapter 11. The court approved joint administration of the five bankruptcy cases. Thereafter, the debtors filed a chapter 11 plan which did not seek to substantively consolidate the debtors. Under the plan, a third-party investor would invest $30 million in exchange for the Mezzanine Debtor's ownership interest in the Lenders, and the owner of the OpCo mortgage debt would be repaid in smaller monthly installments over a longer period of time. The Lenders, which were the sole creditors of the Mezzanine debtors, sought to block confirmation of the plan arguing that Section 1129(a)(10) requires the consent of a dissenting class from each debtor, and thus, the Plan could not be confirmed without their consent.

The bankruptcy court confirmed the Plan over the Lender's objections, finding that the plain language of Section 1129(a)(10) required only that "a plan" have one accepting, impaired class of creditors, even if the plan covered multiple debtors. The bankruptcy court concluded that the "per-debtor" interpretation of Section 1129(a)(10) set forth in *Tribune* was not persuasive.[122] The court sharply distinguished *Tribune* on the grounds that Section 102(7) does not alter the meaning of Section 1129(a)(10): "Section 102(7) effectively amends section 1129(a)(10) to read: 'at least one class of claims that is impaired under the plans has accepted the plans.'"[123] With five of ten classes having voted in favor of the joint plan, the bankruptcy court

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[122] *Id*. at 729.

[123] *Id*.

concluded that Section 1129(a)(10) was satisfied. On appeal, the district court affirmed the bankruptcy court's rulings, finding that the plain language of Section 1129(a)(10) only required one accepting, impaired class of creditors per-plan. The case was appealed to the Ninth Circuit.

b. Holding & Analysis

In a case of first impression among the courts of appeals, the Ninth Circuit held that Section 1129(a)(10) applies on a "per-plan" basis, rather than a "per-debtor" basis, rejecting a contrary holding from the Bankruptcy Court for the District of Delaware. The court held that the plain language of Section 1129(a)(10) necessitates the per-plan approach because "once a single impaired class accepts a plan, section 1129(a)(10) is satisfied as to the entire plan."[124] According to the court, this interpretation was persuasive because Section 1129(a)(10) "makes no distinction concerning or reference to the creditors of different debtors under 'the plan,' nor does it distinguish between single-debtor and multi-debtor plans."[125] Therefore, the Ninth Circuit concluded that having determined that "the plan" in Section 1129(a)(10) meant the joint chapter 11 plan for all five debtors, it was not the Ninth Circuit's job "to modify the plain language of a statute by interpretation."[126]

The Ninth Circuit also dismissed the Lender's argument that statutory context supported the per-debtor interpretation, thus disagreeing with *In re Tribune*.[127] Regarding Section 102(7) of the Bankruptcy Code, the Ninth Circuit stated that applying it to the text of Section 1129(a)(10) revised

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124 *Id*. at 729.

125 *Id*.

126 *Id*.

127 464 B.R. 126 (Bankr. D. Del. 2011). In *Tribune*, the bankruptcy court held, in part, that Section 1129(a)(10) should be interpreted as "per-debtor" because Section 102(7) provides that the "singular includes the plural" throughout title 11, and other subsections of Section 1129(a) support a per-debtor interpretation. *In re Tribune*, 464 B.R. at 131.

the statute to read "at least one class of claims that is impaired under the plans has accepted the plans," which the court found to be consistent with the per-plan approach.[128] As for other subsections of Section 1129(a), the Ninth Circuit noted that, for example, that Section 1129(a)(3) (the good-faith requirement) does not need to be interpreted as "per-debtor" because nothing in the plain text of the statute indicates that it applies in this manner.

In a separate concurrence, Judge Friedland agreed with the majority that the per-plan approach was preferable, but noted that "any unfairness" in the case "resulted not from the interpretation of § 1129 that Lender challenged in this appeal, but instead from the fact that this particular reorganization treated the five Debtor entities as if they had been substantively consolidated."[129] Judge Friedland agreed with the majority that the appellate court could not reach the issue because it had not been raised before the bankruptcy court. "Joint administration is," in Judge Friedland's opinion, "a tool of convenience," whereas substantive consolidation affects substantive rights.[130] In *Transwest*, she agreed with the Lender that though the debtor's "respective bankruptcy estates may technically have remained separate," they were treated under the plan "as a single entity."[131] Unfairness resulted, she contended, because the plan operated as a *de facto* substantive consolidation without any evaluation by the court of whether substantive consolidation was appropriate. Had the parties raised the issue, it "might have alleviated concerns about whether consolidation of the proceedings was in fact unfair."[132] Overall, Judge

[128] 881 F.3d at 729.

[129] *Id*. at 731.

[130] *Id*.

[131] *Id*.

[132] *Id*. at 732.

Friedland voiced "concerns that entangling various estates in a complex, multi-debtor reorganization diminishes the protections afforded to creditors by the Bankruptcy Code."[133]

II. *JPMorgan Chase Bank v. Charter Commc'ns* (*In re Charter Commc'ns*)[134]

a. Facts

On March 27, 2009, Charter Communications, Inc. and its affiliates (collectively, the "debtor") filed a Chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Southern District of New York. Before filing for bankruptcy, the debtor reached an agreement with its key bondholders and its controlling shareholder, Paul G. Allen, on the terms of a consensual, pre-arranged plan of reorganization that raised about $1.6 billion of capital and debt financing and eliminated about $8 billion in debt (the "Plan"). Support for the Plan was contingent on reinstating nearly $12 billion in bank and bond debt under senior credit agreements and indentures so that these financing agreements would stay in place under the same terms and conditions agreed to before the bankruptcy filing.

JPMorgan and the first lien lenders (collectively the "Lenders") argued that the Plan was nothing more than a scheme to allow a group of hedge funds to take control of the company. The Lenders argued that the plan did not satisfy the requirement of Section 1129(a)(10) because the impaired classes of claims were "artificially gerrymandered" solely for the purpose of obtaining the approval of an impaired class of creditors.

133 *Id*. at 733.

134 419 B.R. 221(Bankr. S.D.N.Y. 2009)

b. Holding & Analysis

In *dicta*, the bankruptcy court noted that Section 1129(a)(10) was satisfied with respect to multiple non-substantively consolidated debtors where the plan contained a single impaired accepting class.[135] The bankruptcy court confirmed the debtor's chapter 11 reorganization plan over the objection of the Lenders that argued that the classification of their claims separate from general unsecured claims was done to gerrymander an accepting, impaired class of claims to satisfy Section 1129(a)(10). The court noted that even if the noteholders were classified together with other unsecured creditors, the plan could still be confirmed because compliance with Section 1129(a)(10) is tested on a per-plan, not per-debtor, basis. In reaching this conclusion, the court relied on *In re Enron*[136] and *In re SGPA, Inc.,*[137] noting that the debtors operated on an integrated basis and emphasized that the plan was the result of negotiations during the height of the 2008 financial industry meltdown, and likely presented the only possibility of a successful exit from bankruptcy.[138] The court indicated that because the debtors had agreed to joint administration, only one impaired accepting class was necessary to satisfy the requirements of Section 1129(a)(10).

III. *In re Tribune*

a. Facts

On December 8, 2008, Tribune Company and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under chapter 11 of the United States Bankruptcy

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[135] 419 B.R. at 266.

[136] No. 01–16034, 2004 Bankr. LEXIS 2549 (Bankr. S.D.N.Y. July 15, 2004).

[137] No. 01–02609, 2001 WL 34750646 (Bankr. M.D. Pa. Sept. 28, 2001).

[138] 419 B.R. at 266.

Code. Two competing plans of reorganization were proposed for the Debtors: one proposed jointly by the Debtors, the Official Committee of Unsecured Creditors and certain senior lenders (the "DCL Plan"), and one proposed jointly by the holders of certain bonds that were issued prior to the 2007 leveraged buyout of Tribune (the "Noteholder Plan").

Each of the plans covered 110 separate Debtors and were not substantively consolidated. The plans were each put out to vote to the creditors and neither of the plans received approval of one impaired class for each of the debtors. The DCL Plan Proponents asserted that Section 1129(a)(10) requires acceptance by one impaired class for *each debtor* in a multi-debtor plan. The Noteholders disagreed with the DCL Plan Proponents' contention, but argued, in response, that the same objection must be raised with respect to the DCL Plan.

b. Holding & Analysis

The bankruptcy court concluded that the joint plan "actually consists of a separate plan for each Debtor," and each such plan must separately satisfy the confirmation requirements of section 1129(a).[139] First, the court noted the lack of "decisional authority" on the split of approaches, citing to *In re SGPA, Inc.,*[140], *In re Enron*[141], and *In re Charter Commc'ns*[142]. The

[139] 464 B.R. at 182.

[140] 2001 Bankr.LEXIS 2291 (Bankr. M.D. Pa. Sept. 28, 2001). In *In re SGPA*, the Court overruled the objection of complaining creditors and confirmed a joint plan, holding that it was unnecessary "to have an impaired class of creditors of each Debtor to vote to accept the Plan." *In re SGPA, Inc.,* 2001 Bankr.LEXIS 2291, at *19 (Bankr. M.D. Pa. Sept. 28, 2001). However, the Court found explicitly that the objecting creditors suffered no adverse effect and that the result would not have changed if the debtors had been substantively consolidated. *Id*.

[141] 2004 Bankr.LEXIS 2549 (Bankr. S.D.N.Y. July 15, 2004). In *In re Enron*, the court also considered the § 1129(a)(10) issue and decided that both the plain statutory meaning and "the substantive consolidation component of the global compromise" allowed confirmation of a 177-debtor joint plan when at least one class of impaired claims voted to accept the plan. *In re Enron,* 2004 Bankr.LEXIS 2549, at *234-35 (Bankr. S.D.N.Y. July 15, 2004) . The *Enron* Court relied, in part, on *SGPA*.

[142] 419 B.R. 221 (Bankr. S.D.N.Y. 2009). In *In re Charter Commc'ns,* the Court overruled an objection that certain classes of creditors were "artificially" impaired to meet the § 1129(a)(10) requirement. *In re Charter Commc'ns*, 419 B.R. 221, 226 (Bankr. S.D.N.Y. 2009). The Court observed that the debtors were managed "on

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court analyzed each case, but noted that "none of the three courts considered the § 1129(a)(10) issue central to its decision in the matter before it."[143]

Next, the court looked to the "plain meaning" of the text and relying on Section 102(7).[144] The court held that the fact that Section 1129(a)(10) refers to a singular plan rather than multiple plans "is not a basis, alone, upon which to conclude that, in a multiple debtor case, only one debtor—or any number fewer than all debtors—must satisfy this standard."[145] Thus, the term "plan" in Section 1129(a)(10) could be understood to refer to multiple plans in a jointly administered case where the debtors retained their separate entity status. The *Tribune* court further explained that Section 1129(a)(10) must be read in conjunction with the other requirements for plan confirmation under Section 1129(a). In particular, the court noted that because all debtors in a joint plan must satisfy other plan-confirmation requirements in Section 1129(a), such as good faith (Section 1129(a)(3)) and the best interests of creditors (Section 1129(a)(7)), there is no justifiable reason to excuse each of the joint debtors from obtaining an accepting class required by Section 1129(a)(10). Finally, the court noted that many large chapter 11 cases are jointly administered and have joint plans as a matter of convenience, but such convenience does not justify abrogating the rights of impaired creditors of any one jointly administered debtor by dispensing with the statutory requirement of at least one accepting, impaired class of creditors for confirmation under Section 1129(a)(10).

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an integrated basis making it reasonable and administratively convenient to propose a joint plan. That joint plan has been accepted by numerous other impaired accepting classes, thereby satisfying the requirement of section 1129(a)(10)." *Id.*

143 464 B.R. at 182.

144 *Id.*

145 *Id.*

IV. Afterthought

Although not binding, the *Transwest* concurrence may prove to have even more effect on future chapter 11 cases. The concurrence raised an important question – whether a per-plan approach is a form of substantive consolidation and whether courts should carefully consider issues of substantive consolidation to avoid any unfairness that results from application of the per-plan approach. While the issue of whether adopting the "per-plan" approach constitutes a form of substantive consolidation was not properly before the Ninth Circuit in *Transwest*, the warning from the concurrence is clear: creditors who believe a plan improperly combines the assets and liabilities of different estates would be well advised to object to confirmation on grounds of substantive consolidation, rather than just Section 1129(a)(10).

TOPIC 7: RIGHTS OF SIMILARLY SITUATED CREDITORS TO PARTICIPATE IN RIGHTS OFFERINGS

I. Rights Offerings and Backstops

Rights offerings have become an increasingly common method for debtors to raise capital to fund distributions to creditors and post-restructuring capital needs. In a typical chapter 11 rights offering, a group of creditors purchases post-emergence debt or equity securities from the chapter 11 debtor. In order to make the investment opportunity economically attractive and to compensate for any risks associated with the debtor's bankruptcy emergence, equity is often offered at a discount to plan value. Typically, a group of creditors (such as a class of bondholders or debtholders) will agree to backstop the rights offering in the event of undersubscription of the rights offering.

In a typical backstop arrangement, a subset of rights-offering participants agree (via a backstop agreement) to purchase all or a certain percentage of the offered securities in the event of undersubscription, in exchange for certain backstop consideration. Backstop consideration can take several different forms, including: (i) a backstop fee (typically either (a) a flat fee, (b) a percentage of the offered rights, or (c) a direct allocation of equity); (ii) the right to purchase a certain minimum amount of the offered securities; (iii) a break-up fee payable in the event that the rights offering does not close, or the debtor chooses to partner with a different group of backstop parties.

While rights offerings and backstops can be mutually beneficial arrangements, whereby existing creditors gain increased control over a reorganized debtor and pursue an investment opportunity, and a debtor obtains financing to fund its commitments under its bankruptcy plan and/or to ensure sufficient liquidity to operate post-emergence, they can draw the ire of creditors left out of the rights offering and/or backstop. Rights offerings and backstops can be susceptible to objections under Bankruptcy Code section 1123(a)(4) if the rights offering and/or backstop is provided to a subset of a class members based on account of their claims or interests.

II. *Objections* under Bankruptcy Code Section 1123(a)(4)

A common objection to rights-offerings and backstops is under section 1123(a)(4), which provides that creditors in the same class must be provided equal treatment on account of their claims. This type of objection usually arises when the ability to participate in a rights offering or private placement (or related backstop consideration) is afforded to some class members, but not to others. Section 1123(a)(4) objections are often overruled:

- *In re SunEdison, Inc.*, No. 16-10992 (SMB) Hr'g Tr. at 85:9-16 (Bankr. S.D.N.Y. July 25, 2017) ("The debtors are free to offer to anyone on a preferential basis, the opportunity to provide exit financing[.]") (citing *Peabody*);

- *In re Peabody Energy Corp.*, No. 16-42529, ECF No. 2763 (Bankr. E.D. Mo. Mar. 17, 2017) (confirming chapter 11 plan over objection of bondholders who were not participating in the rights offering); In re Peabody Energy Corp., 2017 WL 1177911, at *5 (E.D. Mo. Mar. 30, 2017), appeal pending, Case No. 18-1302 (8th Cir. 2018) (holding that the purchase of equity by existing creditors through a private placement agreement was on account of "rights or contributions, including their commitments (and ability) to provide financing" and was not "on account of" their existing creditor claims);

- *In re CHC Grp. Ltd.*, No. 16-31854 (BJH), ECF No. 1794 at 23-25 (Bankr. N.D. Tex. Mar. 3, 2017) (confirming chapter 11 plan and finding the premiums to be consideration paid in return for creditors' agreement to backstop a rights offering, and not treatment on account of their claims under the plan);

- *In re TCI 2 Holdings, LLC*, 428 B.R. 117, 133 (Bankr. D.N.J. 2010) ("The Backstop Fee . . . is not a distribution to the Second Lien Noteholders on account of their Second Lien Note claims. Rather, the Backstop Fee is offered as consideration for the $225 million commitment made by the Backstop Parties, which will be paid only if the $225 million is funded."); and

- *In re Aleris Int'l, Inc.*, Case No. 09-10478 (BLS), 2010 WL 3492664, at *14 (Bankr. D. Del. May 13, 2010) ("To the extent a Backstop Party receives additional or different consideration under the Plan, the Backstop Party receives such consideration in exchange for the commitments of the Backstop Party under the Equity Commitment Agreement or as part of the 9019 Settlement. Because the Plan provides the same treatment for each Claim or Interest in each class, the Plan satisfies section 1123(a)(4) of the Bankruptcy Code.").

Of course, whether the court will grant an objection under section 1123(a)(4) ultimately depends on the facts and circumstances. For example, a bankruptcy court in Delaware upheld a section 1123(a)(4) objection to a rights offering which had a minimum-claim-value threshold for participation.[146] There, the court ruled in favor of a claimant who was excluded from the offering based on the size of its claim, holding that the claimant should be afforded the opportunity to participate in the rights offering.[147]

III. Case Study: Pacific *Drilling S.A.*, *et al.* (Case No. 17-13193) (Bankr. S.D.N.Y.)

- Terms of the Rights Offering and Private Placement
  - Chapter 11 plan proposed $500 million combined rights offering and equity private placement as follows:[148]
    - a. $350 million Rights Offering of New Common Shares of Reorganized PDSA, which shares available for purchase by all holders of Allowed 2017 Notes Claims, Allowed 2020 Notes Claims, and Allowed Term Loan B Claims (collectively, the "Undersecured Claims");
    - b. $100 million private placement of New Common Shares in Reorganized PDSA, which shares shall be made available to members of the Ad Hoc Group and certain other holders of Undersecured Claims; and
    - c. $50 million private placement of New Common Shares in Reorganized PDSA, which shares shall be made available to Quantum Pacific (Gibraltar) Limited.
- Backstop
  - Ad hoc group acted as the backstop parties and agreed to purchase any New Common Shares that were not otherwise purchased pursuant to the rights offering.

[146] *In re Washington Mut. Inc.*, 442 B.R. 314, 360-61 (Bankr. D. Del. 2011).

[147] *Id.*

[148] *See Motion for Approval of Rights Offerings Procedures*, Case No. 17-13193 (MEW), Doc. No. 554, at 3 (Bankr. S.D.N.Y.).

- As consideration for agreeing to backstop, each ad hoc party "will receive its Pro Rata Portion of a number of New Shares equal to 8% of the New Shares offered pursuant to the Rights Offering and the Private Placements, subject to the terms and conditions set forth in the Commitment Agreement."[149]

- Ruling
  - Without an objection, the bankruptcy court, *sua sponte*, found that the private placement component of the capital raise with respect to the ad hoc group was a non-starter and took issue with the 8% backstop commitment premium, saying he would only approve the fee "on what's not already committed" as part of the debtors' $500 million equity issuance. In other words, the debtors would not be authorized to pay the 8% commitment premium in connection with the commitments made by the ad hoc group, Quantum Pacific, and the reserve parties.
  - The court further observed that to resolve the "equal treatment problem" that would be "deadly" to the debtors' plan, the $100 million private placement must be opened "to anyone who is presently excluded but wants to become a reserve party."
  - In response to the court's concerns (essentially, rulings), the debtors submitted a revised proposal (i) that eliminated the private placement contemplated by the ad hoc group, (ii) revised the 8% backstop premium to only apply to the portion of the equity rights offerings that had not yet been committed, and (iii) 5% fee for the backstop parties for the remainder of the $500 million equity raise.[150]

- Takeaways
  - *Pacific Drilling* teaches that, where a right to participate in a rights offering is offered (or perceived by the court to be offered) as treatment of a creditor's claim, the opportunity to participate in the rights offering should be afforded to all creditors in the relevant class or the plan should provide the flexibility to afford economically equivalent treatment to all creditors in a class. Moreover, backstop parties should assume real obligations in exchange for backstop fees, break-up fees, and minimum participation rights.

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[149] *Motion to Approve Rights Offering*, Case No. 17-13193 (MEW), Doc. No. 554.

[150] *Supplement Brief in Support of Revised Rights Offering*, Case No. 17-13193 (MEW), Doc. No. 607, at 5 (Bankr. SDNY).