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What's Wrong with Chapter 11?

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CONCURRENT SESSION

2017

11 U.S. Code § 365 - Executory contracts and unexpired leases

§ 365 Executory contracts and unexpired leases

(a)

Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)

(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

(A)

cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;

(B)

compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C)

provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

(A)

the insolvency or financial condition of the debtor at any time before the closing of the case;

(B)

the commencement of a case under this title;

(C)

the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or

(D)

the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

(3) For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

(A)

of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;

(B)

that any percentage rent due under such lease will not decline substantially;

(C)

that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D)
that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

(4)
Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)
(A)
applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B)
such party does not consent to such assumption or assignment; or

(2)
such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor; or

(3)
such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief.

(d)
(1)
In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2)
In a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(3)
The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

(4)
(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i)
the date that is 120 days after the date of the order for relief; or
(ii)
the date of the entry of an order confirming a plan.
(B)
(i)
The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.
(ii)
If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.
(5)
The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2), first arising from or after 60 days after the order for relief in a case under chapter 11 of this title under an unexpired lease of personal property (other than personal property leased to an individual primarily for personal, family, or household purposes), until such lease is assumed or rejected notwithstanding section 503(b)(1) of this title, unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f). Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.
(e)
(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—
(A)
the insolvency or financial condition of the debtor at any time before the closing of the case;
(B)
the commencement of a case under this title; or
(C)
the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.
(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—
(A)
(i)
applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and
(ii)
such party does not consent to such assumption or assignment; or
(B)
such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.
(f)
(1)
Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.
(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—
(A)

the trustee assumes such contract or lease in accordance with the provisions of this section; and
(B)
adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.
(3)
Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.
(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
(1)
if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or
(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title—
(A)
if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title, at the time of such rejection; or
(B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title—
(i)
immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or
(ii)
at the time of such rejection, if such contract or lease was assumed after such conversion.
(h)
(1)
(A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and—
(i)
if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or
(ii)
if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.
(B)
If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.
(C)
The rejection of a lease of real property in a shopping center with respect to which the lessee elects to retain its rights under subparagraph (A)(ii) does not affect the enforceability under applicable nonbankruptcy law of any provision in the lease pertaining to radius, location, use, exclusivity, or tenant mix or balance.
(D)
In this paragraph, "lessee" includes any successor, assign, or mortgagee permitted under the terms of such lease.
(2)

(A) If the trustee rejects a timeshare interest under a timeshare plan under which the debtor is the timeshare interest seller and—
(i)
if the rejection amounts to such a breach as would entitle the timeshare interest purchaser to treat the timeshare plan as terminated under its terms, applicable nonbankruptcy law, or any agreement made by timeshare interest purchaser, the timeshare interest purchaser under the timeshare plan may treat the timeshare plan as terminated by such rejection; or
(ii)
if the term of such timeshare interest has commenced, then the timeshare interest purchaser may retain its rights in such timeshare interest for the balance of such term and for any term of renewal or extension of such timeshare interest to the extent that such rights are enforceable under applicable nonbankruptcy law.
(B)
If the timeshare interest purchaser retains its rights under subparagraph (A), such timeshare interest purchaser may offset against the moneys due for such timeshare interest for the balance of the term after the date of the rejection of such timeshare interest, and the term of any renewal or extension of such timeshare interest, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such timeshare plan, but the timeshare interest purchaser shall not have any right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.
(i)
(1)
If the trustee rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under a timeshare plan, under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property or timeshare interest.
(2) If such purchaser remains in possession—
(A)
such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and
(B)
the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.
(j)
A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that such purchaser or party has paid.
(k)
Assignment by the trustee to an entity of a contract or lease assumed under this section relieves the trustee and the estate from any liability for any breach of such contract or lease occurring after such assignment.
(l)
If an unexpired lease under which the debtor is the lessee is assigned pursuant to this section, the lessor of the property may require a deposit or other security for the performance of the debtor's obligations under the lease substantially the same as would have been required by the landlord upon the initial leasing to a similar tenant.
(m)
For purposes of this section 365 and sections 541(b)(2) and 362(b)(10), leases of real property shall include any rental agreement to use real property.
(n)
(1) If the trustee rejects an executory contract under which the debtor is a licensor of a right to intellectual property, the licensee under such contract may elect—

(A)
to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or
(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for—
(i)
the duration of such contract; and
(ii)
any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.
(2) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, under such contract—
(A)
the trustee shall allow the licensee to exercise such rights;
(B)
the licensee shall make all royalty payments due under such contract for the duration of such contract and for any period described in paragraph (1)(B) of this subsection for which the licensee extends such contract; and
(C) the licensee shall be deemed to waive—
(i)
any right of setoff it may have with respect to such contract under this title or applicable nonbankruptcy law; and
(ii)
any claim allowable under section 503(b) of this title arising from the performance of such contract.
(3) If the licensee elects to retain its rights, as described in paragraph (1)(B) of this subsection, then on the written request of the licensee the trustee shall—
(A)
to the extent provided in such contract, or any agreement supplementary to such contract, provide to the licensee any intellectual property (including such embodiment) held by the trustee; and
(B)
not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment) including any right to obtain such intellectual property (or such embodiment) from another entity.
(4) Unless and until the trustee rejects such contract, on the written request of the licensee the trustee shall—
(A) to the extent provided in such contract or any agreement supplementary to such contract—
(i)
perform such contract; or
(ii)
provide to the licensee such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law) held by the trustee; and
(B)
not interfere with the rights of the licensee as provided in such contract, or any agreement supplementary to such contract, to such intellectual property (including such embodiment), including any right to obtain such intellectual property (or such embodiment) from another entity.
(o)
In a case under chapter 11 of this title, the trustee shall be deemed to have assumed (consistent with the debtor's other obligations under section 507), and shall immediately cure any deficit under, any commitment by the debtor to a Federal depository institutions regulatory agency (or predecessor to such agency) to maintain the capital of an insured depository institution, and any claim for a subsequent breach of the obligations thereunder shall be entitled to priority under section 507. This subsection shall not extend any commitment that would otherwise be terminated by any act of such an agency.

(p)
(1)
If a lease of personal property is rejected or not timely assumed by the trustee under subsection (d), the leased property is no longer property of the estate and the stay under section 362(a) is automatically terminated.
(2)
(A)
If the debtor in a case under chapter 7 is an individual, the debtor may notify the creditor in writing that the debtor desires to assume the lease. Upon being so notified, the creditor may, at its option, notify the debtor that it is willing to have the lease assumed by the debtor and may condition such assumption on cure of any outstanding default on terms set by the contract.
(B)
If, not later than 30 days after notice is provided under subparagraph (A), the debtor notifies the lessor in writing that the lease is assumed, the liability under the lease will be assumed by the debtor and not by the estate.
(C)
The stay under section 362 and the injunction under section 524(a)(2) shall not be violated by notification of the debtor and negotiation of cure under this subsection.
(3)
In a case under chapter 11 in which the debtor is an individual and in a case under chapter 13, if the debtor is the lessee with respect to personal property and the lease is not assumed in the plan confirmed by the court, the lease is deemed rejected as of the conclusion of the hearing on confirmation. If the lease is rejected, the stay under section 362 and any stay under section 1301 is automatically terminated with respect to the property subject to the lease.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2574; Pub. L. 98–353, title III, §§ 362, 402–404, July 10, 1984, 98 Stat. 361, 367; Pub. L. 99–554, title II, §§ 257(j), (m), 283(e), Oct. 27, 1986, 100 Stat. 3115, 3117; Pub. L. 100–506, § 1(b), Oct. 18, 1988, 102 Stat. 2538; Pub. L. 101–647, title XXV, § 2522(c), Nov. 29, 1990, 104 Stat. 4866; Pub. L. 102–365, § 19(b)–(e), Sept. 3, 1992, 106 Stat. 982–984; Pub. L. 103–394, title II, §§ 205(a), 219(a), (b), title V, § 501(d)(10), Oct. 22, 1994, 108 Stat. 4122, 4128, 4145; Pub. L. 103–429, § 1, Oct. 31, 1994, 108 Stat. 4377; Pub. L. 109–8, title III, §§ 309(b), 328(a), title IV, § 404, Apr. 20, 2005, 119 Stat. 82, 100, 104.)

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

CZYZEWSKI ET AL. *v.* JEVIC HOLDING CORP. ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 15–649. Argued December 7, 2016—Decided March 22, 2017

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

Respondent Jevic Transportation filed for Chapter 11 bankruptcy after being purchased in a leveraged buyout. The bankruptcy prompted two lawsuits. In the first, a group of former Jevic truck-drivers, petitioners here, was awarded a judgment against Jevic for Jevic's failure to provide proper notice of termination in violation of state and federal Worker Adjustment and Retraining Notification (WARN) Acts. Part of that judgment counted as a priority wage claim under §507(a)(4), entitling the workers to payment ahead of general unsecured claims against the Jevic estate. In the second suit, a court-authorized committee representing Jevic's unsecured creditors sued Sun Capital and CIT Group, respondents here, for fraudulent conveyance in connection with the leveraged buyout of Jevic. These parties negotiated a settlement agreement that called for a structured dismissal of Jevic's Chapter 11 bankruptcy. Under the proposed structured dismissal, petitioners would receive nothing on their WARN claims, but lower-priority general unsecured creditors would be paid. Petitioners argued that the distribution scheme accordingly violated the Code's priority rules by paying general unsecured claims ahead of their own. The Bankruptcy Court nevertheless approved the settlement agreement and dismissed the case, reasoning that because the proposed payouts would occur pursuant to a structured dismissal rather than an approved plan, the failure to follow ordinary priority rules did not bar approval. The District Court and the Third Circuit affirmed.

Held:

1. Petitioners have Article III standing. Respondents argue that petitioners have not "suffered an injury in fact," or at least one "likely to be redressed by a favorable judicial decision," *Spokeo, Inc.* v. *Robins*, 578 U. S. ___, ___, because petitioners would have gotten nothing even if the Bankruptcy Court had never approved the structured dismissal and will still get nothing if the structured dismissal is undone now. That argument rests upon the assumptions that (1) without a violation of ordinary priority rules, there will be no settlement, and (2) without a settlement, the fraudulent-conveyance lawsuit has no value. The record, however, indicates both that a settlement that respects ordinary priorities remains a reasonable possibility and that the fraudulent-conveyance claim could have litigation value. Therefore, as a consequence of the Bankruptcy Court's approval of the structured dismissal, petitioners lost a chance to obtain a settlement that respected their priorities or, if not that, the power to assert the fraudulent-conveyance claim themselves. A decision in their favor is likely to redress that loss. Pp. 9–11.

2. Bankruptcy courts may not approve structured dismissals that provide for distributions that do not follow ordinary priority rules without the consent of affected creditors. Pp. 11–18.

(a) Given the importance of the priority system, this Court looks for an affirmative indication of intent before concluding that Congress means to make a major departure. See *Whitman* v. *American Trucking Assns., Inc.*, 531 U. S. 457, 468. Nothing in the statute evinces such intent. Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. Read in context, §349(b), which permits a bankruptcy judge, "for cause, [to] orde[r] otherwise," seems designed to give courts the flexibility to protect reliance interests acquired in the bankruptcy, not to make general end-of-case distributions that would be flatly impermissible in a Chapter 11 plan or Chapter 7 liquidation. Precedent does not support a contrary position. *E.g., In re Iridium Operating LLC,* 478 F. 3d 452 (CA2), distinguished. Cases in which courts have approved deviations from ordinary priority rules generally involve interim distributions serving significant Code-related objectives. That is not the case here, where, *e.g.*, the priority-violating distribution is attached to a final disposition, does not preserve the debtor as a going concern, does not make the disfavored creditors better off, does not promote the possibility of a confirmable plan, does not help to restore the *status quo ante*, and does not protect reliance interests. Pp. 11–16.

(b) Congress did not authorize a "rare case" exception that permits courts to disregard priority in structured dismissals for "sufficient reasons." The fact that it is difficult to give precise content to the concept of "sufficient reasons" threatens to turn the court below's exception into a more general rule, resulting in uncertainty that has potentially serious consequences—*e.g.*, departure from the protections granted particular classes of creditors, changes in the bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals, risks of collusion, and increased difficulty in achieving settlements. Courts cannot deviate from the strictures of the Code, even in "rare cases." Pp. 16–18.

787 F. 3d 173, reversed and remanded.

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

SUPREME COURT OF THE UNITED STATES

No. 15–649

CASIMIR CZYZEWSKI, ET AL., PETITIONERS *v.* JEVIC HOLDING CORP., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[March 22, 2017]

JUSTICE BREYER delivered the opinion of the Court.

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

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

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

I

A

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

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

It is important to keep in mind that Chapter 11 foresees three possible outcomes. The first is a bankruptcy-court-confirmed plan. Such a plan may keep the business operating but, at the same time, help creditors by providing for payments, perhaps over time. See §§1123, 1129, 1141. The second possible outcome is conversion of the case to a Chapter 7 proceeding for liquidation of the business and a distribution of its remaining assets. §§1112(a), (b), 726. That conversion in effect confesses an inability to find a plan. The third possible outcome is dismissal of the Chapter 11 case. §1112(b). A dismissal typically "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"—in other words, it aims to return to the prepetition financial status quo. §349(b)(3).

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

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

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

2

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

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

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

B

In 2006, Sun Capital Partners, a private equity firm, acquired Jevic Transportation Corporation with money borrowed from CIT Group in a "leveraged buyout." In a leveraged buyout, the buyer (B) typically borrows from a third party (T) a large share of the funds needed to purchase a company (C). B then pays the money to C's shareholders. Having bought the stock, B owns C. B then pledges C's assets to T so that T will have security for its loan. Thus, if the selling price for C is $50 million, B might use $10 million of its own money, borrow $40 million from T, pay $50 million to C's shareholders, and then pledge C assets worth $40 million (or more) to T as security for T's $40 million loan. If B manages C well, it might make enough money to pay T back the $40 million and earn a handsome profit on its own $10 million investment. But, if the deal sours and C descends into bankruptcy, beware of what might happen: Instead of C's $40 million in assets being distributed to its existing creditors, the money will go to T to pay back T's loan—the loan that allowed B to buy C. (T will receive what remains of C's assets because T is now a secured creditor, putting it at the top of the priority list). Since C's shareholders receive money while C's creditors lose their claim to C's remaining assets, unsuccessful leveraged buyouts often lead to fraudulent conveyance suits alleging that the purchaser (B) transferred the company's assets without receiving fair value in return. See Lipson & Vandermeuse, *Stern,* Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts, 2013 Wis. L. Rev. 1161, 1220–1221.

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

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

Petitioners' WARN suit against Sun continued throughout most of the litigation now before us. But eventually Sun prevailed on the ground that Sun was not the workers' employer at the relevant times. See *In re Jevic Holding Corp.*, 656 Fed. Appx. 617 (CA3 2016).

Second, the Bankruptcy Court authorized a committee representing Jevic's unsecured creditors to sue Sun and CIT. The Bankruptcy Court and the parties were aware that any proceeds from such a suit would belong not to the unsecured creditors, but to the bankruptcy estate. See §§541(a)(1), (6); *Official Comm. of Unsecured Creditors of Cybergenics Corp.* v. *Chinery*, 330 F. 3d 548, 552–553 (CA3 2003) (en banc) (holding that a creditor's committee can bring a derivative action on behalf of the estate). The committee alleged that Sun and CIT, in the course of their leveraged buyout, had "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." *In re Jevic Holding Corp.*, 787 F. 3d 173, 176 (CA3 2015). In 2011, the Bankruptcy Court held that the committee had adequately pleaded claims of preferential transfer under §547 and of fraudulent transfer under §548. *In re Jevic Holding Corp.*, 2011 WL 4345204 (Bkrtcy. Ct. Del., Sept. 15, 2011).

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

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

Apparently Sun insisted on a distribution that would skip petitioners because petitioners' WARN suit against Sun was still pending and Sun did not want to help finance that litigation. See 787 F. 3d, at 177–178, n. 4 (Sun's counsel acknowledging before the Bankruptcy Court that "'Sun probably does care where the money goes because you can take judicial notice that there's a pending

WARN action against Sun by the WARN plaintiffs. And if the money goes to the WARN plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis'"). The essential point is that, regardless of the reason, the proposed settlement called for a structured dismissal that provided for distributions that did not follow ordinary priority rules.

Sun, CIT, Jevic, and the committee asked the Bankruptcy Court to approve the settlement and dismiss the case. Petitioners and the U. S. Trustee objected, arguing that the settlement's distribution plan violated the Code's priority scheme because it skipped petitioners—who, by virtue of their WARN judgment, had mid-level priority claims against estate assets—and distributed estate money to low-priority general unsecured creditors.

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

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

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

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

II

Respondents initially argue that petitioners lack standing because they have suffered no injury, or at least no injury that will be remedied by a decision in their favor. See *Spokeo, Inc.* v. *Robins*, 578 U. S. ___, ___ (2016) (slip op., at 6) (explaining that, for Article III standing, a plaintiff must have "(1) suffered an injury in fact, (2) that is fairly traceable to the challenged conduct of the defendant, and (3) that is likely to be redressed by a favorable judicial decision"). Respondents concede that the structured dismissal approved by the Bankruptcy Court contained distribution conditions that skipped over petitioners, ensuring that petitioners received nothing on their multimillion-dollar WARN claim against the Jevic estate. But respondents still assert that petitioners suffered no loss.

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

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

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

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

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

III

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

The Code's priority system constitutes a basic underpinning of business bankruptcy law. Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. In

Chapter 7 liquidations, priority is an absolute command—lower priority creditors cannot receive anything until higher priority creditors have been paid in full. See 11 U. S. C. §§725, 726. Chapter 11 plans provide somewhat more flexibility, but a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors. See §1129(b).

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

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

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

Insofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the prepetition financial status quo. See §349(b)(1) (dismissal ordinarily reinstates a variety of avoided transfers and voided liens); §349(b)(2) (dismissal ordinarily vacates certain types of bankruptcy orders); §349(b)(3) (dismissal ordinarily "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"); see also H. R. Rep. No. 95–595, p. 338 (1977) (dismissal's "basic purpose . . . is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case").

Section 349(b), we concede, also says that a bankruptcy judge may, "for cause, orde[r] otherwise." But, read in context, this provision appears designed to give courts the flexibility to "make the appropriate orders to protect rights acquired in reliance on the bankruptcy case." H. R. Rep. No. 95–595, at 338; cf., *e.g., Wiese* v. *Community Bank of Central Wis.*, 552 F. 3d 584, 590 (CA7 2009) (upholding, under §349(b), a Bankruptcy Court's decision not to reinstate a debtor's claim against a bank that gave up a lien in reliance on the claim being released in the debtor's reorganization plan). Nothing else in the Code authorizes a court ordering a dismissal to make general end-of-case distributions of estate assets to creditors of the kind that normally take place in a Chapter 7 liquidation or Chapter

11 plan—let alone final distributions that do not help to restore the *status quo ante* or protect reliance interests acquired in the bankruptcy, and that would be flatly impermissible in a Chapter 7 liquidation or a Chapter 11 plan because they violate priority without the impaired creditors' consent. That being so, the word "cause" is too weak a reed upon which to rest so weighty a power. See *United Sav. Assn. of Tex.* v. *Timbers of Inwood Forest Associates, Ltd.*, 484 U. S. 365, 371 (1988) (noting that "[s]tatutory construction . . . is a holistic endeavor" and that a court should select a "meanin[g that] produces a substantive effect that is compatible with the rest of the law"); *Kelly* v. *Robinson*, 479 U. S. 36, 43 (1986) (in interpreting a statute, a court "must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy" (internal quotation marks omitted)); cf. *In re Sadler*, 935 F. 2d 918, 921 (CA7 1991) ("'Cause' under §349(b) means an acceptable reason. Desire to make an end run around a statute is not an adequate reason").

We have found no contrary precedent, either from this Court, or, for that matter, from lower court decisions reflecting common bankruptcy practice. The Third Circuit referred briefly to *In re Buffet Partners, L. P.*, 2014 WL 3735804 (Bkrtcy. Ct. ND Tex., July 28, 2014). The court in that case approved a structured dismissal. (We express no view about the legality of structured dismissals in general.) But at the same time it pointed out "that not one party with an economic stake in the case has objected to the dismissal in this manner." *Id.*, at *4.

The Third Circuit also relied upon *In re Iridium Operating LLC*, 478 F. 3d 452 (CA2 2007). But *Iridium* did not involve a structured dismissal. It addressed an *interim* distribution of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf. See *id.*, at 459–460. The *Iridium* court observed that, when evaluating this type of preplan settlement, "[i]t is difficult to employ the rule of priorities" because "the nature and extent of the Estate and the claims against it are *not yet fully resolved*." *Id*., at 464 (emphasis added). The decision does not state or suggest that the Code authorizes nonconsensual departures from ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues.

We recognize that *Iridium* is not the only case in which a court has approved interim distributions that violate ordinary priority rules. But in such instances one can generally find significant Code-related objectives that the priority-violating distributions serve. Courts, for example, have approved "first-day" wage orders that allow payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' prepetition invoices, and "roll-ups" that allow lenders who continue financing the debtor to be paid first on their prepetition claims. See *Cybergenics*, 330 F. 3d, at 574, n. 8; D. Baird, Elements of Bankruptcy 232–234 (6th ed. 2014); Roe, 99 Va. L. Rev., at 1250–1264. In doing so, these courts have usually found that the distributions at issue would "enable a successful reorganization and make even the disfavored creditors better off." *In re Kmart Corp*., 359 F. 3d 866, 872 (CA7 2004) (discussing the justifications for critical-vendor orders); see also *Toibb* v. *Radloff*, 501 U. S. 157, 163–164 (1991) (recognizing "permitting business debtors to reorganize and restructure their debts in order to revive the debtors' businesses" and "maximizing the value of the bankruptcy estate" as purposes of the Code). By way of contrast, in a structured dismissal like the one ordered below, the priority-violating distribution is attached to a final disposition; it does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not help to restore the *status quo ante*; and it does not protect reliance interests. In short, we cannot find in the violation of ordinary priority rules that occurred here any significant offsetting bankruptcy-related justification.

Rather, the distributions at issue here more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards. See, *e.g., In re Braniff Airways, Inc.*, 700 F. 2d 935, 940 (CA5 1983) (prohibiting an attempt to "short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets"); *In re Lionel Corp.*, 722 F. 2d 1063, 1069 (CA2 1983) (reversing a Bankruptcy Court's approval of an asset sale after holding that §363 does not "gran[t] the bankruptcy judge *carte blanche*" or "swallo[w] up Chapter 11's safeguards"); *In re Biolitec, Inc.*, 528 B. R. 261, 269 (Bkrtcy. Ct. NJ 2014) (rejecting a structured dismissal because it "seeks to alter parties' rights without their consent and lacks many of the Code's most important safeguards"); cf. *In re Chrysler LLC*, 576 F. 3d 108, 118 (CA2 2009) (approving a §363 asset sale because the bankruptcy court demonstrated "proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority"), vacated as moot, 592 F. 3d 370 (CA2 2010) (*per curiam*).

IV

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

For one thing, it is difficult to give precise content to the concept "sufficient reasons." That fact threatens to turn a "rare case" exception into a more general rule. Consider the present case. The Bankruptcy Court feared that (1) without the worker-skipping distribution, there would be no settlement, (2) without a settlement, all the unsecured creditors would receive nothing, and consequently (3) its distributions would make some creditors (high- and low-priority creditors) better off without making other (mid-priority) creditors worse off (for they would receive nothing regardless). But, as we have pointed out, the record provides equivocal support for the first two propositions. See *supra*, at 9–11. And, one can readily imagine other cases that turn on comparably dubious predictions. The result is uncertainty. And uncertainty will lead to similar claims being made in many, not just a few, cases. See Rudzik, A Priority Is a Priority Is a Priority—Except When It Isn't, 34 Am. Bankr. Inst. J. 16, 79 (2015) ("[O]nce the floodgates are opened, debtors and favored creditors can be expected to make every case that 'rare case'").

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

For these reasons, as well as those set forth in Part III, we conclude that Congress did not authorize a "rare case" exception. We cannot "alter the balance struck by the statute," *Law* v. *Siegel*, 571 U. S. ___, ___ (2014) (slip op., at 11), not even in "rare cases." Cf. *Norwest Bank Worthington* v. *Ahlers*, 485 U. S. 197, 207 (1988) (explaining that courts cannot deviate from the procedures "specified by the Code," even when they sincerely "believ[e] that . . . creditors would be better off"). The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 15–649

CASIMIR CZYZEWSKI, ET AL., PETITIONERS *v.* JEVIC HOLDING CORP., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[March 22, 2017]

JUSTICE THOMAS, with whom JUSTICE ALITO joins, dissenting.

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

We granted certiorari to decide "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." Pet. for Cert. i. According to petitioners, the decision below "deepened an existing . . . split" among the Courts of Appeals on this question. *Id.*, at 8; see *id.*, at 15–16 (citing *In re AWECO, Inc.*, 725 F. 2d 293, 298 (CA5 1984), and *In re Iridium Operating LLC*, 478 F. 3d 452, 464 (CA2 2007)). After we granted certiorari, however, petitioners recast the question presented to ask "[w]hether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." Brief for Petitioners i. Although both questions involve priority-skipping distributions of estate assets, the recast question is narrower—and different—than the one on which we granted certiorari. It is also not the subject of a circuit conflict.

I think it is unwise for the Court to decide the reformulated question today, for two reasons. First, it is a "novel question of bankruptcy law" arising in the rapidly developing field of structured dismissals. *In re Jevic Holding Corp.*, 787 F. 3d 173, 175 (CA3 2015). Experience shows that we would greatly benefit from the views of additional courts of appeals on this question. We also would have benefited from full, adversarial briefing. In reliance on this Court's Rules prohibiting parties from changing the substance of the question presented, see Rule 24.1(a); see also Rule 14.1(a), respondents declined to brief the question that the majority now decides, see Brief for Respondents 52. Second, deciding this question may invite future petitioners to seek review of a circuit conflict only then to change the question to one that seems more favorable. "I would not reward such bait-and-switch tactics." *City and County of San Francisco* v. *Sheehan*, 575 U. S. ___, ___ 2015) (Scalia, J., concurring in part and dissenting in part) (slip op., at 3); see also *Visa, Inc.* v. *Osborn, post, p.* ___.

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

Rule 3017-2 Combined Hearings on Approval of Disclosure Statements and Confirmation of Plans in Liquidating Chapter 11 Cases.

(a) Applicability. This Local Rule shall be applicable to all cases arising under chapter 11 of the Code where the following requirements are met:

(i) All or substantially all of the assets of the debtor[s] were or will be liquidated pursuant to a sale under 11 U.S.C. § 363; and

(ii) The plan of liquidation proposes to comply with section 1129(a)(9) of the Code; and

(iii) The plan of liquidation does not seek non-consensual releases/injunctions with respect to claims creditors may hold against non-debtor parties; and

(iv) The debtor's combined assets to be distributed pursuant to the proposed plan of liquidation are estimated, in good faith, to be worth less than $25 million (excluding causes of action).

(b) Combined Disclosure Statement and Plan of Liquidation. A plan proponent may combine the disclosure statement and plan of liquidation into one document.

(c) Interim Approval of the Disclosure Statement; Approval of Solicitation Procedures and Scheduling Combined Hearing on Approval of the Adequacy of Disclosure Statement and Confirmation of Plan. In the event that the requirements of subsection (a) above are satisfied, upon the filing of a disclosure statement and proposed plan of liquidation, a plan proponent may file a motion requesting (1) interim approval of the disclosure statement; (2) approving solicitation procedures; and (3) the scheduling of a joint hearing to consider final approval of the adequacy of the disclosure statement and confirmation of the proposed plan of liquidation. Such motion may be granted without notice and a hearing if:

(i) Notice. The motion provides at least fourteen (14) days' notice to the United States Trustee and the creditors' committee (or the twenty (20) largest unsecured creditors, if no creditors' committee is formed), and all parties who have requested service of notices under Fed. R. Bankr. 2002(d). If an objection is timely filed within such notice period, a hearing on the motion will not occur less than seven (7) days after expiration of the notice period; and

(ii) Provisions to be Highlighted. All motions under this rule requesting a joint disclosure statement and confirmation hearing must: (A) recite whether the proposed form of order and/or plan of liquidation contains any provision of the type indicated below and (B) identify the location of any such provision in the proposed form of order and/or plan of liquidation:

(A) Provisions which seek consensual releases/injunctions with respect to claims creditors may hold against non-debtor parties; and

(B) Provisions that seek to release any claims the debtor[s] may have against non-debtor parties who are insiders of a debtor; and

(C) Any provision which seeks an exemption under section 1146 of the Code; and

(iii) The motion identifies the proposed balloting agent, which may include counsel to the plan-proponent; and

(iv) The motion identifies any voting procedures in addition to those required in section (d) of this Local Rule; and

(v) The requested hearing date will not occur earlier than forty-five(45) days after entry of an order scheduling the combined hearing to consider the final approval of the adequacy of the disclosure statement and confirmation of the plan of liquidation; and

(vi) The motion is accompanied by a proposed order which, in addition to setting the hearing date, approves: (A) on an interim basis, the disclosure statement; (B) the voting procedures to be utilized; (C) the form of notice to be provided to creditors and interest holders of the debtor[s]; and (D) the form of ballot which will be provided to creditors and interest holders entitled to vote on the proposed plan of liquidation. The proposed order shall further provide that objections not made to the types of relief requested under (B), (C) or (D) of this subparagraph (vi) at the time of the hearing on the motion shall not be considered at the time of the combined hearing on the disclosure statement and plan.

(d) Solicitation and Voting Procedures. The proposed order shall contain, inter alia, the following provisions:

(i) Establishment of a record date pursuant to Fed. R. Bankr. P. 3017(d) and 3018(a); and

(ii) Establishment of a voting deadline not more than ten (10) days prior to the combined hearing.

(e) Form of Ballots. If a proposed plan of liquidation seeks consensual releases/injunctions with respect to claims creditors may hold against non-debtor parties, then the ballot must inform the creditors of such releases/injunctions and disclose the manner in which to indicate assent or opposition to such consensual releases/injunctions.

(f) Combined Confirmation Hearing. The order approving the voting procedures shall provide for a combined hearing on the final approval of the disclosure statement and confirmation of the plan not less than forty-five (45) days from the entry of the order approving the voting procedures and the objection deadline shall be at least thirty-eight (38) days from such date.

Docket #0493 Date Filed: 08/15/2016

IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re:	§	Chapter 11
MIDSTATES PETROLEUM COMPANY, INC., *et al.*,[1]	§	Case No. 16-32237 (DRJ)
Debtors.	§	(Jointly Administered)

EMERGENCY MOTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS FOR LEAVE, STANDING AND AUTHORITY TO PROSECUTE CLAIMS ON BEHALF OF THE DEBTORS' ESTATES AND FOR RELATED RELIEF

THIS MOTION SEEKS AN ORDER THAT MAY ADVERSELY AFFECT YOU. IF YOU OPPOSE THE MOTION, YOU SHOULD IMMEDIATELY CONTACT THE MOVING PARTY TO RESOLVE THE DISPUTE. IF YOU AND THE MOVING PARTY CANNOT AGREE, YOU MUST FILE A RESPONSE AND SEND A COPY TO THE MOVING PARTY. YOU MUST FILE AND SERVE YOUR RESPONSE WITHIN 21 DAYS OF THE DATE THIS WAS SERVED ON YOU. YOUR RESPONSE MUST STATE WHY THE MOTION SHOULD NOT BE GRANTED. IF YOU DO NOT FILE A TIMELY RESPONSE, THE RELIEF MAY BE GRANTED WITHOUT FURTHER NOTICE TO YOU. IF YOU OPPOSE THE MOTION AND HAVE NOT REACHED AN AGREEMENT, YOU MUST ATTEND THE HEARING. UNLESS THE PARTIES AGREE OTHERWISE, THE COURT MAY CONSIDER EVIDENCE AT THE HEARING AND MAY DECIDE THE MOTION AT THE HEARING.

EMERGENCY RELIEF HAS BEEN REQUESTED. IF THE COURT CONSIDERS THE MOTION ON AN EMERGENCY BASIS, THEN YOU WILL HAVE LESS THAN 21 DAYS TO ANSWER. IF YOU OBJECT TO THE REQUESTED RELIEF OR IF YOU BELIEVE THAT THE EMERGENCY CONSIDERATION IS NOT WARRANTED, YOU SHOULD FILE AN IMMEDIATE RESPONSE.

EMERGENCY RELIEF IS NEEDED BY AUGUST 17, 2016 OR AS SOON THEREAFTER AS THE COURT'S SCHEDULE PERMITS IN ORDER TO RESOLVE THIS MOTION IN TIME FOR THE COMMITTEE TO REQUEST A CONTINUANCE OF THE CONFIRMATION HEARING CURRENTLY SCHEDULED FOR AUGUST 29, 2016, WHICH THE COMMITTEE INTENDS TO REQUEST BY SEPARATE MOTION ASSUMING THIS MOTION IS GRANTED.

REPRESENTED PARTIES SHOULD ACT THROUGH THEIR ATTORNEY.

[1] The debtors in these chapter 11 cases, along with the last four digits of each debtor's federal tax identification number, are: Midstates Petroleum Company, Inc. (1816) and Midstates Petroleum Company LLC (2434). The debtors' service address is: 321 South Boston Avenue, Suite 1000, Tulsa, Oklahoma 74103.

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By and through its counsel, the Official Committee of Unsecured Creditors (the "Committee") appointed in the chapter 11 cases (the "Cases") of the above-captioned debtors and debtors-in-possession (collectively, the "Debtors"), hereby files this *Emergency Motion of the Official Committee of Unsecured Creditors for Leave, Standing and Authority to Prosecute Claims on Behalf of the Debtors' Estates and for Related Relief* (the "Motion") for entry of an order authorizing the Committee to pursue and, if appropriate, settle certain Claims (defined below) against all appropriate parties, including the defendants (the "Defendants") named in the attached draft proposed complaint (the "Complaint"), and other potential parties, on behalf and for the benefit of the Debtors' estates. In support of this emergency Motion, the Committee respectfully represents and sets forth as follows:

PRELIMINARY STATEMENT[2]

These Cases and the Debtors' proposed Plan (as defined below) represent the culmination of an unlawful scheme to defraud the Debtors' general unsecured creditors based on a **patently false claim** and "agreement" that 98.8% of the value of the Debtors' oil and gas assets is subject to perfected, valid and enforceable liens held by the Prepetition Secured Parties and merely 1.2% of the value of the Debtors' assets is unencumbered. The Plan Support Parties[3] knew or should have known that the so-called "agreed" encumbered asset value was false at the time, but nevertheless proceeded with the implementation of the improper PSA and prosecution of the Plan with reckless disregard for the truth.

Because it was not in their self-interests, the Plan Support Parties did nothing to verify their "agreed" allocation of value of encumbered assets. Instead, they included in the PSA and

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the *First Amended Joint Chapter 11 Plan of Reorganization of Midstates Petroleum Company, Inc. and its Debtor Affiliate* [Doc. 389-1] (the "Plan") or the PSA (defined below), as applicable.

[3] As used herein, the term "Plan Support Parties" means all parties to the PSA other than the Debtors.

the Plan a "death-trap" provision, drastically limiting any recovery for unsecured creditors in the event of a challenge to that false allocation of value, and a timeline for plan confirmation that was intended to ensure that no meaningful review and exposure of their self-serving and false allocation of value would occur.

The Committee has nevertheless been engaged in an ongoing investigation, including an examination using the Debtors' own database of information and other information that was readily available to the Plan Support Parties if they had had any interest or motivation to verify the false encumbrance percentage. The Committee has determined – so far – that the actual value of the Debtors' unencumbered assets is in the ***hundreds of millions of dollars***, extraordinarily greater than the scant amount of recovery value proposed by the Debtors and the Plan Support Parties in the Plan and PSA. In addition, the misrepresentation of such an implausible level of encumbrance in combination with other egregious acts gives rise to certain other equitable and legal remedies against certain of the Debtors' officers and directors and some or all of the pre-petition secured parties. As such, the Debtors hold very valuable and meritorious claims against those parties that, when successfully prosecuted, will provide a substantial source of recovery for the Debtors' estates and unsecured creditors.

Accordingly, the Committee files this Motion seeking the broadest possible standing and exclusive authority to file the Complaint (and any other applicable form of request for relief) and pursue, on behalf of the Debtors' estates, claims for declaratory, equitable, affirmative and other relief against the appropriate parties (including without limitation, the Defendants), and if appropriate in the Committee's judgment, granting the Committee the exclusive authority to enter into settlements resolving such claims. More specifically, in this Motion, the Committee seeks standing to (1) pursue claims for avoidance of mortgages, liens and security interests against the Debtors' assets; (2) pursue claims against any and all parties to the Plan Support Agreement based upon, among other things, wrongful, inequitable and unlawful conduct; and (3) pursue certain claims against the Debtors' officers and directors.[4]

Through the Complaint (and not intending to limit the relief sought herein), the Committee seeks, at a minimum, the following: (i) a declaratory judgment that the Debtors' Unencumbered Assets (as defined below) are not subject to valid and enforceable mortgages, liens or security interests; (ii) avoidance of any and all mortgages and liens on and security interests that purport to encumber such assets; (iii) equitable subordination of the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders (as each such term is defined in the PSA); (iv) damages and other appropriate relief on account of a finding that certain officers and directors of the Debtors breached their fiduciary duties owed to the Debtors; (v) damages and other appropriate relief on account of a finding that the conduct of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders aided and abetted the breaches of fiduciary duties committed by certain officers and directors of the Debtors; (vi) damages and other relief on account of a civil conspiracy between and among certain officers of the Debtors, the Consenting Second Lien Noteholders, and the Consenting Cross-Over Noteholders to perpetuate a fraud upon the Debtors; (vii) the recharacterization of adequate protection payments made to the Second Lien Noteholders and the Third Lien Noteholders as payments toward the principal of their secured claims (to the extent they have secured claims); (viii) the disgorgement and/or avoidance and recovery of all adequate protection payments made,

[4] The draft Complaint attached as Exhibit B hereto sets forth the claims the Committee presently anticipates bringing based on the facts uncovered to date. However, the draft Complaint is not intended to limit (a) the Committee's standing, (b) the scope of the Claims, (c) the parties against whom the Claims may be pursued, (d) or the right to trial by jury on all issues so triable. The Committee seeks the broadest standing to pursue the types of claims identified herein and in the draft Complaint and any other claims that may be related thereto or may be uncovered through additional investigation. Moreover, to the extent that any counts of the Complaint require the Debtors to be parties for purposes of adjudication, the Committee reserves the right to add the Debtors as nominal defendants.

and other adequate protection interests and liens given, to the Third Lien Noteholders under the Final Cash Collateral Order as their claims are entirely unsecured; (ix) the disallowance of the proofs of claim and all other claims asserted by the Second Lien Noteholders and the Third Lien Noteholders under section 502(d) of the Bankruptcy Code; and (x) the surcharge of the Adequate Protection Collateral (as defined in the Final Cash Collateral Order) of the Second Lien Noteholders and the Third Lien Noteholders (to the extent their claims are secured if at all) under section 506(c) of the Bankruptcy Code (collectively, together with the other claims the Committee reserves the right to bring, the "Claims").

The Committee seeks exclusive authority to bring the Claims because, at the outset of these Cases, the Debtors fully compromised and waived their ability to do so. Specifically, pursuant to the *Final Order (I) Authorizing Postpetition Use of Cash Collateral, (II) Granting Adequate Protection to the Prepetition Secured Parties, (III) Modifying the Automatic Stay, and (IV) Granting Related Relief* (the "Final Cash Collateral Order") [Doc. 324], the Debtors stipulated to and waived their ability to challenge or avoid the validity, enforceability, priority, or perfection of the Prepetition First Liens, the Prepetition Second Liens, and the Prepetition Third Liens (together, the "Prepetition Liens") or to assert affirmative claims against the Plan Support Parties.[5] The Debtors also forfeited any right to assert claims related to the PSA by becoming a party to the PSA and committing not to take any actions contrary to the PSA. See PSA ¶¶3, 5(a)(iii), 5(b).[6] The Debtors' waiver of their ability to bring the Claims, however, was without

[5] The terms "Prepetition First Liens," "Prepetition Second Liens," and "Prepetition Third Liens" shall have the meanings ascribed to them in the Final Cash Collateral Order.

[6] Although the Debtors listed the PSA on their schedule of executory contracts, they have never sought to assume it. Instead, the Debtors are seeking to implement the PSA through confirmation of the Plan.

prejudice to the Committee's right to assert such claims. See Final Cash Collateral Order ¶¶E, 18, 23.

The Committee's investigation of over 7,000 oil and gas leases, mortgages and related security documents continues, but has to date revealed assets worth ***hundreds of millions of dollars*** that are not subject to perfected mortgages, liens or security interests—contrary to the fraudulent "agreement" of the Plan Support Parties. The scope and results of the Committee's investigation are sound, its Claims are meritorious, and their successful prosecution will directly and materially benefit the Debtors' estates and result in a far greater recovery to unsecured creditors than proposed in the Plan.

As fully set forth below, all of the legal requirements for granting the Committee the requested derivative standing on behalf of the Debtors' estates are satisfied. Prosecution of the Claims is critical and if the Court denies this Motion, the value of the Claims to the estates and the unsecured creditors will go unrealized, because the Debtors cannot pursue them under the express terms of the Final Cash Collateral Order and the PSA. Moreover, to not allow the Claims to be prosecuted would result in extreme prejudice and substantial harm to the Debtors' unsecured creditors and would result in an extraordinary windfall to parties who have no entitlement to it and/or who have acted unjustly. Accordingly, the Court should grant this Motion and allow the Committee the broadest possible standing to pursue the Claims on behalf of the Debtors' estates.

The Committee also seeks relief under Section 18 of the Final Cash Collateral Order in connection with its request for standing and in order to give full effect to the Committee's right to pursue the Claims and preserve all available remedies to the fullest extent possible. Section 18 of the Final Cash Collateral Order provides in relevant part that:

> …the stipulations, admissions, and releases contained in the Final Cash Collateral Order shall be binding upon the Debtors' estates and the Committee unless the Committee files a motion seeking standing to file an adversary proceeding or contested matter by not later than August 15, 2016 (x) challenging the amount, validity, enforceability, priority or extent of the First Lien Indebtedness, Second Lien Indebtedness, or Third Lien Indebtedness or the liens on the Prepetition Collateral securing the First Lien Indebtedness, Second Lien Indebtedness, or Third Lien Indebtedness, or (y) otherwise asserting any other claims, counterclaims, causes of action, objections, contests or defenses against the First Lien Agent, the First Lien Secured Parties, the Second Lien Trustee, the Second Lien Secured Parties, the Third Lien Trustee, or the Third Lien Secured Parties on behalf of the Debtors' estates.[7]

Pursuant to and expressly invoking paragraph 18 of the Final Cash Collateral Order, this Motion constitutes the Committee's objection to the stipulations, findings, admissions and

[7] Section 18 of the Final Order further provides, in relevant part, as follows:

> If no adversary proceeding or contested matter, or motion from the Committee seeking standing to commence such an adversary proceeding or contested matter, is timely filed prior to the expiration of the Challenge Period, without further order of the Court: (w) the Debtors' stipulations and admissions contained this Final Order shall be binding on all parties in interest, including the Committee; (x) the First Lien Indebtedness, Second Lien Indebtedness, and Third Lien Indebtedness shall constitute allowed claims, not subject to counterclaim, setoff, subordination, recharacterization, defense or avoidance, for all purposes in the Chapter 11 Cases and any subsequent chapter 7 case; (y) the respective Prepetition Agent's liens on the Prepetition Collateral shall be deemed to have been, as of the Petition Date, and to be, legal, valid, binding, perfected and of the priority specified in paragraph D, not subject to defense, counterclaim, recharacterization, subordination or avoidance; and (z) the First Lien Indebtedness, Second Lien Indebtedness, and Third Lien Indebtedness, the respective Prepetition Agent's liens on the Prepetition Collateral and the respective Prepetition Secured Parties (and their respective agents, affiliates, subsidiaries, directors, officers, representatives, attorneys or advisors) shall not be subject to any other or further challenge by the Committee or any other party in interest, and the Committee or party in interest shall be enjoined from seeking to exercise the rights of the Debtors' estates, including without limitation, any successor thereto ... If any such adversary proceeding or contested matter is timely filed prior to the expiration of the Challenge Period, the stipulations and admissions contained in this Final Order, including without limitation, in paragraph D of this Final Order, shall nonetheless remain binding and preclusive (as provided in the second sentence of this paragraph) on the Committee and any other person, including any Trustee, except as to any such findings and admissions that were expressly challenged in such adversary proceeding or contested matter.

releases contained in the Final Cash Collateral Order, as more particularly set forth on the schedule attached as Exhibit C to the Motion (collectively, the "Challenged Stipulations"), and the Committee's request that the Court confirm and order that none of the Challenged Stipulations is binding on the Committee pending adjudication of the Complaint through a final Court order.

JURISDICTION AND AUTHORITY

1. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and the Court may enter a final order consistent with Article III of the United States Constitution.[8] Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

2. The statutory predicates for the relief requested herein are sections 105(a), 1103(c), 1107(a), 1109(b) of title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code") and Rules 3007 and 7001 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

BACKGROUND

A. General Background

3. On April 30, 2016 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors are operating their businesses and managing their assets and property as debtors-in-possession pursuant to Bankruptcy Code sections 1107(a) and 1108. No request for the appointment of a trustee or examiner has been made in these Cases.

[8] The Committee hereby confirms its consent to entry of a final order by this Court in connection with this Motion if it is later determined that the Court, absent the consent of the parties, cannot enter final orders or judgments consistent with Article III of the Constitution.

4. On May 12, 2016, the Committee was appointed and since has worked diligently to get up to speed, commence its investigations, and engage directly with the Debtors on all matters at issue in these Cases.

B. The Debtors' Prepetition Capital Structure

5. The Debtors' prepetition capital structure is well known to the Court and is described in the Final Cash Collateral Order. It will not be repeated here. For purposes of this Motion, it is sufficient to note that the obligations under the First Lien Credit Facility, Second Lien Notes and Third Lien Notes purport to be secured by first-priority liens, second-priority liens and third-priority liens, respectively on, among other things, the Debtors' ownership interest in their oil and gas assets intended to represent at least substantially all of the present value of the Debtors' proved reserves, and the Debtors' deposit and securities accounts. It is undisputed that the holders of the Third Lien Notes were completely unsecured as of the Petition Date and today because the value of the Debtors' assets is insufficient to satisfy in full the Second Lien Notes, which have priority over the Third Lien Notes.

C. The Debtors' Cash Collateral Motion and Final Cash Collateral Order

6. On May 1, 2016, the Debtors filed the *Debtors' Emergency Motion for Entry of Interim and Final Orders (I) Authorizing Postpetition Use of Cash Collateral, (II) Granting Adequate Protection to the Prepetition Secured Parties, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Related Relief* (the "Cash Collateral Motion") [Doc. 4].

7. On June 30, 2016, the Court entered the Final Cash Collateral Order. Pursuant to the Final Cash Collateral Order, the Debtors acknowledged, admitted, agreed and stipulated that among other things (the "Stipulations"):

- Pursuant to the First Lien Loan Documents, the First Lien Indebtedness is secured by valid, binding, perfected, enforceable, non-avoidable, first-priority liens and security interests in, to and against the Prepetition

Collateral, and are not subject to, pursuant to the Bankruptcy Code or other applicable law, avoidance, disallowance, reduction, recharacterization, recovery, subordination, attachment, offset, counterclaim, defense, "claim" (as defined in the Bankruptcy Code), impairment or any other challenge of any kind. There exists no basis upon which the Debtors can properly challenge or avoid the validity, enforceability, priority or perfection of the First Lien Indebtedness or the Prepetition First Liens.

- Pursuant to the Second Lien Notes Documents, the Second Lien Indebtedness is secured by valid, binding, perfected, enforceable, non-avoidable, second priority liens and security interests in, to and against the Prepetition Collateral, and is not subject to, pursuant to the Bankruptcy Code or other applicable law, avoidance, disallowance, reduction, recharacterization, recovery, subordination, attachment, offset, counterclaim, defense, "claim" (as defined in the Bankruptcy Code), impairment or any other challenge of any kind. There exists no basis upon which the Debtors can properly challenge or avoid the validity, enforceability, priority, or perfection of the Second Lien Indebtedness or the Prepetition Second Liens.

- Pursuant to the Third Lien Notes Documents, the Third Lien Indebtedness is secured by valid, binding, perfected, enforceable, non-avoidable, third-priority liens and security interests in, to and against the Prepetition Collateral, and is not subject to, pursuant to the Bankruptcy Code or other applicable law, avoidance, disallowance, reduction, recharacterization, recovery, subordination, attachment, offset, counterclaim, defense, "claim" (as defined in the Bankruptcy Code), impairment or any other challenge of any kind. There exists no basis upon which the Debtors can properly challenge or avoid the validity, enforceability, priority, or perfection of the Third Lien Indebtedness or the Prepetition Third Liens.

See Final Cash Collateral Order ¶D(6), (8), (10).

8. The Final Cash Collateral Order provides that the stipulations and admissions "shall be binding upon the Debtors and any successors thereto in all circumstances...[and]...shall also be binding upon the Debtors' estates and all other parties in interest, including the Committee...for all purposes...unless...the Committee [] has filed a motion seeking standing to file [] an adversary proceeding or contested matter by not later than August 15, 2016 at 5:00 p.m....challenging the amount, validity, enforceability or extent of the First Lien Indebtedness, Second Lien Indebtedness, or Third Lien Indebtedness or the liens on

the Prepetition Collateral [securing such indebtedness]." *Id.* at ¶18. It is pursuant to this paragraph 18 of the Final Cash Collateral Order that the Committee timely files this Motion.

D. The Proposed Plan

9. The Debtors assert that they filed these Cases to effectuate a balance-sheet restructuring on the terms set forth in a certain Plan Support Agreement dated April 30, 2016, the Restructuring Term Sheet (the "Term Sheet") and the RBL Term Sheet attached thereto (collectively, the "PSA").[9] The PSA was the product of months of prepetition negotiations among the Plan Support Parties,[10] without the participation of the Debtors' unsecured creditor constituency. The PSA, including the Term Sheet and RBL Term Sheet, are exhibits to the *Declaration of Nelson M. Haight in Support of Chapter 11 Petitions and First Day Motions*, filed with the Court on May 1, 2016 [Doc. 16].

10. The Defendant Officers were directly and personally involved in negotiating the terms of the PSA and the Plan, and the Defendant Directors were directly and personally involved in approving and authorizing the PSA and the Plan purportedly on behalf of the Debtors. The PSA was approved by a unanimous vote by Board members Defendant Stover, Defendant Carr, Defendant Ogle, and Defendant Brace during a board meeting held on April 30, 2016. Senior executives of the Debtors, including Defendant Brace, Defendant Haight, and Defendant Weatherholt were intimately involved in formulating the Debtors' restructuring efforts and in implementing the Debtors' reorganization strategy, including negotiations which resulted in the PSA.

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[9] The term PSA includes the Plan and all subsequent amendments and supplements thereto.

[10] The term "Plan Support Parties" means the Consenting Parties" as defined in the PSA, comprised of the First Lien Agent, each Consenting First Lien Lender, and each Consenting Noteholder (each as defined in the PSA). The Second Lien Notes Trustee and the Third Lien Notes Trustee are not Plan Support Parties.

11. Pursuant to the PSA, the Debtors were required, among other things, to file a plan, a disclosure statement, and a motion to approve the disclosure statement within 14 calendar days of the Petition Date – i.e., by May 14, 2016. Accordingly, on May 14, 2016, the Debtors filed the *Joint Chapter 11 Plan of Reorganization of Midstates Petroleum, Inc. and its Debtor Affiliate* [Doc. 144] and the *Disclosure Statement for the Joint Chapter 11 Plan of Reorganization of Midstates Petroleum, Inc. and its Debtor Affiliate* [Doc. 145]. Amended versions of the plan and disclosure statement were filed at Docs. 278, 279, 361, 365, 382, and 383. A solicitation version of the amended plan was filed at Doc. 389-1 (the "Plan") and a solicitation version of the amended disclosure statement was filed at Doc. 389-2 (the "Disclosure Statement").

12. As required by the PSA, the Plan embodies a purported intercreditor settlement (the "Purported Intercreditor Settlement") among the Plan Support Parties, pursuant to which:

- The Debtors and the Plan Support Parties "agreed" that 98.8% of the value of the Debtors' assets are encumbered by valid and enforceable liens in favor of the Administrative Agent, the First Lien Lenders, the holders of the Second Lien Notes (the "Second Lien Noteholders"), and the holders of the Third Lien Notes (the "Third Lien Noteholders");
- The Consenting Second Lien Noteholders agreed that the Third Lien Noteholders will receive 2.5% of the equity of the reorganized Debtors and warrants to acquire 15% of additional equity;
- The Prepetition Secured Lenders will be deemed to waive any applicable deficiency claims and adequate protection claims subject to certain conditions; and
- The Consenting Second Lien Noteholders, on the one hand, and the Consenting Cross-Over Noteholders, in their capacities as holders of Third Lien Notes, on the other hand, will be deemed to have mutually waived and released all claims against one another as they relate to the Debtors and the Plan, including the right to object or otherwise oppose the Plan, while the PSA remains in force; and
- The Consenting Second Lien Noteholders waive any diminution in value claim *unless* the Committee or another unsecured creditor challenged any aspect of the Plan, in which case a dollar-for-dollar reduction in the recovery for the unsecured creditors would occur, including for the fees and costs of defending against such challenges.

13. The foundation of the Purported Intercreditor Settlement and the Plan is the false claim and "agreement" that 98.8% of the value of the Debtors' assets are subject to perfected, valid and enforceable liens held by the Prepetition Secured Parties (the "Asserted Perfection Percentage"). Even in the absence of intentional misconduct, it was entirely unreasonable to accept such a claim on its face based on industry standards. Yet, the claim was untested, unverified, and not validated by the Debtors or any of the other Plan Support Parties, whose interest was in depriving other creditors from realizing their just entitlement to very significant recoveries to which they would otherwise be entitled under the Plan.

14. As required by the PSA, the Plan provides for only *de minimis* recoveries for general unsecured creditors in Class 7—namely, 1.2% of the equity in the reorganized Debtors. Based on the Debtors' valuation of such equity, unsecured creditors will receive, at most, **a 0.9% recovery** on their claims, which meager recovery will be reduced to a **0.5% recovery, or potentially to no recovery at all**, when the "death-trap" provision in the Plan is triggered and the proposed Management Incentive Plan is implemented.

15. As described in the Disclosure Statement, the projected recovery for Class 7 is 0.9% if no "Challenge" or purported intercreditor "Settlement Termination Event" is triggered and 0.5% if such triggering events occur. Even this nominal recovery will be diminished, however, by the alleged deficiency and other claims of the Second Lien Noteholders and the Third Lien Noteholders as a result of: (1) the triggering of the "death trap" by, among other things, seeking leave to file this complaint; and (2) the equity to be issued in connection with a management incentive plan (the "MIP") that will be implemented in connection with the consummation of the Plan for the benefit of the Debtors' senior management, as contemplated by the PSA.

16. Moreover, although the Consenting Second Lien Noteholders purport to have waived any alleged diminution in value claims, the "death-trap" provides that if the so-called settlement between the Consenting Second Lien Noteholders and the Consenting Cross-Over Noteholders is not approved as part of the Plan, the equity distribution to the unsecured creditors will be charged for any diminution in value claims.

17. The MIP constitutes a personal benefit to the officers and directors of the Debtors. For example, the Debtor's President and CEO, Frederic Brace, is scheduled to receive a base salary of $700,000, plus a target bonus of 100% of base salary and 18.75 percent of emergence grant shares. *Even if Brace is terminated for cause*, he will continue to be paid and receive an additional lump sum payment of $700,000. Further, Brace is entitled to take employment with *other* companies while "working" for reorganized Midstates, and is expressly not subject to non-compete or non-solicitation provisions.

18. The Debtors' CFO, Nelson Haight, is scheduled to receive a base salary of $375,000, a target bonus of 80% of his base salary, severance equal to 1.5x the sum of his base salary and bonus, and 13.55% of the emergence grant shares. The Debtors' General Counsel, Scott Weatherholt, is scheduled to receive $300,000 in base salary, a target bonus of 60% of his base salary, severance equal to 1x the sum of his base salary and bonus, and 6.7% of emergence shares.

19. As set forth in the Disclosure Statement, the recoveries to unsecured creditors could be reduced to zero as a result of the "death-trap."

20. As required by the PSA, the Plan provides for the following treatment of certain claims against the Debtors:

- Holders of priority and secured claims (other than secured claims arising under the First Lien Facility, the Second Lien Notes, or the Third Lien Notes) will be paid in full, in cash;
- The First Lien Lenders will receive approximately $82 million in cash and, in return, will provide a reserve-based exit facility in the amount of $170 million;
- Second Lien Noteholders will receive: (a) cash in an amount equal to the Debtors' cash on hand as of the Plan's effective date, less cash payments and reserves to be funded under the Plan (including a cash collateral account to be funded in connection with the exit facility) and $70 million of balance sheet cash, but in no event more than $60 million, and (b) 96.3% of the equity in reorganized Midstates;
- Third Lien Noteholders will receive 2.5% of the equity in reorganized Debtors and warrants to acquire an additional 15% of such equity, which warrants will strike at a $600 million equity valuation for reorganized Midstates and will expire 42 months after the Plan's effective date; and
- Holders of Unsecured Notes and general unsecured claims (classified in Class 7 under the Plan) will receive their pro rata share of 1.2% of the equity in the reorganized Debtors.

21. In sum, the Plan provides for a cash recovery for the Third Lien Lenders, who hold entirely unsecured claims, of approximately **$43 million** on account of approximately **$555.9 million** of unsecured deficiency claims in Class 6 (or a projected recovery of **7.8%**).

22. In contrast, the Plan provides for a cash recovery value for unsecured creditors of approximately **$6.2 million** on account of approximately **$674.2 million** of unsecured claims in Class 7 (or a projected recovery of **0.9%**). Such cash recovery value, when the "death-trap" is triggered, will be reduced to approximately **$3.5 million**. In addition, assuming the MIP goes into effect, such recovery will be further reduced by approximately **$3.2 million**. Taking into account other claims that may be asserted in connection with a Challenge would further reduce the recovery to unsecured creditors, potentially to **<u>zero ($0)</u>**. The Plan Support Parties have argued that this proposed recovery is greater than what holders of claims in Class 7 are lawfully entitled to recover. This contention is knowingly and patently false.

23. There is no legitimate dispute that the Third Lien Lenders are completely unsecured. Nevertheless, the Plan treatment of, and recovery to, holders of Third Lien Notes is substantially greater than the Plan treatment of, and recover to, holders of other unsecured creditors. This is because the Cross-Over Ad Hoc Committee, which includes holders of both Second Lien Notes and Third Lien Notes, negotiated with the Ad Hoc Committee of Second Lien Noteholders to improve unfairly their recovery on account of the Third Lien Notes at the expense of the Debtors and the unsecured creditors.

24. The Defendant Officers' focus in the PSA negotiations was purely of self-interest related to their own continued employment post-restructuring, their salary and bonuses, and obtaining releases from liability. Indeed, Defendant Haight testified that, REDACTED [redacted] See excerpts from transcript of August 12, 2016 deposition of Nelson Haight (the "Haight Dep.") attached as Exhibit D hereto, at 174:10-25.

25. The Defendant Officers further abdicated their duties in regard to the PSA by conducting no investigation into potential claims of the Debtors before agreement to broad releases, including of the Defendant Officers themselves. In response to questioning regarding any investigation of potential claims prior to agreeing to the releases, Defendant Haight testified: [redacted] REDACTED [redacted] Haight Dep. at 250:10-16 (Exhibit D).

26. The Defendant Officers, acting out of self-interest, actively assisted the members of the Ad Hoc Committee of Second Lien Lenders and the Cross-Over Ad Hoc Committee in a scheme to buy the votes of members of the Cross-Over Ad Hoc Committee (in their positions as Second Lien Noteholders) to support the Plan for overly generous treatment of the same

members (in their capacity as Third Lien Noteholders) under the Plan, at the expense, and to the detriment, of the Debtors and other creditors. As Mr. Haight testified: REDACTED [redacted] Haight Dep. at 188:4-10 (Exhibit D).

27. The Defendant Directors approved the filing of the Chapter 11 petitions without adequately informing themselves in regard to the PSA or the Plan. Indeed, Defendant Haight, who participated in all the relevant board meetings, testified that REDACTED [redacted] Haight Dep. at 261:7-10 (Exhibit D). Mr. Haight testified that REDA [redacted] Haight Dep. at 261:11-15 (Exhibit D).

28. The Defendant Directors' failure to properly inform themselves is plain. The Chairman of the Board himself testified on August 4, 2016 that REDACTED [redacted] See excerpts from transcript of August 4, 2016 deposition of Bruce Stover (the "<u>Stover Dep.</u>") attached as Exhibit E hereto, at 77:15-17, 78:5-22, 79:12-18, 80:5-9, 86:23-87:3. REDACTED [redacted] Stover

Dep. at 88:5-14, 89:13-25 (Exhibit E). REDACTED [redacted] Stover Dep. at 89:23-90:3 (Exhibit E).

29. The PSA also requires an extremely truncated timeline for the Debtors' chapter 11 cases, which has forced the Committee to expedite its investigation into whether and the extent to which the Debtors' assets are in fact covered by perfected, valid, and enforceable liens and to determine whether the Plan provides general unsecured creditors with the recoveries to which they are entitled as a matter of law pursuant to the Bankruptcy Code.

E. <u>The Committee's Investigation</u>

30. The Committee has a fiduciary duty to represent the interests of unsecured creditors generally. This duty requires that the Committee undertake prudent and reasonable steps to ensure that, among other things, the treatment of unsecured creditors under the Plan is fair and reasonable, and to investigate potential causes of action that might improve recoveries to unsecured creditors.

31. From the outset of these cases, the Committee has been appropriately skeptical of the prepetition "agreement" that 98.8% of the value of the Debtors' assets is encumbered by valid, perfected and enforceable liens. The Debtors hold in excess of 7,000 oil and gas wells and leases in Texas, Oklahoma and Louisiana and would be by far the industry exception if they had indeed achieved this level of perfection of liens on their oil and gas assets.

32. The Committee embarked on an investigation and analysis of the purported perfection of security interests in the Debtors' oil and gas assets by reviewing mortgages, well information, leases and title opinions, among other evidence of asset ownership. The Committee also took the depositions of the Debtors' Chief Financial Officer and their designated land

department representative, and representatives of the ad hoc committees representing the Plan Support Parties.

33. The Committee's investigation to date has revealed that, contrary to the claimed 98.8% perfection rate, a substantial number of liens on the Debtors' wells and leases in fact are not perfected under applicable state law. The unperfected liens represent at least 212 leases which, together with the extrapolated exception rate, generate an unencumbered value of at least $368,591,000 (PV0), or at least $130,755,000 (PV10) based on the Debtors' Reserve Report update prepared as of August 1, 2016 and the May 20, 2016 strip pricing used by the Debtors in the Plan presentation.[11]

34. The untested "agreement" that 98.8% of the value of the Debtor's assets is subject to perfected, valid and enforceable liens is false, and the Defendant Officers, the Consenting Second Lien Noteholders and the Consenting Cross-Over Noteholders knew it was false or recklessly disregarded its truth or falsity.

35. The claimed 98.8% perfection rate was readily proven false upon a reasonable investigation by the Committee. Reliance on the grossly exaggerated Asserted Perfection Percentage renders the Plan unconfirmable and millions of dollars in fees and expenses are likely to be incurred uncovering the unlawful, wrongful and inequitable conduct of certain of the Debtors' officers and directors, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders, to the detriment of the Debtors' estates generally, with the Debtors' unsecured creditors bearing the brunt of the attempt to usurp their just recovery.

[11] The Committee does not concede and reserves all rights as to the proper PV factor to be applied to its calculations herein and have provided all dollar values at both PV0 and PV10 for illustrative purposes only.

a. ***The Debtors' Lease/Mortgage Processes***

36. A proper collateral review in the oil and gas context is different from typical asset based lending structures, in that it necessarily requires the analysis of thousands of leases, mortgages, other security documents, title opinions and state law with respect to mortgage perfection issues. Given the volume of data required to manage thousands of leases and accompanying security documents, oil and gas companies such as the Debtors typically maintain databases to catalogue and track the information necessary to prepare the schedules that are attached to mortgages to obtain perfected, valid and enforceable security interests. Here, the Debtors utilized database software called "Enertia."

37. The Debtors, however, do not electronically track mortgages that have been filed of record in county real property records on their leasehold interests. As confirmed in an email from the Debtors' valuation consultant, Huron Consulting, REDACTED [redacted] See, April 4, 2016 Email from Monty Kehl to Kenneth Toudouze, FTI0000377, attached as Exhibit F hereto.

38. Instead, the Debtors catalogued their oil and gas leases in Enertia. After each lease was executed and recorded, the lease was supposed to be forwarded to the Debtors' land department and entered into the Enertia database manually. Once entered into Enertia, the data was exported to a spreadsheet (the "<u>Master Lease Schedule</u>") and provided to the mortgagee for review. If any lease was inadvertently omitted from the Enertia database, it would not have appeared on the Master Lease Schedule or the subsequently generated mortgage schedules, and therefore the encumbrance would not have been recorded. See, Haight June Dep. at 96:23-97:5 (Exhibit H).

39. REDACTED [redacted]

REDACTED

See, excerpts from transcript of August 11, 2016 deposition of Julie Ewing ("Ewing Dep.") attached as Exhibit G hereto, at 107:13-23.

40. Once the mortgagee agreed with the information set out in the Master Lease Schedule, the Debtors ran a report to generate the lease schedules describing the Debtors' interest in oil and gas properties, which reports were used by the mortgagee as an exhibit to the mortgage for perfection purposes. As a result, human error in entering data into Enertia and failures to properly integrate lease assignments into Enertia protocols has necessarily led to a significant misreporting of information essential to perfecting liens on a large number of the Debtors' oil and gas properties.

41. Further, the Master Lease Schedule was not reconciled to the title opinions obtained from third parties in connection with drilling and preparation of division orders. Obtaining title opinions is a routine and common practice in the oil and gas industry generally, and by the Debtors specifically, before drilling any well to make sure that the well is drilled in the correct location and the Debtors hold valid leases for that location. Title opinions are also obtained as a common practice in the oil and gas industry generally, and by the Debtors specifically, once a well begins to flow before the Debtors make payments due to interest holders to ensure that the payments are being made to the correct parties. As the Debtors' CFO, Nelson Haight, acknowledged at his deposition, "[g]enerally,...we have to have a title opinion before we'll spud a well." See, excerpt from transcript of June 14, 2016 deposition of Nelson Haight ("Haight June Dep.") attached as Exhibit H hereto, at 90:19-25.

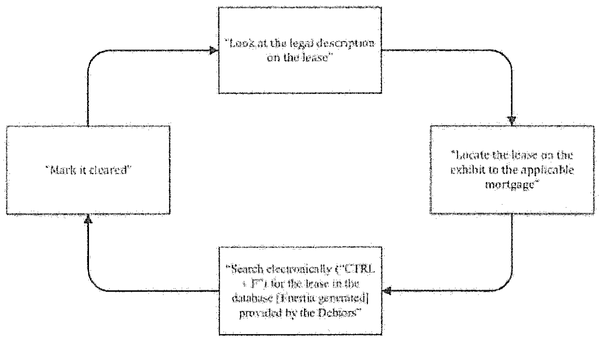
42. If the title opinions contain information that is different from or missing from the Master Lease Schedule or well schedule, it is likely that assets are not subject to perfected, valid

and enforceable liens. If the Master Lease Schedule or mortgage schedule attached to a mortgage is inaccurate or fails to identify leases or wells, it is likely that assets are not subject to perfected, valid and enforceable liens. However, neither the Debtors nor the Plan Support Parties reconciled their title opinions with the Master Lease Schedule. As part of the Committee's investigation, the Committee's professionals reviewed title opinions and reconciled them to the Master Lease Schedule and the mortgage schedules and discovered a significant error rate (in excess of 25.1% of the information reviewed) and a very significant value of assets that are not subject to perfected, valid and enforceable liens.

b. ***<u>Debtors' Encumbered Asset Review Process</u>***

43. The Debtors laid out their process for reviewing their encumbered assets in their Omnibus Reply in Support of Cash Collateral Motion [Doc. 275 at ¶ 22], where the Debtors described a simple four-step process: "(a) look at the legal description in the lease..., (b) locate the lease on the exhibit to the applicable mortgage, (c) search electronically ("CTRL + F") for the lease in the database [Enertia generated] provided by the Debtors, and (d) mark it cleared."

44. The below graphic illustrates the lien review process proposed by the Debtors:



45. This asset review process assumes every lease has been entered into Enertia, and entered accurately. There is no independent verification or confirmation that the information on the Master Lease Schedule is accurate.

46. The Plan Support Parties willfully turned a blind eye to these flaws when agreeing among themselves that 98.8% of the Debtors' assets were subject to valid, perfected, and enforceable liens. As described by Mr. Haight in his June 14, 2016 deposition, the Debtors performed a detailed review of the leases in connection with the refinancing transactions they undertook in 2015. See, Haight June Dep. at 25:6 (Exhibit H). In contrast, Peter Almond, a director at SunTrust Bank (the First Lien Agent), testified in his deposition that REDACTED [redacted] See, excerpt from transcript of August 9, 2016 deposition of Peter Almond ("Almond Dep.") attached as Exhibit I hereto, at 74:9-75:3; Haight Dep. at 220:2-10 (Exhibit D).

47. However, when it was time to perform a review of the leases in connection with the PSA, the Debtors simply printed a list of their lease assets as of May 2015, ***assumed that all of those assets were subject to valid liens***, then "compared that to a list out of Enertia as of maybe March or April of this year ...." See, Haight June Dep. at 25:6 (Exhibit H) (emphasis added).

48. More recently, Mr. Haight testified as the Debtors' Rule 30(b)(6) witness that REDAC [redacted] See, Haight Dep. at 250:23-251:3 (Exhibit D).

49. There was no reasonable basis for the assumption that all of the Debtors' oil and gas properties were subject to valid and enforceable liens because, as, Mr. Haight further testified, REDACTED [redacted] See, Haight Dep. at 218:24-220:10 (Exhibit D). There was, therefore, no legal analysis performed by the Debtors prior to entering into the PSA as to whether ***any*** liens against the Debtors assets were valid, enforceable or perfected. Moreover, REDACTED [redacted] Thus, the single most important "fact" on which the parties to PSA agreed and relied to construct the Plan and the Debtors' entire restructuring was a complete sham.

50. Moreover, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders made no effort to verify whether any of the liens granted in connection with the May 2015 transactions were valid and enforceable and made no effort to verify whether any of the liens granted in connection with the May 2015 transactions were valid and enforceable and made no effort to verify the accuracy of the Asserted Perfection Percentage before they represented in the PSA and to the Court that the Asserted Perfection Percentage was accurate.

51. Certain officers and directors of the Debtors and each of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders either knew or should have known that the Asserted Perfection Percentage was false on its face, or recklessly disregarded its truth or falsity, given their lack of any due diligence and the general perfection failure rate in the industry.

52. Indeed, contemporaneous communications produced to the Committee in discovery so far demonstrate that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders "agreed" to the 98.8% encumbrance claim without any regard to its inaccuracy – their focus instead was on preventing the Committee from seeking to review this obviously flawed figure. For example, REDACTED [redacted] See, Email from B. Resnick to J. Sussberg, March 5, 2016 (emphasis added) attached as Exhibit J hereto.

c. ***Results of the Committee Investigation***

53. After the Committee was appointed, given the extremely limited time available before any Challenge had to be commenced, its professionals implemented a reasonably scoped investigation to test the claim that 98.8% of the Debtors' assets were in fact subject to perfected, valid and enforceable liens.

54. Following its appointment on May 12, 2016, the Committee worked diligently to review over 7,000 separate oil and gas leases, mortgages, third party title opinions and related documents to determine the accuracy of the Asserted Perfection Percentage and the actual value of the Debtors' property that is not subject to a valid, perfected and enforceable mortgage, lien or security interest.

55. While the Committee's review is still ongoing given the sheer volume of documents to be reviewed and the exceedingly tight deadline imposed on the Committee, to date the Committee has examined a significant portion of the title opinions, leases, wells and

mortgages for the Debtors' wells located in Oklahoma, which properties encompass approximately 95% of the entire value of the Debtors' oil and gas assets.

56. The Committee's investigation has uncovered that the failure to reconcile the Master Lease Schedule and Enertia database with drilling or division order title opinions has resulted in three common errors which cause an ***absolute failure of mortgages and liens or the imperfection of mortgages and liens*** under applicable law.[12] The main error identified by the Committee is that the well associated with a lease is not identified on the recorded mortgage and either: (1) the recorded mortgage fails to identify the lease; (2) the recorded mortgage provides an incorrect location or geographic description for the lease; and/or (3) the recorded mortgage fails to accurately describe the book and page number where the lease is filed. The Committee has identified other errors as well.

57. Of the Oklahoma leases reviewed to date, the Prepetition Secured Lenders failed to perfect their liens on or security interests in at least 212 leases in Woods County and Alfalfa County, Oklahoma alone (the "Known Unperfected Liens").

58. Of the 212 Known Unperfected Liens, the liens on 134 leases absolutely fail under Oklahoma law because (a) the wells associated with such leases are not identified on the recorded mortgage and (b) the leases themselves are not identified on the recorded mortgages. A spreadsheet identifying these leases is attached as Exhibit A to the Complaint.

59. Of the 212 Known Unperfected Liens, the liens on 6 leases are not perfected under Oklahoma law because the wells associated with such leases are not identified on the recorded mortgage and the recorded mortgage contains an incorrect location or geographic

[12] While the three main errors causing a lack of perfection are described herein, these three errors are merely examples of a wider variety of fatal perfection flaws that render many of the mortgages invalid, unenforceable and unperfected. The Committee is not limiting the grounds pursuant which it seeks standing to avoid the alleged mortgages and liens and reserves all rights in that regard.

description for the lease. A spreadsheet identifying theses leases is attached as Exhibit B to the Complaint.

60. Of the 212 Known Unperfected Liens, the liens on 12 leases are not perfected under Oklahoma law because the wells associated with such leases are not identified on the recorded mortgage and the recorded mortgage fails to accurately describe the book and page number where the lease is filed. A spreadsheet identifying these leases is attached as Exhibit C to the Complaint.

61. In addition to the Known Unperfected Liens identified above, a series of 29 Oklahoma PDNP (proven, developed and non-producing) assets and PUDs (proven, undeveloped reserves) identified on the Reserve Report prepared as of December 31, 2015 have been re-classified to PDP (proven, developed and producing) wells (the "PUD Converted New Wells"). Together with the PUD Converted New Wells, 69 new properties in Oklahoma (the "Previously Unscheduled New Properties") not previously identified by the Debtors on their Reserve Report prepared as of December 31, 2015 as PUD or PDNP assets were added to the Debtors' updated Reserve Report as of August 1, 2016. Of those 69 new properties, 17 were previously unidentified new wells (the "Previously Unscheduled New Wells"). Because the PUD Converted New Wells and the Previously Unscheduled New Wells were developed after mortgagees filed their mortgages, ***none of these new wells are included on the mortgage schedules***.

62. **Exhibit D** to the Complaint is a schedule of these new properties, for which no reference to leases or wells was included in the mortgage schedules. The estimated value of unencumbered assets due to unperfected liens for all previously unscheduled properties is approximately $143,482,000 (PV0), or $51,328,000 (PV10).

63. Even if a well location is properly identified on a recorded mortgage, only the Debtors' interest (and such associated value) at the wellhead is purportedly perfected under a recorded mortgage. The Committee also reviewed numerous well units that under the August 1, 2016 Reserve Report also contained independent PUD value to verify that all leases in such units were included on the recorded mortgages. **Exhibit E** is a schedule of 60 leases in units for which the well is included on the recorded mortgage, but certain leases associated with the PUD value in such unit contain one of the following defects: (1) the recorded mortgage fails to identify the lease; (2) the recorded mortgage provides an incorrect location or geographic description for the lease; or (3) the recorded mortgage fails to accurately describe the book and page number where the lease is filed.

64. Due to time constraints imposed on the Committee by the Final Cash Collateral Order, the Committee has not had an opportunity to complete its review of the Debtors' entire lease portfolio. The Committee's review is ongoing. However, by extrapolating the 25.1% exception rate generated by the Committee's review to date to the balance of the Debtors' leases, ***the total projected value of the Debtors' oil and gas assets that are unencumbered by a valid, enforceable and perfected lien, based on the facts and allegations contained in the proposed Complaint and such other factual and legal grounds that the Committee may identify as a result of its continuing investigation (the "Unencumbered Assets")[13], is at least $368,591,000 (PV0) or $130,755,000 (PV10). This amount represents 18.3% of the PV0 value of all of the Debtors' oil and gas properties.[14]***

[13] The Committee expressly reserves the right to amend the Complaint to include any and all additional facts, assertions and grounds for declaring that the liens granted against the Debtor's oil and gas assets are not valid, enforceable and perfected.

[14] The percentages and dollar values contained herein are only representative of the Committee's review to date and only pertain to certain defects in perfection while excluding others. The Committee reserves all rights with respect

F. **The Consenting Second Lien Noteholders' and Consenting Cross-Over Noteholders' Egregious and Inequitable Conduct**

65. The circumstances surrounding the PSA and the Debtor's slide into bankruptcy reveal egregious and wrongful conduct by certain officers and directors of the Debtors and the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders. These parties have maliciously exploited their levered position to materially prejudice and harm the unsecured creditors, and correspondingly, all non-offending creditors in these cases. Several of the facts outlined above, along with others, tell of a carefully calculated scheme to:

(i) claim a dramatically inflated amount of assets encumbered by valid, perfected and enforceable mortgages, liens and security interests;

(ii) buy-off the Consenting Noteholders who hold Third Lien Notes Claims (who are unsecured based on the collateral valuation) with an inequitable recovery; and

(iii) damage any creditor willing to challenge the scheme by incorporating a "death-trap" into the Plan.

66. Moreover, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders have gone to great lengths to force this Plan and Disclosure Statement through this Court at break-neck pace in the hope that the Committee and other damaged parties will not be able adequately to investigate the perfection flaws and affirmative claims.

67. *First*, certain officers and directors of the Debtors and the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders knew or should have known that the bold claim that 98.8% of the value of the Debtors' assets is subject to perfected, valid and enforceable liens required independent due diligence and verification and is not a matter that can simply be "agreed" to by the parties. The absence of any due diligence or verification of this

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to any and all defects in any and all of the Debtors' Oil and Gas Assets, wherever located, and the percentages and dollar values set forth herein and on the attached exhibits are for illustrative purposes only.

assertion not only constitutes, at minimum, bad faith, but a reckless disregard for the truth. Had any one of the Consenting Second Lien Noteholders or Consenting Cross-Over Noteholders tested the Debtors' Master Lease Schedule against third party title opinions, the errors the Committee has readily identified would have been obvious. Not only is this conduct actionable, it renders the Plan unconfirmable. **Such an "agreement" is no more valid that if the Plan Support Parties agreed that the Earth is flat.**

68. To arrive at the Asserted Perfection Percentage, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders performed no independent analysis of the security documents. For example, the Rule 30(b)(6) representative for the Consenting Second Lien Ad Hoc Committee testified that REDACTED [redacted] See excerpt from transcript of August 3, 2016 deposition of John-Paul Hanson ("Hanson Dep.") attached as Exhibit K hereto, at 87:8-18. Peter Almond, SunTrust Bank's director, testified that REDACTED [redacted] Almond Dep. 147:23-148:1 (Exhibit I).

69. Karn Chopra, the 30(b)(6) representative of Centerview Partners LLC (the financial advisor for the Cross-Over Ad Hoc Committee), testified that REDACTED [redacted] See excerpts from transcript of August 4, 2016 deposition of Karn Chopra ("Chopra Dep.") attached as Exhibit L hereto, at 116:3-117:4, 117:10-19. In particular, when asked what the position of the Cross-Over Ad Hoc

Committee was with respect to the perfection, validity and enforceability of the liens held by the prepetition secured parties in connection with the May, 2015 financing transactions, Mr. Chopra testified as at his deposition as follows:

REDACTED

Chopra Dep. 115:4-19 (Exhibit L) (emphasis added); see also, Chopra Dep. 192:18-25 REDACTED [redacted] (Exhibit L).

70. Mr. Chopra testified further as follows:

REDACTED

REDACTED

Chopra Dep. 212:15-23 (Exhibit L).

71. Similarly, SunTrust Bank's representative, Peter Almond, testified that REDACTED [redacted] Almond Dep. 157:9-158:13 (August 9, 2016).

72. In a flawed and apparent last minute attempt to cover their tracks, the Consenting Second Lien Noteholders inserted the following language into the Term Sheet (Exhibit A) annexed to the PSA: "… *which valuation allocation reflects the Debtors good faith determination of their encumbered and unencumbered assets as of the Petition Date*." Such insertion confirms that no due diligence was performed on the Debtors' determination of its

claimed encumbrance percentage and that the Consenting Second Lien Noteholders belatedly sought to distance themselves from such a claim.

73. The Consenting Second Lien Noteholders, the Consenting Cross-Over Noteholders, and certain of the Debtors' officers and directors knew or should have known that the Debtors did not make any such determination. Their agreement to, and representation of, the Asserted Perfection Percentage was made with knowledge of its falsity or with reckless disregard as to its truth or falsity and with conscious indifference to the rights of the Debtors and their stakeholders.

74. *Second*, the Consenting Second Lien Noteholders reached an agreement to provide preferred treatment to the Third Lien Noteholders orchestrated by the Second Lien Ad Hoc Committee and the Cross-Over Ad Hoc Committee. The Third Lien Noteholders held entirely unsecured claims on the Petition Date. Rather than treating the claims of the Third Lien Noteholders the same as holders of general unsecured claims, however, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders instead agreed to provide a recovery of 7.8% to the Third Lien Noteholders – *almost nine times* even the best-case 0.9% recovery granted to holders of general unsecured claims under the Plan.

75. This treatment, discriminates unfairly against holders of general unsecured claims by providing the completely "out of the money" Third Lien Noteholders with a recovery that is vastly greater than what the Plan proposes to provide to other similarly situated creditors – the unsecured creditors represented by the Committee. As one advisor put it pre-filing, REDACTED [redacted]

See, April 27, 2016 email from J. Hanson to D. Aronson [EID SLG_UCC0001522 –

SLG_UCC0001523] attached hereto as Exhibit M; see also, Hanson Dep. 175:11-12 REDACTED [redacted] (Exhibit K).

76. The reason for the preferential treatment of the Third Lien Noteholders is simple. The members of the Second Lien Ad Hoc Committee do not represent holders of at least 2/3 of the amount of the Second Lien Notes. Thus, without the support of additional holders of Second Lien Notes, they could not satisfy the voting requirements of section 1126(c) of the Bankruptcy Code for plan approval.

77. The Cross-Over Ad Hoc Committee, whose members hold both Second Lien Notes and Third Lien Notes, represented a sufficient amount of Second Lien Notes such that by obtaining the support of the Cross-Over Ad Hoc Committee to the PSA, the Second Lien Ad Hoc Committee could achieve the required vote of at least 2/3 of the amount of Second Lien Notes in favor of the plan. See, Hanson Dep. at 174:1-25 (Exhibit K); Haight Dep. at 96:10-97:10 (Exhibit D).

78. Although the PSA suggests that the intercreditor settlement between the Consenting Second Lien Noteholders and the Consenting Cross-Over Noteholders resolved intercreditor disputes, at deposition, the representative of the Second Lien Ad Hoc Committee REDACTED [redacted] See, Hanson Dep. at 170:6-173:16 (Exhibit K). The same witness, the financial advisor to counsel for the Ad Hoc Committee of Second Lien Noteholders, also stated in an email that REDACTED [redacted] See, April 27, 2016 Email from JP Hanson to Daniel Aronson, SLG_UCC0001522.

79. The Plan Support Parties thus implemented a scheme to divert enough value to the Third Lien Noteholders to win their support as holders of Second Lien Notes, while leaving enough of their Third Lien Notes claims unsecured to ensure that their egregiously inequitable Plan could be confirmed.

80. *Third*, despite the fact that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders knew or should have known that the Asserted Perfection Percentage was false, they also "agreed" among themselves to falsely claim that the treatment afforded to general unsecured creditors under the Plan represented ***a greater recovery than that to which they would be entitled*** by simply recognizing the absolute priority of claims and the assets available to pay such claims. This is perhaps the most egregious falsehood perpetrated by the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders. The result of the false Asserted Perfection Percentage is that ***the general unsecured creditors are the only parties that will receive less than what they are entitled to under the Plan***. Because the value of the Unencumbered Assets is more than $368 million (at PV0) or $130 million (at PV10) -- materially greater than 1.2% of the Debtors' assets as provided for in the Plan and the PSA, the share of the Unencumbered Assets to which holders of general unsecured claims are entitled is enormously higher than the recovery provided in the Plan.

81. *Fourth*, at the same time the Consenting Second Lien Noteholders were buying the votes of the members of the Cross-Over Ad Hoc Committee with value that should be going to the unsecured creditors, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders were structuring the Plan to prevent any creditor objections to their collusive and deceptive scheme by including a "death-trap" provision, designed to coerce the Committee to shirk its fiduciary duty of investigating the Asserted Perfection Percentage and seeking to prove

the failure to perfect and avoidance of purported mortgages on over $369 million of leasehold interests.

82. The death-trap was intended to improperly coerce the Committee into allowing the false Asserted Perfection Percentage to escape the notice of unsecured creditors and the Court by presenting the Committee with a Hobson's Choice of either not fulfilling its fiduciary obligations to unsecured creditors by investigating the accuracy of the Asserted Perfection Percentage or give up even the meager amounts allocated to them by the Plan Support Parties by triggering the death-trap. As counsel to the Consenting Second Lien Noteholders candidly described the Plan Support Parties' intentions, REDACTED March 5, 2016 email from B. Resnik to J. Sussberg [EID SLG_UCC0000026]. The death trap provision violates the most basic principles of due process and fairness, is antithetical to the rights of creditors as provided under the Bankruptcy Code, and is an attempt to prevent the Committee from discharging its fiduciary duties. It is abundantly clear that the death-trap provision was not included in the PSA for any legitimate reason, but rather to prevent any meaningful review of what the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders had orchestrated under the PSA.

83. *Fifth*, in a further attempt to conceal their conspiratorial acts, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders designed a process and have worked feverishly to move these cases through the plan confirmation process at an unreasonable speed—apparently in an attempt to conceal its egregious conduct from the Committee and the Court. The proposed Plan-related deadlines are at odds with the complexity of these Cases and the enormity of the investigation and collateral review the Committee must undertake.

84. The PSA required plan confirmation in less than 120 days, with 40 calendar days from the Petition Date to the approval of a disclosure statement and 75 calendar days from the disclosure statement approval to confirmation. Forcing the Committee to undertake an investigation and lien analysis of over 7000 leases in such a truncated period (an analysis that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders never even attempted) is entirely unreasonable and when coupled with the false Asserted Perfection Percentage, the death-trap and other bad acts, is ample evidence that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders attempted to structure the Plan and confirmation process in a way that would prevent the Committee from discovering their egregious conduct and if discovered, from protecting the interests of unsecured creditors and bringing it to the Court's attention.

RELIEF REQUESTED

85. The Committee respectfully requests that this Court grant the Committee broad leave, standing and exclusive authority to pursue the Claims, including, without limitation by filing the draft Complaint (or such other revised complaint as the Committee deems appropriate), to prosecute the Claims and, in the discretion of the Committee, to pursue one or more settlements with respect to all or a portion of the Claims, in each case on behalf of the Debtors' estates.

BASIS FOR RELIEF

A. The *Louisiana World Exposition* Standard for Derivative Standing is Satisfied

86. It is well settled within this and other circuits that under certain circumstances, a bankruptcy court may permit a committee derivatively to prosecute causes of action on behalf of a bankruptcy estate pursuant to 1103(c)(5) and/or 1109(b) of the Bankruptcy Code. *Louisiana World Exposition, Inc. v. Fed. Ins. Co.*, 858 F.2d 233, 247 (5th Cir. 1988) (hereinafter "LWE II")

(citing among other cases, *Louisiana World Exposition, Inc. v. Fed. Ins. Co (In re Louisiana World Exposition, Inc.)*, 832 F.2d 1391, 1397 (5th Cir. 1987) (hereinafter "LWE I"); *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1363 (5th Cir.1986) (suggesting that section 1109(b) provides a basis for the standing of a creditors' committee); see also, *In re MortgageAmerica Corp.*, 831 F.2d 97, 98 (5th Cir.1987) (creditors' committee may, in some circumstances, have the right to initiate an avoidance action); *In re STN Enterprises*, 779 F.2d 901, 904 (2d Cir.1985) ("We agree with these bankruptcy courts that 11 U.S.C. §§ 1103(c)(5) and 1109(b) imply a qualified right for creditors' committees to initiate suit with the approval of the bankruptcy court.").

87. Although the Bankruptcy Code does not expressly authorize a committee to initiate an adversary proceeding or pursue other causes of action on behalf of a debtor's estate, Congress allowed for a creditors' committee expressly to protect the rights of their constituents and similarly situated creditors. See, H.R. Rep. No. 95-595, at 91 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6053. To this end, section 1103(c) of the Bankruptcy Code authorizes the creditors' committee to "perform such other services as are in the interest of those represented," 11 U.S.C. § 1103(c)(5), and in furtherance thereof, section 1109(b) provides in pertinent part that "[a] party in interest, including...a creditors' committee...may raise and may appear and be heard on any issue in a case under [chapter 11]." 11 U.S.C. § 1109(b).

88. This right of a creditors' committee to raise and be heard would be meaningless if the creditors' committee did not also have the right to act on behalf of the estate when the debtor unjustifiably fails to do so. Indeed, "an important objective of the Code [to enlarge the value of the estate] would be impeded if the bankruptcy court has no power to authorize another party to proceed on behalf of the estate in the debtor's stead." *In re iPCS, Inc.*, 297 B.R. 283, 290

(Bankr. N.D. Ga. 2003) (citing *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 576-79 (3d Cir. 2003)); see also, *In re Joyanna Holitogs, Inc.*, 21 B.R. 323, 326 (Bankr. S.D.N.Y. 1982) ("A general right to be heard would be an empty grant unless those who have such right are also given the right to do something where those who should will not. In short, the right to be heard given the creditors' committee... includes the right to sue where a trustee or debtor in possession will not.").

89. The instant case is a perfect example of why Congress gave a creditors' committee the right to be heard and why so many circuits recognize the ability of a bankruptcy court to grant derivative standing to a creditors' committee. Here, to obtain authority to use the necessary cash collateral to operate and restructure during these Chapter 11 Cases, the Debtors agreed to, among other things, the Stipulations and were thus prevented from pursuing the Claims which will benefit their estates by millions of dollars. The Debtors also agreed to be bound by the PSA which also prevents the Debtors from asserting the Claims. The Committee was given a challenge deadline of August 15, 2016 to file a standing motion or else it will be bound by and subject to the Stipulations as well. In this circumstance, the Committee must be allowed to raise the Claims and be heard in order to fulfill its fiduciary duties and to protect its constituents and similarly situated creditors.

90. In *LWE I*, the Fifth Circuit acknowledged the ability of the bankruptcy court to grant derivative standing to the creditors' committee—outlining the basic requirements that (i) the claims be colorable; (ii) the debtor must have refused unjustifiably to pursue the claims; and (iii) the committee first obtain leave to sue from the bankruptcy court. *LWE I*, 832 F.2d at 1397 (relevant considerations but not necessarily "a formalistic checklist.") The Committee satisfies each of these elements.

B. The Claims are Colorable

91. The first threshold issue that the Court must address in analyzing the Committee's request for derivative standing is whether the Claims are colorable. The Bankruptcy Code does not specify which standard a court should use to evaluate the colorability of asserted claims in the context of a motion for derivative standing, but the prevailing case law consistently finds that the threshold "is a relatively easy one" to satisfy. *Adelphia Communs. Corp. v. Bank of Am. (In re Adelphia Communs. Corp.)*, 330 B.R. 364, 376 (Bankr. S.D.N.Y. 2005).

92. Indeed, in 2001, the Bankruptcy Court for the Northern District of Texas examined *LWE I* in the context of a colorability analysis and determined that to be colorable, claims must only "raise serious issues for determination." *In re ABC Utils. Servs.*, Case No. 89-41420-BJH-7, 2001 Bankr. LEXIS 2240, *27 (Bankr. N.D. Tex. Oct. 9, 2001) (denying standing on other grounds).

93. Several other courts outside of the Fifth Circuit have applied a Rule 12(b)(6) standard to the colorability analysis. See e.g., *PW Enters. v. N.D. Racing Comm'n (In re Racing Servs, Inc.)*, 540 F.3d 892, 900 (8th Cir. 2008) ("a creditor's claims are colorable if they would survive a motion to dismiss"); *Adelphia Communs. Corp.* 330 B.R. at 375 (The movant need only show that its claims are not facially defective or could otherwise survive a motion to dismiss).[15]

94. Based on its analysis of *LWE I*, the *ABC Utilities* court rejected the "motion to dismiss" standard, finding that a "colorable claim is one that raises a serious question even if the claim ultimately fails to survive a *Rule 12(b)(6)* motion to dismiss." *In re ABC Utils. Servs.*,

[15] "[T]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face'.... A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). The standard to survive a motion to dismiss does not rise to the level of a "probability requirement," but instead simply requires more than "a sheer possibility that a defendant acted unlawfully." *Id.*

2001 Bankr. LEXIS 2240 at *27 (relying on the fact that *LWE I* held the asserted claims colorable and went on to dismiss them on their merits for failing to state a claim.).

95. Under either test—the *ABC Utilities* test or the Rule 12(b)(6) test—the Claims that the Committee alleges in the Complaint far exceed the low threshold for colorability.

a. ***Counts I - II are Colorable***

96. Counts I and II of the Complaint are colorable. The Plan Support Parties have asserted and the Debtors have stipulated to the fact that the First Lien Indebtedness, the Second Lien Indebtedness, and the Third Lien Indebtedness are all secured by purportedly perfected mortgages, liens and security interests on the Debtors Prepetition Collateral, comprised of substantially all of the Debtors' oil and natural gas properties. The Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders have all "agreed" that the value of the perfected collateral represents 98.8% of the value of the Debtors' assets. As noted, the Committee investigation has revealed that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders did absolutely nothing to determine whether the purported liens were valid and enforceable. Each of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders admitted that they did nothing to confirm or validate the value of the Debtors' encumbered assets.

97. The Committee's investigation, described in detail above, demonstrates that at least 18% of the Debtors' oil and gas assets are not subject to valid, enforceable and perfected liens.

98. The determination of whether a creditor has properly perfected its security interest is governed by state law. See, e.g., *Stanton v. Texas Drug Co. (In re Stanton)*, 254 B.R. 357, 361-

62 (Bankr. E.D. Tex. 2000). Under Oklahoma law[16], to perfect a security interest in oil and gas lease or any real property interest, the lienholder must appropriately record its interest. Specifically, every document to be recorded "shall by its own terms describe the property by its specific legal description, and provide such information as is necessary for indexing as required in Sections 287 and 291 of this title..." 19 Okla. Stat. § 298. Sections 287 and 291 require the clerk of each county to keep a grantor-grantee index and a tract index, respectively. 19 Okla. Stat. §§ 287, 291. Needless to say, if a lease is not listed on a mortgage and the well associated with such lease is not listed on a mortgage, there is no perfected security interest in such lease.

99. *Clerical Errors in Location or Geographic Description*. Oklahoma law has previously recognized that certain facts within lien claimant's actual and constructive knowledge may place that claimant on inquiry notice of additional facts that could have been discovered with reasonable diligence, and that such inquiry may properly lead the party on notice to documents outside the property records, notwithstanding certain clerical errors. *Baker Hughes Oilfield Operations, Inc. v. Union Bank of CA, N.A. (In re Cornerstone E&P Co., L.P.)*, 436 B.R. 830, 852 (Bankr. N.D. Tex. 2010). (citing *Sisemore v. Voelkle*, 312 P.2d 922, 925 (Okla. 1957); *McGlumphy v. Jetero Constr. Co.*, 593 P.2d 76, 82 (Okla. 1978); and *Smith v. Thompson*, 402 P.2d 882, 885 (Okla. 1965)). The Oklahoma cases that impute constructive notice "are designed to protect innocent filers from clerical errors rather than to establish the proper standard for constructive notice." *Baker Hughes*, 436 B.R. at 853. In addition, Oklahoma case law has recognized that certain circumstances may place lien claimants on inquiry notice of additional facts that could have been discovered with reasonable diligence, including information contained in documents outside of the county records. *Sisemore*, 312 P.2d at 925; and *McGlumphy*, 593

[16] While the Committee's investigation has, to date, centered primarily on the Debtors' Oklahoma assets, the Committee is seeking standing to challenge and avoid any and all invalid, unenforceable and perfected lien on the Debtors' assets wherever located.

P.2d at 82. Notwithstanding constructive and inquiry notice allowance in Oklahoma, *Baker Hughes* found that that the mortgages including blanket description of leases for oil and gas assets and after-acquired properties, which did not include property descriptions sufficient for indexing in a county tract index, did not impart any constructive or inquiry notice on the plaintiffs. *Id.* at 853-856. As such, any failure to provide appropriate indexing or geographical location information would result in an unperfected lien.

100. *Expansive Granting Language is not Sufficient*. In Oklahoma, a legal description is sufficient "if it identifies the property with such particularity that it cannot be confused with or claimed to apply to, any other property. If the description is ample to distinguish it or set it apart from other property, then its exact and complete description may be shown by parol". *Thompson v. Giddings*, 276 P.2d 229, 233 (Okla. 1954) (it is not necessary for the name of the county and state to appear in a legal description "if said description is adequate without any addition thereto being necessary for its identification, to the exclusion of all other property of the contracting party sought to be charged with the obligation to convey it."). This suggests that in Oklahoma, although property descriptions in granting language need not be precise, they must be sufficient to identify a property to the exclusion of property within the same area. See, *id.* Hence, granting language conveying "all interests in Oklahoma" and those that are otherwise insufficient to allow identification to the exclusion of all other properties may not be sufficient, resulting in an unperfected interest.

101. *Conclusion*. The proposed Complaint is attached as Exhibit A to this Motion together with exhibits identifying each of the errors that the Committee has discovered thus far in Oklahoma. The errors are that the wells associated with such leases are not set out on the mortgage schedules and either (1) the lease at issue was not recorded on the mortgage, (2) the

incorrect geographic location was provided on the mortgage, or (3) the book and page where the lease was filed was incorrectly set out on the mortgage. The presence of only one of the characteristics is sufficient to prove that a mortgage is not perfected. Thus, the Committee disputes the perfection of any of the mortgages identified in the complaint. The Committee's investigation scope and procedure are sound, its analysis is consistent with Oklahoma law and it therefore has met or exceeded the low threshold of establishing a colorable claim for a declaratory judgment that certain of the Debtors' assets are not part of the Prepetition Collateral, as asserted by the Plan Support Parties.

b. *Count III is Colorable*

102. Count III of the Complaint is colorable. This Court may equitably subordinate the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders because of the harm they have sought to cause and have caused the Debtors' estates, and unsecured creditors because they knew (or should have known) that the Asserted Perfection Percentage of 98.8% is wholly false and they designed the Plan, death trap and case timeline in a concerted effort to coerce the Committee to blindly accept the Asserted Perfection Percentage. Specifically, the estate has colorable and sustainable claims to equitably subordinate the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders to the claims of all other creditors of the Debtors, in each case to remedy the inequitable and egregious conduct in which they engaged.[17]

i. *Legal Basis for Equitable Subordination*

103. Under section 510(c) of the Bankruptcy Code, a court has the power equitably to

[17] The Committee believes that prior court approval is not necessarily required under applicable law in order for the Committee to bring a direct claim for equitable subordination under section 510(c) of the Bankruptcy Code. Nonetheless, out of an abundance of caution, the Committee has included the equitable subordination claim in this Motion. Nothing herein is intended or shall be deemed to be a waiver of the Committee's right to bring any direct, rather than derivative, claims, including, without limitation, direct equitable subordination claims, as and when the Committee deems appropriate. All such rights are expressly reserved.

subordinate an allowed claim where (i) the claimant has engaged in inequitable conduct, (ii) the misconduct injured other creditors or conferred an unfair advantage, and (iii) the equitable subordination is not inconsistent with the Bankruptcy Code. *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692, 699-700 (5th Cir. 1977). The application of section 510(c) to a creditor's claims requires a fact intensive analysis. *Adelphia Communs Corp. v. Bank of Am., N.A. (In re Adelphia Communs Corp.)*, 365 B.R. 24, 69 (Bankr. S.D.N.Y. 2007).

ii. *Inequitable Conduct*

104. Courts have generally recognized three categories of inequitable conduct that may give rise to equitable subordination: "(1) fraud, illegality, breach of fiduciary duties; (2) undercapitalization; and (3) claimant's use of the debtor as a mere instrumentality or alter ego." *In re Missionary Baptist Foundation, Inc.*, 712 F.2d 206, 212 (5th Cir 1983). Other courts have allowed equitable subordination when the claimant is unjustly enriched "through another's loss brought about by one's own unconscionable, unjust, unfair, close or double dealing or foul conduct." *In re Tampa Chain Co.*, 53 B.R. 772, 779 (Bankr. S.D.N.Y. 1985). Any inequitable conduct directed at the debtor or its creditors may be sufficient to warrant subordination of the creditor's claim, regardless of whether that inequitable conduct was related to the acquisition or assertion of that claim. *In re Mobile Steel*, 563 F.2d at 700.

iii. *Injury to Unsecured Creditors or Unfair Advantage*

105. The second prong of the *Mobile Steel* test requires that the inequitable conduct must have actually caused injury to the other creditors or resulted in an unfair advantage to the claimant. An unfair advantage can exist where the inequitable conduct results in the granting of a lien, the validation of which would yield little or no distribution to the general unsecured creditors and therefore result in injury to those creditors or unfair advantage to the claimant. *In re Fabricators, Inc.*, 109 B.R. 186, 195 (Bankr. S.D. Miss. 1987).

iv. *Not Inconsistent with the Bankruptcy Code*

106. The third element of the *Mobile Steel* test serves as "a reminder to the bankruptcy court that although it is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable. *Enron Corp. v. Springfield Assocs., L.L.C.* (*In re Enron Corp.)*, 379 B.R. 425, 434 (S.D.N.Y. 2007) (quoting *U.S. v. Noland*, 517 U.S. 535, 539 (U.S. 1996). *Mobile Steel* was decided under the Bankruptcy Act and now that Equitable Subordination is expressly recognized under the Bankruptcy Code, it is thought that this third element is virtually moot. See, *80 Nassau Assocs. v. Crossland Fed. Sav. Bank (In re 80 Nassau Associates)*, 169 B.R. 832 (Bankr. S.D.N.Y. 1994) ("[S]ince the Bankruptcy Code, unlike its predecessors, expressly authorizes the remedy of equitable subordination, the third prong of the *Mobile Steel* test is likely to be moot.)

v. *Equitable Subordination of Non-Insider Claims*

107. In the Fifth Circuit, claims arising between a debtor and an insider will be "rigorously scrutinized by the courts." *In re Fabricators, Inc.*, 926 F.2d 1458, 1465 (5th Cir. 1991). If not an insider[18], for the purposes of equitable subordination, courts will typically require "evidence of more egregious conduct such as fraud, spoliation or overreaching." *Id.*

vi. *The Inequitable and Egregious Conduct of the Plan Support Parties Justifies Equitable Subordination of their Claims as Non-Insiders*

108. The inequitable conduct of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders began when they first started to negotiate the PSA with the goal of obtaining by "agreement" a perfected security interest in the Debtors' assets, to which

[18] The Committee does not concede that the Consenting Second Lien Noteholders and/or the Consenting Third Lien Noteholders are not insiders of the Debtors. However, the Court need not consider whether they are insiders because the Committee has established that the non-insider standard for equitable subordination is met in this case.

they were not legally entitled. All of the facts of this case, when taken together, demonstrate the presence of a scheme by the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders to deprive the unsecured creditors of their rightful recovery from the Debtors' estate. At bottom, the actions of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders exceed the standard required to equitably subordinate the claims of a non-insider. Their conduct is a perfect example of overreaching by a creditor, even perhaps amounting to fraud.

109. The facts are simple. The Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders knew or should have known that they did not hold valid, enforceable and perfected liens against all of the Debtors' oil and gas assets. First, at no time after the May 2015 transactions in which the Second Lien Notes and Third Lien Notes were issued did any of these noteholders take ***any*** steps to confirm that they had any valid, enforceable and perfected liens.

110. Second, they knew or should have known that the Debtors had no reasonable means of tracking perfected security interests in their assets; nevertheless, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders relied on the data from the Enertia database for the basis of their perfection diligence—knowing full well that database did not include such information. The Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders knowingly agreed to the Asserted Perfection Percentage and negotiated the treatment of creditor claims under a plan of reorganization without undertaking any reasonable steps to verify the accuracy of the Asserted Perfection Percentage.

111. After doing everything they could to artificially inflate their perfected position, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders then focused

on structuring a bankruptcy process that would insulate their erroneous Asserted Perfection Percentage from scrutiny. To that end the Consenting Second Lien Noteholders bought the votes of the members of the Cross-Over Ad Hoc Committee. They did so by offering an improper recovery to the holders of the Third Lien Notes (even though they are "out of the money") to entice them to support their inequitable Plan. Then, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders incorporated the death trap to coerce the Committee to not undertake the investigation required by its fiduciary duty and to prevent any objections to the Plan and Disclosure Statement. Finally, in an effort to stymie the Committee's certain investigation, the Plan Support Parties and the Debtors have pushed an unreasonable schedule that threatens the Committee's ability to exercise its fiduciary duties.

vii. *The Plan Support Parties Have Injured the Debtors and Sought Unfair Advantage*

112. The unfair advantage that the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders have sought will materially injure the Debtors' and their unsecured creditors. The Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders are seeking court validation of an agreement that confers on them a perfected security interest in hundreds of millions of dollars of unencumbered property, the value of which should properly be distributed to unsecured creditors. Under the current Plan, general unsecured creditors will receive a recovery of less than 1 percent. If the actual harm perpetrated on the general unsecured creditors is redressed and a strict claims priority is applied to the value of the truly unencumbered assets, they should recover at least 18% on their claims. That alone is sufficient basis for subordinating the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders.

viii. *Equitable Subordination is Not Inconsistent with the Bankruptcy Code*

113. Equitable subordination of the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders is entirely consistent with bankruptcy law and the equities of this case. The Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders should not be permitted to manipulate the Debtors and this Court to unjustly enrich themselves at the expense of the unsecured creditors.

ix. *Conclusion*

114. For the foregoing reasons, the Committee has met or exceeded the low threshold of establishing a colorable claim to equitably subordinate the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders.

c. *Counts IV and V are Colorable*

115. Counts IV and V of the Complaint assert breach of fiduciary duty claims against certain of the Debtors' officers and directors and are colorable. Because the Debtors are organized under the laws of Delaware, the internal affairs doctrine dictates that Delaware law applies with regard to the duties owed by the Debtors' directors and officers. See, *Atherton v. FDIC*, 519 U.S. 213, 223-24 (1997) ("States normally look to the State of a business' incorporation for the law that provides the relevant corporate governance general standard of care"). *Accord, Sommers Drug Stores Co. Employee Profit Sharing v. Corrigan*, 883 F.2d 345, 353-354 (5th Cir. 1989). "A claim for breach of fiduciary duty requires proof of two elements: (1) that a fiduciary duty existed and (2) that the defendant breached that duty." *Beard Research, Inc. v. Kates*, 8 A.3d 573, 602 (Del. Ch. 2010). Directors of a Delaware corporation generally owe two fiduciary duties to the company: a duty of care and a duty of loyalty. Corporate officers owe fiduciary duties that are identical to those owed by the directors. *Gantler v. Stephens*, 965

A.2d 695, 807-09 & n. 37 (Dec. 2009).

116. The duty of care requires that directors inform themselves of "all material information reasonably available to them," prior to making a business decision. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (citation omitted). Directors must "act in an informed and deliberate manner" prior to making a business decision. *Id.* at 873. Gross negligence is the standard in determining if there has been a breach of the duty of care. *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27, 53 (Del. Ch. 2006).

117. The duty of loyalty dictates that directors and officers have an "affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage. In short, directors must eschew any conflict between duty and self-interest." *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1345 (Del. 1987). If directors or officers engage in a self-interested transaction, in which their personal interest affects their decision-making, then they bear the burden to show that the transaction is objectively and entirely fair to the company. See, *Williams v. Geier*, 671 A.2d 1368, 1384 (Del. 1996); see also, *Think3 Litig. Trust v. Zuccarello (In re Think3, Inc.)*, 529 B.R. 147, 175 (Bankr. W.D. Tex. 2015) ("If a fiduciary would be or was affected by the self-interested transaction, a valid claim for the breach of duty of loyalty exists").

118. The following duties are included as part of the duties of care, loyalty, or both:

- **Good Faith:** "To act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation." *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006). Directors cannot "consciously and intentionally disregard[ ] their responsibilities, [or] adopt[ ] a 'we don't care about the risks' attitude concerning a material corporate decision." *Id.* at 754-55 (citing *In re Walt Disney Co.*

Derivative Litigation, 825 A.2d 275, 289 (Del. Ch. 2003)). The duty of good faith is a subset of the duty of loyalty. *Stone ex rel. AmSouth Bancorporation v. Ritter,* 911 A.2d 362, 370 (Del. 2006).

- **Disclosure:** Directors are obligated to disclose all material information when soliciting stockholder action. *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992). "When . . . directors disseminate information to stockholders when no stockholder action is sought, the fiduciary duties of care, loyalty and good faith apply." *Malone v. Brincat*, 722 A.2d 5, 12 (Del. 1998). The duty of disclosure is an application of both the duties of care and loyalty. *Pfeffer v. Redstone*, 965 A.2d 676, 684 (Del. 2009).

- **Candor:** Directors have a duty to disclose to the board material information in their possession bearing upon a board decision, particularly where the directors have a personal interest in the outcome of the board decision. *Mills Acquisition Co. v. Macmillan, Inc.,* 559 A.2d 1261, 1283 (Del. 1989). This is an application of the duty of loyalty.

- **Duties in Particular Transactional Contexts** (*e.g., Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (duty to maximize price in sale of control); *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (duty to act reasonably in response to threat in adoption of takeover defenses)). *Revlon* and *Unocal* duties have been held to be applications of both the duties of care and loyalty. *Malpiede v. Townson,* 780 A.2d 1075, 1086 (Del. 2001) (*Revlon*); *Gilbert v. El Paso Co.*, 575 A.2d 1131, 1146 (Del. 1990) (*Unocal*).

- **Duties of Oversight:** Directors have a duty "to assure [that] a reasonable information and reporting system exists." *In re Caremark International Derivative Litigation,* 698 A.2d 959, 971 (Del. Ch. 1996). The duty of oversight is an application of the duties of care and loyalty. *Guttman v. Huang*, 823 A.2d 492, 506 (Del. Ch. 2003).

119. Here, the Debtors' directors and officers owed a fiduciary duty to the Debtors for the benefit of all of their creditors – including general unsecured creditors. And yet, certain of those individuals negotiated the PSA based upon the Asserted Perfection Percentage, which is demonstrably false and which they knew or should have known was false, and which substantially harms the Debtors' estates and general unsecured creditors, including by depriving the unsecured creditors of their rightful recovery under applicable law. Instead, certain of the

Debtors' directors and officers shirked their duty to ensure the accuracy of the Asserted Perfection Percentage, and instead moved forward with the PSA because the plan transactions included significant personal benefits to the Debtors' officers in the form of assumed employment agreements, a Management Incentive Plan, and the other significant forms of compensation and benefits provided for by the Management Compensation Term Sheet attached to the Plan.

120. The directors and officers breached their duties of care and loyalty and, in doing so, agreed to a deal that converts significant value that should otherwise be for the benefit of the Debtors' general unsecured creditor constituency.

d. *Count VI is Colorable*

121. Count VI asserts a claim against the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders for aiding and abetting the Defendant Directors and Defendant Officers in their breaches of fiduciary duty.

122. "The elements for a claim of aiding and abetting a breach of fiduciary duty are: (1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff resulted from the concerted action of the fiduciary and the nonfiduciary." *Metro. Life Ins. Co. v. Tremont Group Holdings, Inc.*, C.A. No. 7092-VCP, 2012 WL 6632681, 2012 Del. Ch. LEXIS 287, at *68-70 (Del. Ch. Dec. 20, 2012) (internal quotation omitted).

123. "Knowing participation in a fiduciary breach requires that the nonfiduciary act with the knowledge that the conduct advocated or assisted constitutes such a breach." *Triton Constr. Co. v. Eastern Shore Elec. Servs., Inc.*, No. 3290-VCP, 2009 WL 1387115, 2009 Del. Ch. LEXIS 88, at *50 (Del. Ch. May 18, 2009).

124. Here, as demonstrated above and in the draft Complaint, the Debtors' directors

and officers owed a fiduciary duty not only to their secured creditors, but to all of their creditors, and that duty was breached by simply assuming the validity of the Asserted Perfection Percentage without any meaningful diligence or analysis to the extreme detriment of the Debtors' estates and general unsecured creditors. Under the Plan, the Debtors' estates are being deprived of hundreds of millions of dollars of unencumbered asset value because the wrongful and equitable conduct of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders as described in detail above and in the draft Complaint. Through such conduct, the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders satisfy the legal requirements for aiding and abetting the Debtors' directors and officers in breaching their fiduciary duties.

e. ***Count VII is Colorable***

125. Count VII asserts a claim against the Consenting Second Lien Noteholders, Consenting Cross-Over Noteholders, and Defendant Officers for their conspiracy to fraudulently misrepresent the extent of the perfected liens encumbering the Debtors' assets in an attempt to deprive the Debtors and the Debtors' estates of the fair value of their assets.

126. The elements for civil conspiracy are: "(1) two or more persons; (2) an object to be accomplished; (3) a meeting of the minds on the object or course of action; (4) one or more unlawful, overt acts; and (5) damages as a proximate result." *Chon Tri v. J.T.T.*, 162 S.W.3d 552, 556 (Tex. 2005); *accord Triton Constr. Co.*, 2009 Del. Ch. LEXIS 88, at *53 ("The elements for civil conspiracy under Delaware law are: (1) a confederation or combination of two or more persons; (2) an unlawful act done in furtherance of the conspiracy; and (3) damages resulting from the action of the parties to the conspiracy").

127. Here, there were two or more parties – the Defendant Officers and all of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders – who intended to

move forward with a plan that was based on a demonstrably false Asserted Perfection Percentage. They knew or should have known that the Asserted Perfection Percentage was false and did absolutely nothing to test the assertion. Instead, they moved forward with the PSA and structured an expedited plan process and death-trap provision so as to make it as difficult as possible for the Committee and the Court to ascertain the truth of their actions. In doing so, the debtors and the general unsecured creditor constituency have been damaged severely by being denied their rightful share of hundreds of millions of dollars in unencumbered value. The conspirators' actions as described above and in the draft Complaint meet the standards for civil conspiracy.

f. ***Count VIII is Colorable***

128. Count VIII asserts a claim against the Second Lien Noteholders and the Third Lien Noteholders for recharacterization of all adequate protection payments made to them during these cases as payments towards their claims to the extent that they are secured (which is, in effect, only the claims of the Second Lien Noteholders as the Third Lien Noteholders are completely unsecured. As a result, Count IX seeks disgorgement of all such payments made to the Third Lien Noteholders).

129. Under section 506(b) of the Bankruptcy Code, "[t]o the extent that an allowed secured claim is secured by property the value of which … is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose." 11 U.S.C. § 506(b). Thus, only creditors that are oversecured are entitled to receive such fees, costs, or charges.

130. Here, even according to the Debtors' own analysis, the Second Lien Noteholders are substantially undersecured and it is beyond dispute that the Third Lien Noteholders are

entirely unsecured and "out of the money." Yet, pursuant to the Final Cash Collateral Order, the Second Lien Noteholders and the Third Lien Noteholders are receiving adequate protection payments. The right to recharacterize such payments was expressly reserved. Final Cash Collateral Order at ¶¶ E, 18.

131. Upon information and belief, at all relevant times, including on the Petition Date, the Second Lien Noteholders and Third Lien Noteholders were undersecured (and in the case of the Third Lien Noteholders were wholly unsecured) because the value of the collateral securing the Second Lien Notes and Third Lien Notes was less than the amount of the Second Lien Noteholders' and Third Lien Noteholders' claims. Accordingly, any adequate protection payments made to these parties during these Chapter 11 Cases must be recharacterized as payments of the secured portion of their claims, if any, and, in the case of the Third Lien Noteholders, must be disgorged because the Third Lien Noteholders are wholly unsecured.

g. ***Count IX is Colorable***

132. Count IX asserts a claim against the Third Lien Noteholders for the disgorgement and/or avoidance and recovery of all adequate protection payments made, and all other adequate protection rights and interests granted, to them during these Chapter 11 Cases pursuant to the Final Cash Collateral Order.

133. The Final Cash Collateral Order authorized the Debtors, subject to the Committee's right to object, to make payments to the Third Lien Noteholders purportedly as adequate protection and otherwise to provide Third Lien Noteholders with adequate protection in the form of various claims, interests, rights and liens as more fully described in the Final Cash Collateral Order, including, without limitation, the Third Lien Adequate Protection Liens and the Third Lien 507(b) Claim (collectively, the "Third Lien Adequate Protection Interests").

134. Where, as here, the value of the collateral shared by senior and junior lien

creditors is exceeded by the amount of the senior creditors' claims, the junior creditors are not entitled to adequate protection. See, e.g., In re Levitt & Sons, LLC, 384 B.R. 630, 639-40 (Bankr. S.D. Fla. 2008) ("[J]unior lien creditors' liens have no value because there is no value in the collateral beyond the Pre-Petition Debt owed to [the senior lien creditor] on such collateral. Thus, the junior lien claimants are not entitled to adequate protection . . . because at best they have a zero value lien."); *In re Dunckle Assocs., Inc.*, 19 B.R. 481, 485 n.10 (Bankr. E.D. Pa. 1982) ("The law is well settled that valueless junior secured positions ... are not entitled to adequate protection.").

135. The Third Lien Noteholders and/or their agents and professionals were not entitled to receive this adequate protection, however, because it is beyond dispute that they are entirely unsecured. Accordingly, the Third Lien Adequate Protection Interests are subject to disgorgement, avoidance, and recovery by the Debtors' estates.

h. *Count X is Colorable*

136. Count X asserts and objection to the claims asserted by or on behalf of the Second Lien Noteholders and the Third Lien Noteholders in these Chapter 11 Cases, including, without limitation, all formal and informal proofs of claim that may have been filed to date.

137. Pursuant to section 502(d) of the Bankruptcy Code and Bankruptcy Rules 3007, 3012, and 7001, each of the Second Lien Noteholders' and the Third Lien Noteholders' claims should be disallowed until such time as the Claims raised in the proposed Complaint have been finally resolved. If the Committee successfully obtains judgment on its Claims, the Court must disallow the claims of the Second Lien Noteholders and the Third Lien Noteholders until such time as they have satisfied such judgment. *See* 11 U.S.C. § 502(d); *In re Octagon Roofing*, 156 B.R. 214, 219 (Bankr. N.D. Ill. 1993) ("[A] claim may be disallowed not only if the claimant has a § 550 judgment pending against it, but also if that claimant was granted a security interest that

is voidable under § 544 or one of the other avoidance actions, even if a judgment pursuant to § 550 has not been entered.").

i. *Count XI is Colorable*

138. Count XI asserts a colorable claim to surcharge the Adequate Protection Collateral of the Second Lien Noteholders and the Third Lien Noteholders (if any) under section 506(c) of the Bankruptcy Code.

139. Section 506(c) of the Bankruptcy Code provides that the "trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim." This provision allows a claimant who "expends money to provide for the reasonable and necessary costs and expenses of preserving or disposing of a secured creditor's collateral . . . to recover such expenses from the secured party or from the property securing an allowed secured claim held by such party," thus "prevent[ing] a windfall to the secured creditor at the expense of the claimant." *Precision Steel Shearing, Inc. v. Fremont Fin. Corp.* (*In re Visual Indus., Inc.*), 57 F. 3d 321, 325 (3d Cir. 1995). Section 506(c) thus shifts the costs of preserving or disposing of a secured party's collateral from the debtor to the secured party which has benefited from the expenditure, as such "costs might otherwise be paid from the unencumbered assets of the bankruptcy estate." *Id.*

140. Here, all costs and expenses incurred in preserving the Adequate Protection Collateral of the Second Lien Noteholders and the Third Lien Noteholders (if any) to which they are not entitled because of their undersecured and/or unsecured status are subject to recovery by the Debtors' estates pursuant to section 506(c).

C. **The Debtors Unjustifiably Refused to Bring the Claims**

141. After finding that the claims the Committee seeks to assert are colorable, the next component of the analysis is to determine whether the debtor has unjustifiably refused to assert those claims. *LWE II*, 858 F. 2d at 245-46.

142. Numerous courts have recognized that a formal demand that a debtor pursue a claim is not needed in all circumstances for purposes of derivative standing, especially where the demand would be futile. See, e.g., *LWE I* at 1397-1398 (rejecting a lack of standing argument where, among other things, making a formal demand would have been futile); *In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1254 (5th Cir. 1986) (noting that demonstrable futility can excuse the need for a formal demand); *In re First Capital Holdings Corp.*, 146 B.R. 7, 13 (Bankr. C.D. Cal. 1992); *Official Committee of Unsecured Creditors v. Clark (In re Nat'l Forge Co.)*, 326 B.R. 532, 544-45 (W.D. Pa. 2005).

143. In *Nat'l Forge Co.*, the court explained that the policy behind the general requirement that there be a formal demand is to ensure that (i) the debtor is informed of the committee's intent to assert claims, and (ii) the debtor is given the chance to explain its reasons for declining to pursue the claims itself. *Nat'l Forge Co.*, *supra*, 326 B.R. at 544. In that case, as here, there was a debtor in possession financing order that tasked the committee with investigating claims the debtor's lenders and, if appropriate, commencing litigation. *Id.* The debtor was well aware of the investigation and the possibility of litigation. *Id.* Furthermore, as here, the debtor in that case had waived its claims against its lenders in the financing orders. *Id.* at 545. For these reasons and others, the court found that it would have been futile to make any formal demand and that the debtor was not prejudiced by a lack of a demand given its knowledge of the committee's investigation and the possibility of litigation. *Id.* at 544-545.

144. Here, the Debtors commenced these cases and filed the Plan to implement the terms of the PSA. In addition, in the Final Cash Collateral Order, the Debtors waived the right to assert the claims the Committee seeks to pursue. *Final Cash Collateral Order* at ¶¶ D, E. The PSA similarly prevents the Debtors from asserting the claims the Committee seeks to pursue. The Debtors are fully aware of the Committee's investigation here. Under these circumstances, it is beyond futile for the Committee to make a formal demand that the Debtors bring the Claims on their own.

145. Moreover, even if a demand were required, the Debtors would be unjustified in refusing the demand. In *LWE II*, the Fifth Circuit analyzed when a debtor is deemed to have unjustifiably refused to pursue a cause of action, holding when a colorable cause of action exists that would increase the value of the estate and the debtor is either unwilling or unable to fulfil its obligation to pursue that cause of action, a committee may assert it on the debtor's behalf. *Id.* at 252. According to *LWE II*, to determine whether a debtor's refusal to prosecute a cause of action is unjustified, the court must look to "whether the interest of creditors were left unprotected as a result" of the refusal—essentially a cost-benefit analysis. *Id.* at *61 n.20 ("As the interests of creditors are imperiled where valid and profitable state law causes of action are neglected by the [debtor], the unjustified refusal calculus will generally amount to little more than a cost-benefit analysis.") (citing *Coral Petroleum, Inc.*, 797 F.2d at 1363; *Fuel Oil Supply & Terminaling v. Gulf Oil Corp.*, 762 F.2d 1283 (5th Cir. 1985)).[19]

[19] *LWE II* notes specifically that its analysis applies when the debtor is either "unable or unwilling." In that case, there was a conflict of interest that prevented the Debtor from asserting it causes of action against its officers and directors. Similarly, in the instant case, the Debtors are unable to pursue the Claims because it is bound by the terms of the Final Cash Collateral Order and the PSA. Judge Shannon in the Bankruptcy Court for the District of Delaware recently considered whether a debtor's stipulation not to bring claims in exchange for consideration such as DIP financing or use of cash collateral constituted a justifiable business decision such that a committee should be denied derivative standing. See, *In re The Standard Register Company, Inc.*, Case No. 15-10541, June 8, 2015 Hearing Transcript [Doc. 663] at 64-65. Judge Shannon stated that "[i]t cannot be that a Debtors' rational decision to reach an accommodation with its secured lender before filing, with all the obvious benefits associated with that

146. Applying *LWE II's* cost-benefit analysis to the instant case immediately reveals that the benefits that the Claims will confer on the estate and the unsecured creditors far outweigh the costs of any attendant litigation. To date, the Committee investigation has revealed that more than 18% of the Debtors assets, representing more than $100 million at PV10 are unencumbered. In addition, equitable subordination of some or all of the claims of the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders will provide substantial further benefit to the estates. As such, the Debtors' inability to satisfy its obligation to prosecute the Claims, which would result in an enormous benefit to the estates, amounts to an unjustified refusal such that the Court should grant derivative standing to the Committee to pursue them.

REQUEST FOR EMERGENCY CONSIDERATION

147. The Committee requests that the Court hear this Motion on an emergency basis, and set the hearing on the Motion for the already scheduled August 17, 2016, or as soon thereafter as the Court deems appropriate.

148. The Committee has worked diligently to complete its lien investigation and a targeted review of the more than 7,000 lease, mortgage, title opinion and other security documents relevant to its analysis in time to meet the August 15, 2016 challenge deadline established by the Final Cash Collateral Order. Over the past two weeks alone, the Committee has taken Rule 30(b)(6) depositions of (i) the Ad Hoc Committee of Second Lien Noteholder, (ii) the Cross-Over Ad Hoc Committee, (iii) the First Lien Agent, and (iv) the Debtors.

accommodation, is sufficient to insulate potential claims from review by a committee." *Id.* To allow such a result and finding would render the committee's standing rights meaningless. Accordingly, the mere fact that the Debtors received needed consideration in exchange for the Stipulations does not mean that the Debtor's inability to prosecute the Claims is somehow justified.

149. Based on the Committee's review and the information learned from the foregoing depositions, the Committee has determined that Asserted Perfection Percentage is patently false and that hundreds of millions of dollars in unencumbered value exists and must be pursued for the benefit of the Debtors' unsecured creditors. Significantly, the investigation has revealed the existence of Claims that tie directly to the confirmability of the Plan, and the full and final adjudication of the Complaint is a necessary precursor to the Court's ability to conduct the Confirmation Hearing for numerous reasons.

150. The colorable claims that the Committee is seeking to bring necessarily must be determined by the Court before the Court can rightfully consider confirmation of the Plan. It is beyond any reasonable dispute that if the Asserted Perfection Percentage is materially lower than 98.8% and the Consenting Second Lien Noteholders and Consenting Cross-Over Noteholders conspired to deprive the unsecured creditors of their rightful recovery from the Plan's vastly understated amount of unencumbered assets, the Plan is fatally flawed and unconfirmable for any number of reasons including, without limitation:

i. the Disclosure Statement will have provided materially false information that violates section 1125 of the Bankruptcy Code and the solicitation of votes on the Plan will be voidable;

ii. the Plan fails to comply with the applicable provisions of title 11 of the United States Code because, among other things, the Disclosure Statement violates section 1125 of the Bankruptcy Code and the Plan improperly classifies the claims of holders of Third Lien Notes, Unsecured Notes and General Unsecured Claims and treats the claims of holders of Third Lien Notes materially better than the claims of Unsecured Notes and General Unsecured Claims; thus the Plan and the Debtors fail to comply with the requirements of sections 1129(a)(1) and 1129(a)(2) of the Bankruptcy Code;

iii. the Plan was proposed in bad faith and by means forbidden by law in violation of section 1129(a)(3) of the Bankruptcy Code;

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re:	§	Chapter 11
MIDSTATES PETROLEUM COMPANY, INC., *et al.*,[1]	§	Case No. 16-32237 (DRJ)
Debtors.	§	(Jointly Administered)
	§	**Re: Docket No. 492, 493**

DEBTORS' PRELIMINARY OBJECTION TO EMERGENCY MOTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS FOR LEAVE, STANDING AND AUTHORITY TO PROSECUTE CLAIMS ON BEHALF OF THE DEBTORS' ESTATES AND FOR RELATED RELIEF

Yesterday afternoon, the Committee filed a 65-page motion for standing, attaching a 67-page complaint and more than ten other exhibits. Furthermore, the Committee has requested that the motion be heard on August 17, 2016, at 3:00 p.m., approximately 46 hours after it was filed. Not only is this request ironic coming from a party that has cried foul throughout these cases about perceived deficiencies in timing (despite all applicable notice periods being fully honored by the Debtors to date), but it is, more importantly, contrary to the Committee's statements at last week's hearing.

Indeed, at last week's hearing, after initially proposing that its standing motion be heard on August 17, Committee counsel, at the invitation of the Court, came to the conclusion that this motion should ***not*** be heard on August 17:

> **MR. KINEL:** I'm going to walk myself back on that one... I think your Honor is essentially saying that we'd have a status

[1] The debtors in these chapter 11 cases, along with the last four digits of each debtor's federal tax identification number, are: Midstates Petroleum Company, Inc. (1816) and Midstates Petroleum Company LLC (2434). The debtors' service address is: 321 South Boston Avenue, Suite 1000, Tulsa, Oklahoma 74103.

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> conference in light of whatever the committee had filed, and I think that makes perfect sense.
>
> **THE COURT**: ...So, the 3:00 o'clock setting [on August 17], that's—that's a hearing regardless of what happens. It's either a[n] uncontested confirmation hearing, which we already scheduled, or it's a scheduling status conference to talk about what the effects of whatever it is that the committee decides that it wants to file...
>
> **MR. KINEL**: I think it's an excellent idea and very good timing wise...

Hr'g Tr. 36:16–38:2 (Aug. 8, 2016).

This is not even the only example from yesterday of the Committee going back on its agreements on timing. In exchange for the secured creditors' agreement to an extra month to conduct the investigation that led to the motion, the Committee agreed, as counsel to the Debtors stated on the record without any dispute or clarification from counsel to the Committee, "not to seek further adjournments of the disclosure statement hearing or the confirmation hearing, except with respect to the confirmation hearing in the event the terms of the plan approved for a solicitation by the Court provides for any materially less favorable treatment of unsecured creditors than the current plan." Hr'g Tr. 9:13–19 (June 20, 2016). The Plan approved for solicitation was not modified as to the treatment of unsecured creditors in any way: thus, the Committee has no right to request adjournment of the confirmation hearing. Nevertheless, the Committee now states, in no uncertain terms, "that the August 29, 2016 Confirmation Hearing must be adjourned until such time as the claims raised by the Committee in the Complaint have been fully and finally adjudicated or resolved by agreement of the parties." (Motion, ¶ 152.) The Committee then reflexively argues that its request does not strictly violate the cash collateral order, but it does directly contradict the record from the June 20 hearing on the resolution of the parties' disputes regarding cash collateral and the Committee's request to adjourn the disclosure statement hearing.

The reason for ***not*** hearing the motion tomorrow is obvious: the Committee has proposed eleven counts of claims that all must be adequately briefed, argued, and, to the extent necessary, tried, all with an eye toward the Committee's burden of demonstrating that the claims are colorable and that the Debtors have no justification for not pursuing them. The Committee has only ever previewed one of the theories contained in the motion with the Debtors and has yet to make a settlement proposal that indicates the amount of value that the Committee feels unsecured creditors are entitled to receive in these chapter 11 cases. Giving the Debtors, whose stewardship of these purported claims is vital to the success of this restructuring, and the defendants to the claims less than two days' time—in the midst of confirmation preparations—to prepare to oppose the motion would be highly prejudicial.

As the Debtors have stated ever since that June 20 hearing, the proper time to take up these claims is after consideration of confirmation of the Plan. It will be the Debtors' burden at confirmation to prove the treatment provided to the Debtors' secured creditors and unsecured creditors is appropriate given the extent to which the secured creditors' liens are valid, enforceable, and perfected; that the releases contemplated by the plan are justified under applicable law; that the plan is fair and equitable and does not unfairly discriminate; and that it otherwise complies with the requirements of the Bankruptcy Code. If the Debtors demonstrate all of these points, then the Committee's assertions will have been found to be without merit (or, at the least, moot).[2]

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[2] While the Committee has warped this fundamentally legal dispute into a wide-reaching conspiracy theory by mischaracterizing the typical events of a large, prenegotiated restructuring, the Debtors reiterate their previous statements to the Committee on and off the record indicating that the core issue in these cases—the extent of the prepetition secured lenders' liens—will be governed by a disagreement about what the law says. *See, e.g.*, *Debtors' (A) Omnibus Reply in Support of Cash Collateral Motion; (B) Omnibus Reply in Support of Disclosure Statement Motion; and (C) Objection to Emergency Motion of the Official Committee of Unsecured Creditors to Continue Disclosure Statement Hearing* [Docket No. 275] at 12 n.9 ("The Debtors' mortgages provide for blanket liens on all properties described in their exhibits, as well as all lands now or hereafter unitized with the properties described in the exhibits. Under applicable state law, that grant is valid and

But the substance of the Committee's motion is for another day—indeed, that is precisely the point of this preliminary objection. As originally agreed by the parties at last week's hearing, the Debtors look forward to discussing these scheduling points further with the Court at the August 17 status conference and with the parties, in the meantime.[3]

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enforceable against third parties, meaning only one lease or well in any given unit must be properly described for all other properties in that unit to be encumbered."). This preliminary objection is filed without prejudice to any party's rights, remedies, or potential causes of action against the Committee, its members, or its advisors arising out of the filing of the Committee's motion.

[3] For the avoidance of doubt, the Debtors reserve all rights to oppose the Committee's motion, whether before or after the confirmation hearing.

Houston, Texas
Dated: August 16, 2016

/s/ Joshua A. Sussberg, P.C.

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