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Sept. 24, 2020, 5:00-6:15 p.m.

Views from the Bench: Confirmation Roundtables: Competing Interests in Today's Chapter 11

Hon. Ashely M. Chan; U.S. Bankruptcy Court (E.D. Pa.)

Hon. Robert D. Drain; U.S. Bankruptcy Court (S.D.N.Y.)

Jay M. Goffman; Rothschild & Co.

Hon. Christine M. Gravelle; U.S. Bankruptcy Court (D.N.J.)

Paul D. Leake; Skadden Arps Slate Meagher & Flom LLP

Hon. Karen B. Owens; U.S. Bankruptcy Court (D. Del.)

Educational Materials

VIEWS FROM THE BENCH

Confirmation Roundtable

<u>Panelists</u>

Hon. Robert D. Drain*
U.S. Bankruptcy Court (S.D.N.Y.)

Hon. Christine M. Gravelle*
U.S. Bankruptcy Court (D.N.J.)

Hon. Karen B. Owens*
U.S. Bankruptcy Court (D. Del.)

Hon. Ashely M. Chan*
U.S. Bankruptcy Court (E.D. Pa.)

<u>Moderators</u>

Jay M. Goffman
Rothschild & Co.

Paul D. Leake
Skadden, Arps, Slate, Meagher & Flom LLP

September 24, 2020 | Washington, DC

* The views expressed in this presentation do not necessarily represent the views of the judges. Nothing the judges say today may be construed as binding them to any legal position or commentary on the direction their courts may take in the future.

Today's Topics

- Third Party Releases
  - Duty to object to third party releases under section 1141(a) of the Bankruptcy Code
    - Melinta Therapeutics, Inc., No. 19-12748 (Bankr. D. Del. Apr. 2, 2020)
  - Constitutional adjudicatory authority
    - In re Millennium, 945 F.3d 126 (3d Cir. 2019)
- "Best Interests" Test
    - In re Ditech Holding Corp., 606 B.R. 544 (Bankr. S.D.N.Y. 2019)
- Impaired accepting classes and artificial impairment
    - Village Green I, GP v. Fed. Nat'l Mortg. Assoc'n, 811 F. 3d 816 (6th Cir. 2016)
- Proving feasibility during the current pandemic
- Unfair Discrimination
    - In re Tribune Media Co., No. 18-2909, 2020 WL 5035797 (3d Cir. 2020)

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Melinta Therapeutics, Inc., No. 19-12748 (Bankr. D. Del. Apr. 2, 2020)

- Facts:
  - Debtors' proposed plan included a third party release. The releasing parties included holders of claims that were (i) deemed to accept the plan, (ii) voted to accept the plan, or (iii) abstained from voting and failed to opt-out by sending back the form.
  - Relying on In re Emerge Energy Services LP, the U.S. Trustee argued that a failure to opt-out was insufficient to constitute consent to the third party releases.
  - Debtors contended that Emerge (which had adopted the minority position on consent) fails to account for (i) the bankruptcy overlay to the consent analysis, (ii) the fact that all parties in interest have a duty to speak under section 1141 of the Bankruptcy Code, and (iii) the binding nature of a confirmed chapter 11 plan on all parties in interest.
- Holding:
  - Silence was deemed consent to third party releases contained in a chapter 11 plan pursuant to section 1141(a) of the Bankruptcy Code

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In re Millennium, 945 F.3d 126 (3d Cir. 2019)

- Facts:
  - The DOJ sued Millennium for violating various laws, and the Center for Medicare and Medicaid Services ("CMS") notified Millennium that it would be revoking its billing privileges.
  - Millennium entered into a settlement agreement with the DOJ and CMS but would have been unable to service both the settlement and its obligations under its credit agreement.
  - In exchange for full debtor and third party releases of all claims arising prior to the restructuring, Millennium's existing shareholders agreed to:
    1. Contribute $325 million in cash to fund the settlement; and
    2. Give up 100% of their equity interests and transfer ownership of the company to the company's lenders.
  - Millennium sought to implement this settlement through a prepackaged case.
  - Voya objected and argued (i) the releases were unlawful, and (ii) the bankruptcy court lacked subject matter jurisdiction and the constitutional authority to approve them.

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In re Millennium, 945 F.3d 126 (3d Cir. 2019) (cont.)

- Procedural History:
  - Bankruptcy court overruled the objection and confirmed Millennium's plan.
  - Appealed to the district court and remanded to the bankruptcy court on the specific question: whether or not the bankruptcy court had constitutional adjudicatory authority to approve nonconsensual third party releases?
  - Judge Silverstein held that the bankruptcy court has such authority.
- Third Circuit Holding:
  - Affirmed lower court rulings that (i) the bankruptcy court has constitutional authority to approve a plan including nonconsensual releases when it is exercising its "core" statutory authority, and (ii) the releases are "integral" to the restructuring.
  - Limited its decision to the facts of this case:
    - Intensive negotiations between sophisticated parties.
    - Releases were "absolutely required" for the reorganization.
    - Debtors would have gone into liquidation without the releases.

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In re Millennium, 945 F.3d 126 (3d Cir. 2019) (cont.)

- Facts:
  - Debtors were subject to thousands of formal and informal proceedings in which Consumer Creditors were asserting claims and defenses of types described in section 363(o) of the Bankruptcy Code.
    - Section 363(o): "notwithstanding subsection (f), if a person purchases any interest in a consumer credit transaction that is subject to the Truth in Lending Act or any interest in a consumer credit contract … and if such interest is purchased through a sale under this section, then such person shall remain subject to all claims and defenses that are related to such consumer credit transaction or such consumer credit contract, to the same extent as such person would be subject to such claims and defenses of the consumer had such interest been purchased at a sale not under this section."
  - Debtors' chapter 7 liquidation analysis did not consider Consumer Creditors' claims and defenses against nondebtor third parties.

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In re Ditech Holding Corp., 606 B.R. 544 (Bankr. S.D.N.Y. 2019) (cont.)

- Issues:
  - Whether section 363(o) applied to asset sales in a chapter 11 plan?
  - Whether section 1129(a)(7) required consideration of claims against nondebtor third parties?
- Holding:
  - Section 363(o) does not apply to asset sales in a chapter 11 plan.
    - The purchaser of the debtors' assets buys the assets "free and clear" of Section 363(o)-type claims under sections 1123(a), (b) and 1141(c). Accordingly, holders of such claims have no recourse - and no recovery - against the buyer.
  - Denied confirmation of the plan because the debtors failed to satisfy the "best interests" test.
    - Section 363(o) is applicable in a hypothetical liquidation under chapter 7 and, thus, relevant to the court's determination of whether the debtors have met the burden under section 1129(a)(7) that a creditor receives under a plan at least as much as it would receive in a chapter 7 liquidation.

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Impaired Accepting Classes and Artificial Impairment

- Relevant Statutes:
  - Section 1129(a)(10): A plan can only be confirmed when at least one class of claims that is impaired under the plan has voted to accept the plan.
  - Section 1124: A plan impairs a class of claims unless it "leaves unaltered the legal, equitable, and contractual rights" of the claim holders.
- "Artificial" or "economically driven" impairment?
  - Eighth Circuit's View: section 1129(a)(10) recognizes impairment only to the extent that it is caused by economic "need."
  - Ninth Circuit's View: "a creditor's claim is 'impaired' unless its rights are left 'unaltered' by the plan," and "[t]here is no suggestion here that only alterations of a particular kind or degree can constitute impairment."
    - Approach adopted by the Fifth Circuit in In re Village at Camp Bowie I, L.P., 710 F.3d 239 (5th Cir. 2013).

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Village Green I, GP v. Fed. Nat'l Mortg. Assoc'n, 811 F. 3d 816 (6th Cir. 2016)

- Does artificial impairment offend a plan proponent's duty of good faith under section 1129(a)(3)?
- The Sixth Circuit addressed this open question:
  - Rejected the Eighth Circuit's view.
  - Joined the Ninth Circuit's view that section 1129(a)(10) does not distinguish between discretionary and economically driven impairment.
  - Concluded that debtor's motives regarding artificial impairment for the purposes of contriving an impaired accepting class are more appropriately addressed under section 1129(a)(3).
  - Agreed with the district court that the bankruptcy court clearly erred when it found that the debtor proposed its plan in good faith.

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Proving Feasibility In the COVID-19 Era

- Section 1129(a)(11): A plan of reorganization may be confirmed only if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan . . . ."
- Typical Evidence to Prove Feasibility:
  - The debtor's prospective earnings or earning power of the debtor's business.
  - The adequacy of the capital structure and working capital for the debtor's post-confirmation business.
  - The debtor's ability to meet its capital expenditure requirements.
  - Economic conditions in the debtor's industry.
  - The capability of management.
- Does traditional evidence of feasibility hold up in light of COVID-19?

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In re Tribune Media Co., No. 18-2909, 2020 WL 5035797 (3d Cir. 2020)

- Relevant Statutes:
  - Section 510(a): "A subordination agreement is enforceable . . . to the same extent that such agreement is enforceable under applicable nonbankruptcy law."
  - Section 1129(b)(1): "Notwithstanding section 510(a) of this title," the plan cannot "discriminate unfairly" and that it be "fair and equitable" with respect to a dissenting class of creditors.
- Facts:
  - The Senior Noteholders' objected to confirmation, arguing:
    - Plan confirmation via cramdown under section 1129(b)(1) requires strict application of subordination agreements.
    - The plan's misallocation of the funds that they were entitled had the subordination agreement been enforced constituted impermissible "unfair discrimination".

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In re Tribune Media Co., No. 18-2909, 2020 WL 5035797 (3d Cir. 2020) (cont.)

- Holdings:
  - Section 1129(b)(1) trumps section 510(a).
  - But to obtain "cramdown" confirmation, the plan proponent must still convince the Court that the plan does not "unfairly discriminate" between similarly situated creditors.
    - Applying the Markell test, the Third Circuit noted that if a class receives a "materially lower percentage recovery" (as compared to a class of similarly situated creditors, or as compared to that class's recovery if subordination provisions were enforced) then a rebuttable presumption of unfair discrimination exists
    - Here, the difference between what the objecting creditors would receive under the plan and what they would have received had the subordination agreements been enforced was less than 1% (33.6% vs. 34.5%).
    - Less than 1% difference was not material, and as such, there was no "unfair discrimination."

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AMERICAN BANKRUPTCY INSTITUTE

BANKRUPTCY 2020: VIEWS FROM THE BENCH

CONFIRMATION ROUNDTABLE

September 24, 2020

Case Summaries

1. Third-Party Releases

(A) Consent to Third-Party Releases

i. Mem. Decision & Ord. Regarding Third-Party Releases Under the Debtors' Joint Plan, In re SunEdison, No. 16-10992 (SMB) (D.I. 4253) (Bankr. S.D.N.Y. Nov. 8, 2017)

In In re SunEdison, Inc., the debtors' plan of reorganization contained a broad third-party release provision in favor of certain nondebtors, and the parties who were deemed to grant releases under the plan included all holders of claims entitled to vote on the plan who did not vote to reject the plan (the "Non-Voting Releasors").[1] Although no Non-Voting Releasors objected to the plan's release provisions, the court sua sponte raised the issue of whether it should approve the releases by the Non-Voting Releasors.[2] Judge Bernstein first examined whether, by failing to vote on the Plan, Non-Voting Creditors had implicitly consented to the Release and then considered the circumstances under which a bankruptcy court has the authority to approve a third-party release irrespective of creditor consent.[3]

The court declined to approve the releases in their proposed form.[4] First, the court rejected the debtors' argument that the Non-Voting Releasors had implicitly consented to the releases.[5] The debtors contended that the conspicuous warning included in the disclosure statement and ballots regarding the effect of the releases on Non-Voting Releasors was sufficient to deem them as having consented to the nondebtor release.[6] The court rejected this position, concluding that, under New York contract law, silence cannot be deemed to be consent unless the silent party is under a duty to speak.[7] As the court noted, the debtors failed to identify any such duty of the Non-Voting Releasors.[8]

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1 See Amended Disclosure Statement Amended Notice of Filing Solicitation Version of First Amended Disclosure Statement for First Amended Joint Plan of Reorganization of SunEdison, Inc. and its Affiliates ("Plan"), § 11.9, In re SunEdison, Inc., No. 16-10992 (SMB) (D.I. 3314) (Bankr. S.D.N.Y. June 12, 2017). The Plan also included a provision exculpating various parties, including the Debtors, pre- and post-petition lenders, the creditors' committee, and professional advisors from liability under any applicable law in connection with the Debtors' restructuring. See Plan, § 11.7.

2 Mem. Decision & Ord. Regarding Third-Party Releases Under the Debtors' Joint Plan, In re SunEdison, No. 16-10992 (D.I. 4253) (Bankr. S.D.N.Y. Nov. 8, 2017) ("SunEdison").

3 See SunEdison at 5.

4 Id. at 2.

5 Id. at 6-10.

6 Id. at 10-11.

7 Id. at 10-11.

8 Id.

(cont'd)

ii. In re Melinta Therapeutics, Inc., No. 19-12748 (LSS) (Bankr. D. Del. April 2, 2020)

In In re Melinta Therapeutics, Inc., the debtors' proposed a third-party release provision, which defined releasing parties as holders of claims that (i) were deemed to reject the plan or accept the plan, (ii) voted to accept the plan, or (iii) abstained from voting and failed to opt-out of the third-party release.[9] The United States Trustee objected to the third-party release provision.[10] Relying on In re Emerge Energy Services LP, No. 19-11563, 2019 WL 7634308 (Bankr. D. Del. Dec. 5, 2019), the United States Trustee argued that Melinta's third-party release provision was insufficient to imply consent to such releases.[11] In response to the United States Trustee's objection, the debtors modified the third-party release provision to include holders of claims that (i) were deemed to accept the plan, (ii) voted to accept the plan, or (iii) abstained from voting and failed to opt-out by sending back the opt-out form.[12] The debtors also contended that Emerge did not account for the fact that all parties in interest have a duty to speak under section 1141(a) of the Bankruptcy Code, and the binding nature of a confirmed chapter 11 plan on all parties in interest.[13]

Overruling the United States Trustee's objection, the court concluded that section 1141(a) of the Bankruptcy Code provides the source of the duty to speak and, in fact, imposes on all parties in interest a duty to object.[14] Acknowledging that analyzing consent under section 1141(a) of the Bankruptcy Code is a newly emerging argument, the Judge remarked that she found the argument "more compelling than the contractual argument" concluding that it is improper to rely upon state contract law in answering the third-party consent question without considering section 1141(a) of the Bankruptcy Code.[15] Notably, the Judge further observed that "until I hear a real response to the 1141 argument, that is where my thinking is; that 1141 binds creditors to a plan and creditors need to, therefore, speak up and object to release provisions, like they need to other provisions."[16]

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[9] Transcript of Second Day Motions at 57:18-21 ("Second Day Hr'g Tr."), In re Melinta Therapeutics, Inc., No. 19-12748 (LSS) (Bankr. D. Del. April 2, 2020).

[10] See generally Second Day Hr'g Tr.

[11] Debtors' Memorandum of Law in Support of Joint Chapter 11 Plan, ¶ 118, In re Melinta Therapeutics, Inc., No. 19-12748 (LSS) (D.I. 485) (Bankr. D. Del. April 2, 2020). Relying on state law contract principles, the Delaware court in In re Emerge Energy Services LP reasoned that failure to submit an opt-out form did not constitute consent to the plan's third-party release because creditors and interest holders had no duty to speak. In re Emerge Energy Servs. LP, No. 19-11563, 2019 WL 7634308 (Bankr. D. Del. Dec. 5, 2019).

[12] Second Day Hr'g Tr. at 57:18-21, 119:19-23.

[13] Debtors' Memorandum of Law in Support of Joint Chapter 11 Plan, ¶¶ 119-25.

[14] See generally Second Day Hr'g Tr.

[15] Second Day Hr'g Tr. 120:6-10.

[16] Second Day Hr'g Tr. 120:10-14.

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(B) Constitutional Adjudicatory Authority

i. In re Millennium Lab Holdings II, LLC, 945 F.3d 126 (3d Cir. 2019), cert. denied, 207 L. Ed. 2d 142 (2020)

In April 2014, Millennium Lab Holdings II, LLC and its wholly owned subsidiaries (collectively, "Millennium") entered into a credit agreement with various lenders, including Voya Investment Management Co. LLC and Voya Alternative Asset Management LLC (collectively, "Voya").[17] A little less than a year later the Centers for Medicare and Medicaid Services ("CMS") notified Millennium that it intended to revoke Millennium's Medicare billing privileges, an essential aspect of its business.[18] Less than a month later, the U.S. Department of Justice ("DOJ") filed a complaint in the United States District Court for the District of Massachusetts against Millennium.[19] The complaint was the result of a multi-year investigation (going back to at least 2012) and alleged Millennium violated several laws, including the False Claims Act.[20]

To avoid the destruction of its business, Millennium entered into a settlement agreement with the DOJ and CMS agreeing to pay $256 million, of which $50 million was paid as an upfront deposit.[21] However, Millennium was unable to service both the settlement and its obligations under its $1.825 billion credit agreement.[22] Negotiations with an ad hoc group of lenders followed.[23] These negotiations eventually resulted in a deal to deleverage the company's balance sheet and fund the full DOJ settlement.[24] Specifically, the company's existing shareholders agreed to contribute $325 million in cash to fund the restructuring and DOJ payments.[25] The shareholders also agreed to give up 100% of their equity interests and transfer ownership of the business to the company's lenders.[26] In exchange, the shareholders were to receive full debtor and third-party releases of all claims arising prior to the restructuring, including certain state law fraud claims asserted against the shareholders by some of the company's lenders.[27]

Millennium sought to implement its restructuring through a prepackaged plan of reorganization.[28] Voya, one of the holdouts whose state law claims would have been released by the plan, objected to confirmation of the plan.[29] Voya argued the releases were unlawful and the bankruptcy court lacked subject matter jurisdiction and the constitutional authority to approve

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[17] In re Millennium Lab Holdings II, LLC, 945 F.3d 126, 130 (3d Cir. 2019), cert. denied, 207 L. Ed. 2d 142 (2020).
[18] Id.
[19] Id.
[20] Id.
[21] Id.
[22] Id.
[23] Id.
[24] Id.
[25] Id. at 130-31.
[26] Id. at 131.
[27] Id.
[28] Id. at 132.
[29] Id.

(cont'd)

them.[30] The bankruptcy court overruled the objection and confirmed Millennium's plan.[31] The bankruptcy court's decision was appealed to the district court, which remanded to the bankruptcy court on the specific question of whether or not the bankruptcy court had constitutional adjudicatory authority to approve nonconsensual third-party releases.[32] Judge Silverstein determined that she did have such authority; specifically, Judge Silverstein found that the operative provision before the court was in the debtor's plan of reorganization – the confirmation of which is an enumerated core proceeding.[33] The decision was upheld by the district court, and appealed to the United States Court of Appeals for the Third Circuit.[34]

Agreeing with the bankruptcy court, the Third Circuit held that a bankruptcy court has constitutional authority to approve a plan including nonconsensual releases when it is exercising its "core" statutory authority and the releases are "integral" to the restructuring.[35] However, the Third Circuit limited its decision to the facts of this case and emphasized the intensive negotiations between sophisticated parties, the fact that the releases were "absolutely required" for the reorganization, and that the debtors would have gone into liquidation without the releases.[36] The Third Circuit also held that the remaining issues were equitably moot because the confirmed plan was substantially consummated and, as a result of substantial post-confirmation transactions, overturning the releases at this point would "fatally scramble" the confirmed plan and significantly harm third parties who had justifiably relied upon it.[37]

The Third Circuit was clear that its decision was not intended to extend the bankruptcy court's authority or allow creditors to engage in "gamesmanship" by demanding releases.[38] The court emphasized that its prior precedent still applies, which requires that, in order to be approved, such releases have "[t]he hallmarks of . . . fairness, necessity to the reorganization, and specific factual findings to support these conclusions."[39]

ii. Lynch v. Lapidem Ltd. (In re Kirwan Offices S.à.R.L.), 592 B.R. 489 (S.D.N.Y. 2018), aff'd sub nom., 792 F. App'x 99 (2d Cir. 2019)

The District Court for the Southern District of New York endorsed a plan-focused jurisdictional approach when analyzing nondebtor releases contained in a plan.[40] In In re Kirwan Offices, two of the three investors (the "Petitioning Creditors") commenced an involuntary proceeding against the company without the consent of the third investor (the "Objector"). The Objector moved to dismiss the involuntary petition, arguing that the Petitioning Creditors had filed

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30 Id.
31 945 F.3d at 132-33; see generally In re Millennium Lab Holdings II, LLC, 543 B.R. 703 (Bankr. D. Del. 2016).
32 945 F.3d at 132; see generally In re Millennium Lab Holdings II, LLC, 242 F.Supp. 3d 322 (D. Del. 2017).
33 945 F.3d at 133; see generally In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017).
34 945 F.3d at 133; see generally In re Millennium Lab Holdings II, LLC, 591 B.R. 559 (D. Del. 2018).
35 945 F.3d at 137.
36 Id. at 137, 143.
37 Id. at 143-44.
38 Id. at 139.
39 Id. (citation omitted).
40 In re Kirwan Offs. S.à.R.L., 592 B.R. 489, 497-98 (S.D.N.Y. 2018), aff'd sub nom., 792 F. App'x 99 (2d Cir. 2019).

(cont'd)

the case in a bad-faith scheme to circumnavigate his consent rights over the pending litigation.[41] Judge Drain denied the motion to dismiss. The Petitioning Creditors filed a chapter 11 plan that included a nonconsensual third-party release prohibiting the Objector from initiating an arbitration in London that was aimed at showing that the involuntary bankruptcy was unauthorized. Without discussing his subject matter jurisdiction, Judge Drain approved the third-party releases and confirmed the plan.[42]

The Objector appealed the confirmation order, contending that the bankruptcy court lacked subject matter jurisdiction and constitutional power to grant the releases.[43] In affirming Judge Drain's decision, the district court held that the "bankruptcy court acts pursuant to its core jurisdiction when it considers the involuntary release of claims against a third party, nondebtor in connection with the confirmation of a proposed plan of reorganization, which is a statutorily defined core proceeding."[44] The district court further found that a "confirmed reorganization plan that includes such releases does not address the merits of the claims being released; those . . . are governed by non-bankruptcy law.[45] Rather, it effectively cancels those claims so as to permit a total reorganization of the debtor's affairs in a manner available only in bankruptcy."[46] According to the district court, it did not matter that the claims being released arose under a prepetition contract and were against a nondebtor – rather, it was the fact that extinguishing these claims was essential to the "adjudicat[ion] [of] the proposed corporate reorganization of Kirwan" that brought the releases within the bankruptcy court's core subject-matter jurisdiction.[47] Although this case was appealed to the Second Circuit, the court did not address this issue, holding that res judicata barred the objector's jurisdictional claims.[48]

2. "Best Interests" Test

i. <u>In re Ditech Holding Corp.</u>, 606 B.R. 544 (Bankr. S.D.N.Y. 2019)

In <u>In re Ditech Holding Corp.</u>, the debtors operated as an independent servicer and originator of forward mortgage loans and servicer of reverse mortgage loans.[49] As of the petition date, the debtors were subject to thousands of formal and informal proceedings in which consumer creditors were asserting claims and defenses of types described in section 363(o) of the Bankruptcy Code.[50] Ditech proposed a plan of reorganization–not a 363 sale–that would have transferred its

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41 <u>Id.</u>
42 <u>See generally</u> 592 B.R. 489.
43 <u>Id.</u> at 499.
44 <u>Id.</u> at 504. The district court also held that it had constitutional authority to grant the nondebtor releases because they amount to an extinguishment of claims "as part of the core bankruptcy process" of confirming a plan. <u>Id.</u> at 511.
45 <u>Id.</u>
46 <u>Id.</u> at 504.
47 <u>Id.</u> at 507.
48 <u>See generally</u> <u>In re Kirwan Offs. S.à.R.L.</u>, 792 F. App'x 99 (2d Cir. 2019).
49 <u>In re Ditech Holding Corp.</u>, 606 B.R. 544, 551 (Bankr. S.D.N.Y. 2019).
50 <u>Id.</u>

(cont'd)

businesses to certain purchasers and would have resulted in the discharge of the 363(o) related claims.[51]

Creditors objected to the debtors' plan on multiple grounds, including that asset sales could only be implemented under section 363 of the Bankruptcy Code (therefore implicating 363(o) of the Bankruptcy Code), and in the alternative that section 363(o) of the Bankruptcy Code should apply to the sale of assets under a plan.[52] In addition, the consumer creditor committee argued that the plan did not satisfy the "best interests" test under section 1129(a)(7) of the Bankruptcy Code because the debtors' liquidation analysis failed to account for the fact that, in a chapter 7 liquidation, the purchaser of the debtors' consumer credit agreements would remain subject to creditors' related claims and defenses under section 363(o) of the Bankruptcy Code.[53] Indeed, the liquidation analysis provided that creditors would receive a 0% recovery under a liquidation, which the objecting creditors asserted was not consistent with their rights under section 363(o) of the Bankruptcy Code.[54]

With respect to the 1129(a)(7) objection, the debtors argued that invoking section 363(o) in the context of the "best interests" test was an improper attempt to "bootstrap" the creditors' 363(o) arguments into the debtors' plan.[55] Instead, the debtors contended that application of 363(o) with respect to plan confirmation would tilt the best interests scale in favor of liquidation and render meaningless Congress's determination not to impute section 363(o) into chapter 11 plans.[56] Judge Garrity ultimately ruled that section 363 of the Bankruptcy Code does not apply to the sale of assets under a chapter 11 plan, and thus, the purchaser of the debtors' assets buys them free and clear.[57] However, the court agreed with the objecting creditors and initially denied confirmation on the basis that the debtors failed to satisfy the "best interests" test.[58]

3. <u>Impaired Accepting Classes and Artificial Impairment</u>

Under section 1129(a)(10) of the Bankruptcy Code, if a plan impairs a class of claims, then at least one class of claims that is impaired must vote to accept the plan.[59] Section 1124 of the Bankruptcy Code explains that a plan impairs a class of claims unless it "leaves unaltered the legal,

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[51] <u>Id.</u> at 550-53; <u>see</u> <u>also</u> 11. U.S.C. 363(o). Under section 363(o) of the Bankruptcy Code, certain claims and defenses related to consumer credit transactions and consumer credit contracts may not be cleansed through a "free and clear" sale under section 363(f) of the Bankruptcy Code. <u>Id.</u> at 550-51; <u>see</u> <u>also</u> 11. U.S.C. 363(o).
[52] <u>Id.</u> at 552-53.
[53] <u>Id.</u> at 552-53, 607-08.
[54] <u>Id</u>. at 607-08
[55] <u>Id.</u> at 608.
[56] <u>Id.</u>
[57] <u>See</u> <u>generally In re Ditech Holding Corp.</u>, 606 B.R. 544 (Bankr. S.D.N.Y. 2019).
[58] <u>Id.</u> at 621.
[59] 11 U.S.C. § 1129(a)(10).

(cont'd)

equitable, and contractual rights" of the claim holders.[60] In addition, section 1123(b)(1) of the Bankruptcy Code gives a debtor flexibility to impair or leave unimpaired any class of claims.[61]

Circuits are divided over the question of whether section 1129(a)(10) of the Bankruptcy Code draws a distinction between "artificial" and "economically driven" impairment. The Eighth Circuit held in Matter of Windsor on the River Associates, Ltd. that a claim is not impaired [for purposes of section 1129(b)] "if the alteration of the rights in question arises solely from the debtor's exercise of discretion."[62] According to this approach, section 1129(a)(10) of the Bankruptcy Code recognizes impairment only to the extent that it is caused by economic "need."[63]

In contrast, the Ninth Circuit held in In re L & J Anaheim Associates v. Kawasaki Leasing International, Inc. that section 1129(a)(10) of the Bankruptcy Code does not distinguish between discretionary and economically driven impairment.[64] According to the Ninth Circuit, "the plain language of section 1124 says that a creditor's claim is 'impaired' unless its rights are left 'unaltered' by the [p]lan," and "[t]here is no suggestion here that only alterations of a particular kind or degree can constitute impairment."[65] Recently, in Village Green I, GP v. Federal National Mortgage Ass'n, the Sixth Circuit joined the Ninth Circuit's view that section 1129(a)(10) of the Bankruptcy Code does not distinguish between discretionary and economically driven impairment.[66]

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60 11 U.S.C. § 1124(1).

> Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—
>
> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or
>
> (2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—
>
> (A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;
>
> (B) reinstates the maturity of such claim or interest as such maturity existed before such default;
>
> (C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;
>
> (D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and
>
> (E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

11 U.S.C. § 1124.

61 11 U.S.C. § 1123(b)(1).

62 Windsor on the River Assocs. Ltd. v. Balcor Real Est. Fin. Inc. (In re Windsor on the River Assocs. Ltd.), 7 F.3d 127, 132 (8th Cir. 1993).

63 Id. at 132-33.

64 L&J Anaheim Assocs. v. Kawasaki Leasing Int'l Inc. (In re L&J Anaheim Assocs.), 995 F.2d 940 (9th Cir. 1993).

65 Id. at 943.

66 Vill. Green I, GP v. Fed. Nat'l Mortg. Assoc'n, 811 F.3d 816 (6th Cir. 2016).

(cont'd)

i. Village Green I, GP v. Fed. National Mortgage Ass'n, 811 F.3d 816 (6th Cir. 2016)

In Village Green I, GP v. Federal National Mortgage Assoc'n, the debtor filed for chapter 11 protection to halt Federal National Mortgage Association ("FNMA") from foreclosing on the property after missing a payment.[67] At the time of the bankruptcy filing, the apartment complex—the debtor's only asset—was valued at $5.4 million.[68] FNMA was owed $8.6 million.[69]

The debtor's proposed chapter 11 plan classified FNMA's secured claim into one class, while creating two separate classes of unsecured claims.[70] The first class of unsecured claims contained FNMA's deficiency claim (approximately $3.2 million).[71] The other unsecured class contained the claims of the lawyer and the accountant, which totaled approximately $2,400.[72] Under the plan, FNMA was to receive deferred cash payments in respect of its $5.4 million secured claim for 10 years, secured by a mortgage on the property with slightly modified terms.[73] With respect to FNMA's unsecured deficiency claim, the plan proposed to pay FNMA deferred cash payments for 10 years.[74] The separately classified unsecured claims of the lawyer and the accountant were to be paid in full, but in two equal installments 30 and 60 days after the plan's effective date.[75]

The bankruptcy court confirmed the plan.[76] FNMA appealed to the district court, which vacated the confirmation order and remanded the case below for a determination of whether the debtor proposed the chapter 11 plan in good faith.[77] The bankruptcy court found that the plan was proposed in good faith, reasoning that the debtor was "economically justified in rationing every dollar" under the plan.[78] However, after the district court again vacated and remanded the ruling, the bankruptcy court ultimately lifted the automatic stay to permit FNMA to continue its foreclosure proceeding and, sua sponte, dismissed the debtor's chapter 11 case.[79] The district court affirmed those rulings, and the debtor appealed to the Sixth Circuit.[80]

Addressing the first issue, the Sixth Circuit joined the Fifth and Ninth Circuits in holding that "[s]ection 1124(1) by its terms asks only whether a plan would alter a claimant's interests, not whether the debtor had bad motives in seeking to alter them."[81] Instead, the court wrote, the

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67 Id. at 818.
68 Id.
69 Id.
70 Id. at 817-18.
71 Id. at 818.
72 Id. at 817.
73 Id. at 818.
74 Id.
75 Id.
76 Id.
77 811 F.3d at 818.
78 Id. at 819.
79 Id. at 818.
80 Id.
81 Id. at 819.

(cont'd)

debtor's motives "are expressly the business of § 1129(a)(3)."[82] According to the Sixth Circuit, because section 1129(a)(3) expressly requires an inquiry into the debtor's motives in proposing a plan, "there is no reason to graft that inquiry onto the plain terms of § 1124(1)."[83] The Sixth Circuit faulted the bankruptcy court's good faith finding for several reasons.[84] First, the Sixth Circuit noted that the debtor would have more than sufficient cash on the effective date to pay off its minor unsecured claims immediately.[85] Second, the Sixth Circuit wrote, the fact that the lawyer and the accountant were closely associated with the debtor "compounds the appearance that impairment of their claims had more to do with circumventing the purposes of § 1129(a)(10) than with rationing dollars."[86] The purported rationale underpinning good faith evaporated completely, the court noted, when the accountant and the lawyer rejected FNMA's offer to pay their claims in full immediately.[87] In sum, the court took the view that a debtor's motives regarding impairment, including considerations of whether a class of creditors has been artificially impaired for the purposes of contriving an impaired accepting class, are more appropriately addressed under section 1129(a)(3) of the Bankruptcy Code, which requires that a plan be proposed in good faith.[88]

4. Unfair Discrimination

i. In re Tribune Co., No. 18-2909, 2020 WL 5035797 (3d Cir. Aug. 26, 2020)

In In re Tribune Co., the debtor sought to "cramdown" a class of senior unsecured creditors under section 1129(b)(1) of the Bankruptcy Code while not strictly applying the terms of a prepetition subordination agreement.[89] The senior creditors argued that the debtor's subordination agreements should be enforced as written, maintaining that section 510(a) of the Bankruptcy Code generally requires the enforcement of security agreements in bankruptcy.[90] The debtor, on the other hand, argued that section 1129(b)(1) allowed it to disregard the subordination agreements so long as the proposed treatment of the negatively impacted creditors did not result in "unfair discrimination."[91]

As a matter of first impression, the U.S. Court of Appeals for the Third Circuit held that the prohibition against "unfair discrimination" in cramdown plans supplants the requirement that subordination agreements be enforced in bankruptcy.[92] The three-judge appellate panel first concluded that the phrase "notwithstanding section 510(a)" means that a plan could be confirmed over the rejection by a dissenting class of general unsecured creditors via cramdown "in spite of" a subordination agreement, consistent with the plain meaning of "notwithstanding" and previous definitions of the phrase "notwithstanding" used in the bankruptcy context.[93] However, to obtain

82 Id.
83 Id.
84 Id.
85 Id.
86 Id.
87 Id.
88 Id.
89 In re Trib. Co., No. 18-2909, 2020 WL 5035797, at *1 (3d Cir. Aug. 26, 2020).
90 Id. at *1-2.
91 Id. at *6.
92 Id. at *6-9.
93 Id.

(cont'd)

"cramdown" confirmation, the plan proponent must still convince the court that the plan does not "unfairly discriminate" between similarly situated creditors.[94] Even though section 510(a) of the Bankruptcy Code is not applicable in a cramdown, the panel did find instructive the difference between what the objecting creditors would receive under the plan and what they would have received had the subordination agreements been enforced.[95]

Applying this test to the facts of the case, the panel determined that the difference in the senior noteholders' recovery was not material, as the difference was less than 1% (33.6% vs. 34.5%).[96] The panel ruled that this difference was not material, and as such, there was no "unfair discrimination."[97]

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94 Id. at *6-12. In the end, the panel for the Third Circuit articulated eight "principles" of unfair discrimination: (1) a subordination agreement need not be strictly enforced in a cramdown, so long as the allocation is not presumptively unfair (and, if so, the presumption is not rebutted); (2) unfair discrimination applies only to classes that dissent; (3) unfair discrimination is determined from the perspective of the dissenting class; (4) classes must be aligned correctly; (5) a court should measure recoveries in terms of net present value of all payments or the allocation of materially greater risk in connection with the proposed distribution; (6) a court should include subordinated sums in the plan distribution when comparing recovery between classes; (7) there is a presumption of unfair discrimination where there is a materially lower percentage recovery for the dissenting class or a materially greater risk to the dissenting class in connection with the proposed distribution; and (8) a presumption of unfair discrimination may be rebutted. Id. at *9-11.

95 Id. at *7. The panel characterized the "unfair discrimination" standard as "rough justice" that "attempts to ensure that debtors and courts do not have carte blanche to disregard pre-bankruptcy contractual arrangements, while leaving play in the joints." Id. at *6, *12

96 Id.

97 Id. The court compared the senior creditors' recoveries under the plan to their anticipated recoveries in a scenario where the subordination agreements were strictly enforced. Id. at *11-12. The court noted that in many cases a comparison to the treatment of other similarly situated creditors may be more appropriate. Id. at *12.

Faculty

Hon. Ashely M. Chan is a U.S. Bankruptcy Judge for the Eastern District of Pennsylvania in Philadelphia. Prior to taking the bench, she was a shareholder at Hangley Aronchick Segal Pudlin & Schiller and concentrated her practice in the areas of bankruptcy and corporate restructuring. From 1996-97, Judge Chan clerked for Hon. Gloria M. Burns of the U.S. Bankruptcy Court for the District of New Jersey. Before joining HASPS, she was an associate at Morgan, Lewis & Bockius LLP in its business and finance section, where she focused on bankruptcy, corporate restructuring and corporate finance. Judge Chan has received numerous recognitions, including being selected as a Leader in Bankruptcy/Restructuring by *Chambers USA*, being listed in *The Best Lawyers in America* for Bankruptcy and Creditor-Debtor Rights, and being listed as a Pennsylvania Lawyer on the Fast Track by *The Legal Intelligencer* and *Pennsylvania Law Weekly*. She also served as chair of the Eastern District of Pennsylvania Bankruptcy Conference and president-elect and board member of the Homeless Advocacy Project. Judge Chan received her J.D. in 1996 from Rutgers School of Law – Camden, where she received Tax Honors with Distinction and the Rutgers Pro Bono Publico Award.

Hon. Robert D. Drain is a U.S. Bankruptcy Judge for the Southern District of New York in White Plains. Since his appointment, he has presided over such chapter 11 cases as *Loral*, *RCN*, *Cornerstone*, *Refco*, *Allegiance Telecom*, *Delphi*, *Coudert Brothers*, *Frontier Airlines*, *Star Tribune*, *Reader's Digest*, *A&P*, *Hostess Brands*, *Christian Brothers* and *Momentive*. He also has presided over the ancillary or plenary cases of *Corporacion Durango*, *Satellites Mexicanas*, *Parmalat S.p.A.* and its affiliated U.S. debtors, *Varig S.A.*, *Yukos* (II), *SphinX*, *Galvex Steel*, *TBS Shipping*, *Excel Maritime*, *Nautilus*, *Landsbanki Islands*, *Roust* and *Ultrapetrol*. He also has served as the court-appointed mediator in a number of chapter 11 cases, including *New Page*, *Cengage*, *Quicksilver*, *LightSquared*, *Molycorp* and *Breitburn Energy*. Prior to his appointment to the bench in May 2002, Judge Drain was a partner in the bankruptcy department of Paul, Weiss, Rifkind, Wharton & Garrison, where he represented debtors, trustees, secured and unsecured creditors, official and unofficial creditors' committees, and buyers of distressed businesses and distressed debt in chapter 11 cases, out-of-court restructurings and bankruptcy-related litigation. He was also actively involved in several transnational insolvency matters. Judge Drain is a Fellow of the American College of Bankruptcy and a member and board member of ABI, a member of the International Insolvency Institute, and a member and board member of the National Conference of Bankruptcy Judges, as well as a founding member of the Judicial Insolvency Network. He also is the current chair of the Bankruptcy Judges Advisory Group established through the Administrative Office of the U.S. Courts, and was an adjunct professor for several years at St. John's University School of Law's LL.M. in Bankruptcy Program. He is currently is an adjunct professor at Pace University School of Law. Judge Drain has lectured and written on numerous bankruptcy-related topics and is the author of the novel *The Great Work in the United States of America*. He received his B.A. *cum laude* from Yale University and his J.D. from Columbia University School of Law, where he was a Harlan Fiske Stone Scholar for three years.

Jay M. Goffman is vice-chairman of Global Advisory at Rothschild and Co. in New York. His restructurings are largely completed through quick, cost-efficient, out-of-court — or prepackaged — restructurings, which he helped pioneer. Prior to that, he was the global co-head of Skadden's Corporate Restructuring Group. Over the course of his career, Mr. Goffman has been honored with numerous awards directly related to restructuring. He was named among The Decade's Most Influential Lawyers by *The National Law Journal* in March 2010, and he was recognized as one of *The American Lawyer*'s Deal-makers of the Year in April 2011 for his work in restructuring Metro-Goldwyn-Mayer, Inc. (MGM), the largest prepackaged bankruptcy ever completed in under 33 days. Mr. Goffman regularly is selected as one of the leading restructuring lawyers in the world by various corporate restructuring and legal organizations, including *Turnarounds & Workouts* (named among the top 12 U.S. restructuring attorneys), *Chambers USA*, *Chambers Global*, *Lawdragon*, *The Best Lawyers in America*, *IFLR1000*, *Euromoney* and Legal Media Group's *Expert Guide to the World's Leading Insolvency and Restructuring Lawyers*. He frequently lectures and writes on a variety of restructuring topics, including prepacks, mergers and acquisitions in distressed situations, distressed investing, fiduciary duties of boards of directors, "zone of insolvency" issues, confirmation issues, mass-tort issues, cross-border and international insolvency issues, and general and basic bankruptcy analysis. He also assisted the National Bankruptcy Review Commission with respect to legislative amendments regarding prepacks and co-chaired a committee of premier restructuring lawyers addressing potential bankruptcy legislation leading to certain congressional amendments to the Bankruptcy Code regarding prepacks. Mr. Goffman is a Fellow of the American College of Bankruptcy, a member of the International Insolvency Institute and a member of INSOL and its G36 Organization. He serves on ABI's International Committee and co-chaired the ABI Commission to reform Chapter 11's Plan Process Committee, whose mandate was to evaluate all aspects of the reorganization plan process in conjunction with a study of proposed revisions to the Bankruptcy Code. Mr. Goffman received his B.S. in 1980 in chemical psychobiology from the State University of New York at Binghamton and his J.D. in 1983 with honors from the University of North Carolina at Chapel Hill, where he was a member of the *University of North Carolina Law Review*.

Hon. Christine M. Gravelle is a U.S. Bankruptcy Judge for the District of New Jersey in Trenton, named to the bench in 2013. Previously, she was a partner at the law firm of Markowitz Gravelle, LLP in Lawrenceville, N.J., where she focused on commercial litigation and bankruptcy. Judge Gravelle served as president of the Mercer County Bar Association in 2011 after serving nine years as an officer and trustee for the Association. She was a member of the Lawyers Advisory Committee to the Board of Judges of the U.S. Bankruptcy Court for the District of New Jersey from 2008-13, having chaired the committee in her last year of service. She also served as a trustee of the Bankruptcy Section of the New Jersey State Bar Association, and she served on the Board of Trustees of Central Jersey Legal Services as a member and officer. Judge Gravelle received her undergraduate degree *magna cum laude* from the University of Massachusetts at Amherst and her J.D. *magna cum laude* from Suffolk University Law School in Boston.

Paul D. Leake is a partner and global co-head of Skadden, Arps, Slate, Meagher & Flom LLP's corporate restructuring practice in New York. He has led numerous large and complex U.S. and cross-border corporate workouts and restructurings. Mr. Leake represents debtors, commercial banks and bank groups, distressed investment funds, noteholder committees, official creditors' committees and distressed investors in all forms of corporate restructurings. He focuses on advising U.S. and transnational businesses on chapter 11 reorganizations, out-of-court restructurings, secured financings, debtor in possession loans, distressed acquisitions and sales, and investments in troubled companies. Mr. Leake has led high-profile restructurings in most major industries, including retail, health care, oil and gas, shipping, mining, airlines, energy, publishing, telecom, satellite communications and real estate. He previously served as head of the corporate restructuring and reorganization practice at another large global law firm. He has represented ad hoc noteholder and official unsecured creditor committees, senior secured lenders and lender groups, and investment funds and strategic investors in substantial, high-profile distressed M&A transactions. Mr. Leake is regularly listed in rankings of leading restructuring lawyers in the U.S. and globally, including *Chambers USA*, *Chambers Global*, *The Legal 500*, *K&A Restructuring Register*, *IFLR1000*, *The Best Lawyers in America* and *Turnarounds & Workouts*. He has published and lectured extensively on U.S. and transnational insolvency matters. Mr. Leake is a member of the board of directors of Her Justice, a nonprofit organization that supports women living in poverty in New York City by recruiting and mentoring volunteer lawyers to provide free legal help to address individual and systemic legal barriers. He also is a Fellow of the American College of Bankruptcy. Mr. Leake received his B.A. from Amherst College in 1985 and his J.D. from Columbia University in 1988.

Hon. Karen B. Owens is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington. Prior to her appointment, she was a director in the Bankruptcy and Insolvency group of Ashby & Geddes, P.A., where she maintained a diverse practice, representing corporate debtors, estate professionals, various secured and unsecured creditor constituencies, and other interested parties in reorganization and liquidation proceedings and bankruptcy-related litigation. Prior to joining Ashby & Geddes, Judge Owens started her career at Skadden, Arps, Slate, Meagher & Flom as a corporate restructuring associate, and later went on to clerk for Hon. Brendan Linehan Shannon of the U.S. Bankruptcy Court for the District of Delaware. She received her Bachelor's degree from Pennsylvania State University, where she was Phi Beta Kappa, and her J.D. *summa cum laude* from American University's Washington College of Law, where she served as an associate managing editor for the *American University Law Review* and as legal intern to Hon. Stephen S. Mitchell of the U.S. Bankruptcy Court for the Eastern District of Virginia.