AMERICAN BANKRUPTCY INSTITUTE

2021 Virtual Annual Spring Meeting

Cautionary Tales in Asset Sales

Hosted by the Asset Sales and Bankruptcy Litigation Committees

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CONCURRENT SESSION

2021

I. Collusion in 363 Sales: *Neiman Marcus*

A. Summary of case

B. US Trustee involvement

C. Bankruptcy remedies for collusion in 363 sales

D. Potential criminal & Sherman Act violations in in 363 sales

II. Litigating Challenges to 363 Sales: *Waypoint*

A. Summary of case

B. Standing to object to a 363 sale / raise 363(n) issues based on allegations of collusion

C. Joint ventures among potential bidders

D. Best practices for 363 sale buyers

E. Debtors' role in ensuring a fair and open sale process

III. "Higher or Better" v. "Higher and Better": *BJ Services*

A. Summary of case

B. Appropriate standard for approving 363 sales

C. Whose interests are relevant?

D. Does the public interest matter?

UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	**CASE NO.**
	§	
NEIMAN MARCUS GROUP LTD, LLC,	§	**20-32519 (DRJ)**
et al.,	§	**(Chapter 11)**
	§	**Jointly Administered**
DEBTORS[1]	§	

STATEMENT OF THE ACTING UNITED STATES TRUSTEE PURSUANT TO COURT ORDER REGARDING THE CONDUCT OF MARBLE RIDGE CAPITAL LP AND DAN KAMENSKY

TO THE HONORABLE DAVID R. JONES
UNITED STATES BANKRUPTCY JUDGE:

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Neiman Marcus Group LTD LLC (9435); Bergdorf Goodman Inc. (5530); Bergdorf Graphics, Inc. (9271); BG Productions, Inc. (3650); Mariposa Borrower, Inc. (9015); Mariposa Intermediate Holdings LLC (5829); NEMA Beverage Corporation (3412); NEMA Beverage Holding Corporation (9264); NEMA Beverage Parent Corporation (9262); NM Bermuda, LLC (2943); NM Financial Services, Inc. (2446); NM Nevada Trust (3700); NMG California Salon LLC (9242); NMG Florida Salon LLC (9269); NMG Global Mobility, Inc. (0664); NMG Notes PropCo LLC (1102); NMG Salon Holdings LLC (5236); NMG Salons LLC (1570); NMG Term Loan PropCo LLC (0786); NMG Texas Salon LLC (0318); NMGP, LLC (1558); The Neiman Marcus Group LLC (9509); The NMG Subsidiary LLC (6074); and Worth Avenue Leasing Company (5996). The Debtors' service address is: One Marcus Square, 1618 Main Street, Dallas, Texas 75201.

COMES NOW the Acting United States Trustee for Region 7 (the "United States Trustee"), by and through the undersigned counsel, who respectfully submits this statement in response to the Court's order of August 5, 2020 [Dkt. No. 1442] (the "Order"), and represents as follows:

PRELIMINARY STATEMENT AND SUMMARY

This statement sets out the evidence gathered by the United States Trustee and his preliminary analysis pursuant to the Court's order directing a statement of position "regarding the conduct of Marble Ridge and Mr. Kamensky in this case." Dkt. No. 1442. Marble Ridge Capital LP ("Marble Ridge") was until recently one of the three co-chairs of the Official Committee of Unsecured Creditors (the "Committee") appointed in the jointly administered chapter 11 cases of the Neiman Marcus Group (the "Debtors"), and Dan Kamensky, the managing partner and principal of Marble Ridge, served as Marble Ridge's representative on the Committee. The Court's Order expressed concern over "alarming" allegations about the conduct of Marble Ridge and Mr. Kamensky and ordered the United States Trustee to review the allegations and file this statement within fourteen days of the Order. *Id.*

Based on the United States Trustee's time-limited investigation, on July 31, Marble Ridge, through Mr. Kamensky, breached its fiduciary duty of loyalty to the creditors it represented by coercing an outside investor to refrain from bidding against Marble Ridge on a key transaction that was considered integral to a successful plan of reorganization.[2] Furthermore, Marble Ridge's initial explanation of its own actions to the Court and to the United States Trustee was, at best,

[2] Nevertheless, after initially refusing to bid, the outside investor ultimately made a competing offer for the assets once information about Marble Ridge's conduct became the subject of this investigation.

incomplete and misleading. Based on these facts, further proceedings before the Court may be appropriate to permit the Court to hear from the witnesses and receive evidence concerning Marble Ridge and Mr. Kamensky and to consider what remedial measures, if any, are appropriate.[3]

I. SCOPE AND LIMITATIONS OF UNITED STATES TRUSTEE'S INVESTIGATION

Immediately following the August 5 Order, the United States Trustee prepared requests for documents and interviews to individuals who appeared to have knowledge relating to the allegations against Marble Ridge and Mr. Kamensky.[4] The United States Trustee sent document requests to: (i) Richard Pachulski, counsel to the Committee; (ii) Michael Warner, co-counsel to the Committee; (iii) Moshin Meghji, financial advisor to the Committee; (iv) Eric Geller, of Jefferies Financial Group, Inc. ("Jefferies"); (v) Mr. Kamensky; (vi) Edward Weisfelner, counsel to Marble Ridge; and (vii) Chad J. Husnick and Anup Sathy, counsel to the Debtors. These requests sought:

> documents and media of any kind pertaining to the potential purchase or conversion to cash of MYT Series B Preferred Shares held or to be held by the unsecured creditors of the debtors Neiman Marcus Group LTD LLC, et al. and/or any potential conflict of interest arising therefrom.

The United States Trustee directed the requests both to the individuals as well as to their respective companies and requested responses by August 10. The United States Trustee also requested a

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[3] Because of the preliminary and non-adversarial nature of the United States Trustee's investigation, the United States Trustee does not comment on the availability or viability of any causes of action that might be asserted by particular parties in this case.

[4] The United States Trustee, in coordination with the Executive Office for United States Trustees, assembled a team to undertake this investigation that, in addition to the undersigned, included, among others, a former Assistant United States Attorney.

litigation hold on responsive documents. Although in many cases documents were not produced until after the August 10 deadline, the United States Trustee nevertheless received and reviewed approximately 3,200 pages of documents.

Between August 14 and August 17, the United States Trustee also conducted voluntary individual interviews via videoconference with Mr. Pachulski, Mr. Meghji, and Mr. Kamensky. In place of Mr. Geller, the United States Trustee interviewed a different Jefferies employee who requested that his name be kept anonymous in this report as a condition of his voluntary interview and cooperation. The United States Trustee agreed to this condition with respect to this statement only, and this individual will accordingly be referred to as "Jefferies Employee No. 1" or "JE1" in this statement. Mr. Weisfelner also made a presentation to the United States Trustee that sought to explain the background of Marble Ridge's involvement with the Debtors and these cases. Each interview lasted between ninety minutes and four hours. Except in the case of Mr. Weisfelner's presentation, a court reporter transcribed all interviews, and all witnesses were accompanied by counsel and agreed to be sworn.

This investigation was conducted on a fully voluntary basis, and the United States Trustee commends each of the persons or firms interviewed or providing documents for their cooperation. Because the United States Trustee's investigation was not ordered under Rule 2004, the United States Trustee did not have the power to compel testimony or production of documents. Although the understandable, but short, deadline for submission of this statement somewhat constrained the United States Trustee's work, this statement nevertheless renders sufficient evidence for the Court and the parties to determine appropriate next steps. Due to these time constraints, the United States

Trustee was unable to provide any of the parties with an opportunity to review or respond to this statement prior to its submission to the Court.[5]

II. STATEMENT OF FACTS

A. Pre-Petition Background

Marble Ridge is the holder of certain of Neiman Marcus's debt and characterizes itself as the largest single unsecured creditor of the Debtors as of the petition date. Since 2018, Marble Ridge and the Debtors have been engaged in a protracted legal dispute involving the Debtors' interests in MyTheresa, an e-commerce retailer, which were transferred to the Debtors' (non-debtor) parent in 2018 as an equity distribution (the "MyTheresa Distribution"). This transaction, which Marble Ridge has characterized as a fraudulent transfer, was the subject of two state court actions filed before the petition date, one by Marble Ridge and another by an Indenture Trustee allegedly on Marble Ridge's behalf.

In 2019, Neiman Marcus entered into a recapitalization agreement that had the effect of resolving potential claims arising out of the MyTheresa Distribution with many of its creditors—though not with Marble Ridge, which declined to participate in the exchange. Of significance here, those negotiations also created a "waterfall" that governed how the proceeds of MyTheresa would be distributed in the event of a sale or other monetization. Under that waterfall, the first $450 million of any sale would go to certain secured lenders and to the holders of Series A preferred stock in the holding company for the MyTheresa assets, while the next $250 million would go to the holders of Series B preferred stock, which was initially distributed to a Neiman

[5] For the same reasons, the United States Trustee was unable to cite specifically to documents and transcripts in this statement.

Marcus affiliate (the "Series B Shares"). The Series B Shares were apparently designed to represent an indirect source of recovery for Neiman Marcus's owners in the event of a MyTheresa sale; they were also highly illiquid, because they would be payable only in the event of a sale or monetization and even then only if the amount realized was at least $450 million.

On April 28, Neiman Marcus appointed Marc Beilinson[6] and Scott Vogel as "disinterested managers" to its Board of Managers (the "Disinterested Managers"). The Disinterested Managers were charged with determining "whether a conflict exists with respect to any issue in connection with the Debtors' chapter 11 cases," as well as with investigating the MyTheresa Distribution.

B. Commencement of the Bankruptcy Case and the Appointment of the Committee.

On May 7, the Debtors filed voluntary petitions seeking relief under chapter 11 of the Bankruptcy Code. That same day, the United States Trustee sent out a standard questionnaire to the Debtors' largest creditors in order to solicit interest in serving on the Committee. Among other things, that questionnaire informed prospective committee members that they would be required to act as "fiduciaries who represent all unsecured creditors as a group."

On May 10, Marble Ridge, through its general counsel, submitted a completed questionnaire expressing its willingness to serve on the Committee. In its cover email, Marble Ridge stated that:

> If appointed to the Committee, Marble Ridge would be represented by Dan Kamensky. Mr. Kamensky has more than 20 years of bankruptcy and investing experience and fully understands the fiduciary responsibilities associated with membership on the Committee. Mr. Kamensky is committed to devote the time and energy necessary to earnestly represent all unsecured creditors.

[6] Mr. Beilinson resigned his position in June after a health emergency.

On May 19, the United States Trustee appointed a nine-member Committee that included Marble Ridge. Dkt. No. 455. Marble Ridge would subsequently be elected as one of three co-chairs of the Committee, which retained the law firms of Pachulski, Stang, Ziehl & Jones and Cole Schotz P.C. as its counsel, and M-III Advisory Partners L.P. as its financial advisor. Dkt. Nos. 1105, 1106, 1225.

C. The Examiner Motion and Motion to Terminate Exclusivity.

The dispute over the MyTheresa Distribution would play a prominent role in many of the contested matters that would be brought before the Court in the first months of these cases. On May 15, Marble Ridge filed the Expedited Motion to Appoint an Examiner, which sought appointment of an examiner under section 1104 of the Bankruptcy Code to investigate the MyTheresa Distribution (the "Examiner Motion"). Dkt. No. 424. The Committee supported the Examiner Motion, but the Debtors, the Disinterested Managers, and certain groups of ad hoc lenders opposed it. Following a hearing before the Court on May 29, Marble Ridge withdrew the Examiner Motion without prejudice. Dkt. No. 664.

On June 21, the Committee filed a motion to terminate exclusivity, which sought permission to file a plan substantially identical to the proposed plan filed by the Debtors, except that it would eliminate certain releases and preserve causes of action relating to the MyTheresa Distribution. Dkt. No. 1061.

Although the litigation positions of the Committee during the first months of the case were closely aligned with those of Marble Ridge, there is no evidence that this was because of any improper influence exercised by Marble Ridge on the other Committee members. Rather, Mr. Pachulski, Committee counsel, characterized the Committee as "great to work with" until the Marble Ridge-Jefferies issues arose on July 31. Mr. Pachulski noted that the Committee was

populated by a diverse group of experienced and highly sophisticated creditors in addition to Marble Ridge and characterized that diversity as a "good thing."

D. Marble Ridge Submits an Offer to Purchase Estate Litigation Claims

On the morning of July 4, Mr. Kamensky told Mr. Pachulski that Marble Ridge would be willing to submit an offer to purchase the MyTheresa-related litigation claims from the Debtors' estate. Mr. Kamensky raised this suggestion again on July 9, during a call between the Committee co-chairs, the Committee professionals, and Mr. Vogel. Mr. Pachulski advised Mr. Kamensky that he thought the offer would be premature given the state of negotiations but informed the rest of the Committee of Mr. Kamensky's expression of interest at some point between July 11 and July 14. Mr. Pachulski stated his belief that Mr. Kamensky's offer was designed either to obtain a fair settlement or to increase the chances of obtaining a plan with a settlement trust. He said that Mr. Kamensky had "zero interest" in actually buying the litigation claims.

On July 24, Mr. Kamensky, on behalf of Marble Ridge, submitted an offer to Mr. Vogel for the purchase of the Debtors' MyTheresa-related litigation claims. At a Committee meeting that same day, Mr. Pachulski, who was not informed in advance of Marble Ridge's offer, informed Mr. Kamensky that he had two options: he could either withdraw his offer and agree not to submit any other offer without prior Committee approval, or if he chose not to withdraw his offer, he would be recused from Committee discussions regarding a settlement. Mr. Kamensky chose to withdraw his offer. Neither the United States Trustee nor the Court was informed of Mr. Kamensky's initial expression of interest, his offer to purchase the claims, or the withdrawal of his offer until after the events of July 31.

E. Marble Ridge Proposes to Fund a Cash Out Option for the Series B Shares

In late July, the parties made progress towards a global settlement of the MyTheresa disputes, which ultimately would be announced to the Court at the disclosure statement hearing of July 30. Because it was probable that any settlement would likely involve the transfer of the Series B Shares that Neiman Marcus's parent had retained, Mr. Pachulski began to explore alternatives for a "cash out" option, under which creditors could exchange the illiquid Series B Shares for cash. Mr. Pachulski believed that this was particularly important for the Debtors' trade creditors, who strongly prefer cash to securities, and he believed a cash out option would help pave the way for a consensual plan of reorganization.

On July 28, following discussions with Mr. Pachulski, Mr. Kamensky emailed the outline of a cash out proposal to the Committee's members and professionals. The most salient feature of this rough proposal was that Marble Ridge would guarantee, or "backstop," the purchase of 60 million Series B Shares at twenty cents per share from other unsecured creditors wishing to sell. Other noteholder creditors would have the right to participate in the purchase of the 60 million shares in proportion to their pro rata share of the overall noteholder group of claims. Marble Ridge would purchase the shares available to any noteholder that did not wish to participate.

At a meeting held on July 29, the Committee members voted to support the global settlement. Mr. Pachulski excused Marble Ridge from the meeting, and the members discussed the outline of the cash out proposal. While not affirmatively accepting Mr. Kamensky's proposal, the Committee agreed to continue negotiations with Marble Ridge. These negotiations appear to have been somewhat time-sensitive, since any last-minute changes to the Disclosure Statement would need to be presented to the Court at a hearing set for August 3, in order to be included in the Disclosure Statement mailed to creditors.

F. Events of July 30 and 31

1. The Jefferies Proposal

Even as the Committee worked on the Marble Ridge proposal, the financial firm Jefferies was considering its own cash out offer. Eric Geller is the senior analyst in the Jefferies Distressed and Special Situations section. The Distressed and Special Situations section in Jefferies trades on its own behalf and for clients, one of whom is Marble Ridge.[7] On the evening of July 30, Mr. Geller learned of the amended Neiman Marcus plan of reorganization providing for the distribution of the Series B Shares to unsecured creditors. That same evening, another Jefferies client contacted Mr. Geller to express interest in purchasing the Series B Shares. Mr. Geller then sent texts around 9:00 PM ET to JE1 and another Jefferies employee to discuss the possibility of making an offer to buy the Series B Shares.

JE1 saw these texts the next morning on July 31, and talked to Mr. Geller at approximately 8:00 AM ET. At 8:10 AM ET, JE1 and Mr. Geller had a call with the Jefferies client. The client expressed an interest in purchasing through Jefferies 70 million of the 140 million Series B Shares set to be distributed. After the call with the Jefferies client, JE1 spoke with an additional client who indicated interest in purchasing 10 million Series B Shares. At that point, JE1 believed there was more than enough interest for Jefferies to move forward with a proposal to buy Series B Shares.

Between 9:00 AM ET and 10:00 AM ET on July 31, Mr. Geller called Mr. Meghji, the Committee's financial advisor. Mr. Geller informed Mr. Meghji that Jefferies was interested in

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[7] Mr. Kamensky later informed the United States Trustee that Jefferies was Marble Ridge's ninth largest trading partner and that Marble Ridge had paid Jefferies approximately $200,000 in trading commissions during the first six months of 2020.

making a bid to purchase the 140 million Series B Shares set to be distributed to unsecured creditors as part of the amended plan of reorganization. He informed Mr. Meghji that the firm was considering offering to buy the shares for a price in the range in "the thirties"—in other words, between thirty and forty cents per share. Mr. Geller sent Mr. Meghji a follow up email at 10:22 AM ET confirming Jefferies's interest in submitting a firm bid to purchase the shares and its capacity to complete the transaction if the Committee chose to accept a bid from Jefferies. Mr. Geller's email requested that Mr. Meghji keep Jefferies's bid confidential from any member of the Committee that was interested in making its own cash out offer for the Series B Shares.

After speaking with Mr. Geller, Mr. Meghji contacted Mr. Pachulski. Mr. Meghji and Mr. Pachulski decided the next necessary step was to schedule a further call with Jefferies to gauge the firm's interest in the shares and the potential for a Jefferies bid to produce a higher return for unsecured creditors than the pending offer from Marble Ridge. At 12:15 PM ET, Mr. Meghji and Mr. Pachulski spoke with Mr. Geller and JE1. Mr. Pachulski explained that while Jefferies could make a bid for the 140 million shares as a block, some unsecured creditors wanted to keep their shares, so an offer that allowed creditors to opt in or out of the sale would be more likely to be successful. Mr. Geller and JE1 had no issue proceeding along those lines and confirmed a price in the "thirties." They also indicated that Jefferies was prepared to submit a proposal by the end of the day.

After the 12:15 PM ET call with the Committee professionals, JE1 began putting together a formal bid to buy Series B Shares from those unsecured creditors who wished to sell them. He informed internal Jefferies legal counsel of the proposed offer, and Jefferies outside legal counsel was tasked to prepare documents for the bid. JE1 discussed the Series B proposal with senior Jefferies management.

Mr. Pachulski and Mr. Meghji came away from the 12:15 PM ET conversation satisfied Jefferies was serious about making a cash out offer for the Series B Shares. They determined they would need to halt work on finalizing the Marble Ridge proposal to allow consideration of a proposal from Jefferies. They decided they needed to inform Mr. Kamensky of this development.

2. Mr. Kamensky Learns of the Jefferies's Proposal and Forces its Withdrawal

At 3:15 PM ET, Mr. Pachulski and Mr. Meghji called Mr. Kamensky. They informed him that another possible bidder had come forward to discuss making a cash out offer on the Series B Shares. They informed him the possible price for this bid was in the range of $0.30 per share. When Mr. Kamensky asked them who the new potential purchaser was, they informed him that it was Jefferies. Mr. Pachulski stated that he did not recall Jefferies's request to keep its potential bid confidential, and it may be that this request was made only to Mr. Meghji. In any event, according to both Mr. Pachulski and Mr. Meghji, Mr. Kamensky received this news calmly, without apparent anger or surprise. Mr. Kamensky stated that he believed the Jefferies's expression of interest was not serious and that nothing would come of it; he stated that Jefferies was likely just fishing for information.

Despite Mr. Kamensky's calm demeanor during his 3:15 PM ET call with Mr. Pachulski and Mr. Meghji, Mr. Kamensky engaged in a frenzy of activity once it concluded. Immediately thereafter, Mr. Kamensky via Instant Bloomberg chat told Christopher Bauer, Head Trader at Marble Ridge, to check his text messages on his iPhone. At 3:20 PM ET, Mr. Bauer received a text message from Mr. Kamensky on his iPhone, which started the text message exchange set out below:

Fri. Jul 31 3:20 PM

Kamensky: Eric Geller from Jefferies called the UCC counsel and offered to buy the units at 30 cents, that is a monumental mistake. I'm getting [JE1] now. he needs to talk me. let me know. They are threatening to put a bid in.

Bauer: For nmg??

Kamensky: yes i just texted [JE1]

Bauer: Yikes what did we bid. Those guys man I hope they were just ignorant to our interests

Consistent with the text exchange between Mr. Kamensky and Mr. Bauer, Mr. Kamensky began communicating with JE1 at 3:20 PM ET using Instant Bloomberg chat messages. Mr. Kamensky told JE1 not to put in a proposal for the Series B Shares. The message chain between Mr. Kamensky and JE1 starting at 3:20 PM ET and ending at 3:28 PM ET is set out in relevant part below:

(2020-07-31 03:20:13 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL) has invited [JE1] (JEFFERIES LLC)

Need you NOW

(2020-07-31 03:20:40 PM EDT)

[JE1] (JEFFERIES LLC)

Call me in 10min

(2020-07-31 03:20:52 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

Tell Geller to stand DOWN

(2020-07-31 03:20:55 PM EDT)

[JE1] (JEFFERIES LLC)

Im on an inernal call

(2020-07-31 03:20:55 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

And let's talk

(2020-07-31 03:20:59 PM EDT)

[JE1] (JEFFERIES LLC)

I can't get off of

(2020-07-31 03:21 :03 PM EDT)

[JE1] (JEFFERIES LLC)

Lets speak in 10 min pls

(2020-07-31 03:21 :28 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

Do I need to reach out to Geller

(2020-07-31 03:28:30 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

DO NOT SEND IN A BID

Mr. Kamensky also contacted Mr. Geller at 3:23 PM ET by Instant Bloomberg and asked to speak right away:

(2020-07-31 03:23:55 PM EDT) DKAMENSKY2 (MARBLE RIDGE CAPITAL) has invited EGELLER9 (JEFFERIES LLC)

hat is your number? Need you now?

Mr. Kamensky later stated to the United States Trustee that his instant messages to Mr. Geller and JE1 were motivated by panic. He feared Jefferies's bid might jeopardize an agreement on a cash out proposal for the Series B Shares. Mr. Kamensky claimed that, in his call with Mr. Pachulski and Mr. Meghji, Mr. Pachulski had said words to the effect of "that would be a problem" in response to Mr. Kamensky saying Jefferies was not a serious bidder. Mr. Kamensky said he interpreted this to mean that Jefferies's potential bid might disrupt the process of including a cash out proposal in the Disclosure Statement and Plan by August 3, which he understood to be a firm deadline. He admitted that he did not further discuss this concern with Mr. Pachulski. Mr. Kamensky also conceded a fear that Jefferies's higher price for the shares, mentioned in his texts with Mr. Bauer, would hurt Marble Ridge's ability to profit from any Series B purchase. He nevertheless claimed that process concerns about endangering the agreement on a cash out provision were his primary motivation for contacting JE1 and Mr. Geller. Mr. Kamensky admitted that contacting and trying to influence a potential rival bidder for property of the bankruptcy estate was wholly inappropriate and a grave mistake. He stated he should have gone to Mr. Pachulski with his concerns about the effect of Jefferies on the cash out process and let Mr. Pachulski make any necessary inquiries.

Following Mr. Kamensky's chat messages, JE1 and Mr. Geller spoke with Mr. Kamensky on the phone at approximately 3:45 PM ET. According to JE1, Mr. Kamensky was very upset and told them to stand down and not put in a bid. JE1 responded that Jefferies was just engaging in its normal business of purchasing assets. Mr. Kamensky told them that they did not understand how deep his interest was in the Series B Shares. He said he had been pursuing this matter for several years and amassed $3.5 million in legal fees. His efforts had made the MyTheresa settlement possible. He said he was determined to acquire the shares, so all that Jefferies's bid would accomplish was driving up his final price and costing him money. He said that as co-chair of the Committee, he would prevent Jefferies from acquiring the shares. Finally, Mr. Kamensky stated that he had been a good partner to JE1 and Jefferies, but if JE1 moved forward with the Series B bid, they would not be partners going forward. JE1 understood this last statement as Mr. Kamensky using a possible termination of the business relationship between Marble Ridge and JE1's section of Jefferies to pressure JE1 to drop the bid. JE1 ended the conversation with Mr. Kamensky by stating they would consider what to do and get back to him.

In his interview with the United States Trustee, Mr. Kamensky admitted that he made each of the coercive statements recounted by JE1, including the promise to use his position as Committee Co-Chair to prevent the Jefferies's bid from winning and the statement that Marble Ridge would end its business relationship with Jefferies if the bid went forward. As Mr. Kamensky remembered it, Mr. Geller at the start of the call said Jefferies was just pursuing its normal business of pursuing bankruptcy assets and wanted to buy half the Series B shares. According to Mr. Kamensky, this remark turned his panic into fury. He said he perceived Jefferies to be shaking him down for half the available assets by barging into a situation they knew nothing about at a sensitive time. Mr. Kamensky said he began to shout, curse, and demand that Jefferies stand down

on any bid, while making the coercive statements recounted by JE1. Mr. Kamensky admitted to the United States Trustee that these statements were entirely inappropriate.

According to Mr. Kamensky, JE1 then asked him why he was so angry. Mr. Kamensky said this led him to regain his composure, and the latter half of the call purportedly involved a calmer discussion of Mr. Kamensky's long history with Neiman Marcus and the complications involved with the Series B Shares.[8] Mr. Kamensky stated to the United States Trustee that he believed at the end of the call JE1 and Mr. Geller would consider Jefferies's next steps in light of the information he provided in the "calm" latter half of the call, not the coercive statements he made in the "angry" first half of the call. Mr. Kamensky claimed that the intended message of the "calm" half of the call was that Jefferies should bid if it was a serious bidder but that it should back off if it was not serious to avoid disruption to the bankruptcy process. He admitted, however, that he never actually said to JE1 and Mr. Geller that Jefferies should bid if it was serious or refrain from bidding if it was not.

JE1 and Mr. Geller had no perception that any portion of their call with Mr. Kamensky had superseded his demands that Jefferies pull its bid or face the consequences. JE1 specifically denied Mr. Kamensky ever gave them any indication that all he wanted was for Jefferies to bid if it was serious. JE1 and Mr. Geller perceived a clear and singular message: Jefferies should withdraw its bid or Mr. Kamensky would exact consequences by terminating their relationship.

Immediately after the call, JE1 spoke with Mr. Geller about his discomfort with what had just happened. JE1 believed that Mr. Kamensky's actions were outside the bounds of normal

[8] Because Mr. Kamensky was interviewed after JE1, the United States Trustee was unable to ask JE1 about the "calmer" portion of the conversation recounted by Mr. Kamensky.

trading behavior. He also believed that Mr. Kamensky was abusing his position as a fiduciary in the bankruptcy case. Furthermore, Mr. Kamensky's demand that Jefferies not bid might involve JE1 and Jefferies in unethical and even illegal conduct. At the same time, JE1 was concerned about his business relationship with Mr. Kamensky and Marble Ridge. JE1 decided to speak with Jefferies general counsel, Mike Sharp, about the situation and called him at approximately 3:55 PM ET.

JE1's discussion with Jefferies general counsel resulted in a two-part decision: (1) Jefferies would withdraw from making any bid to purchase the Series B Shares; (2) JE1 and Jefferies would be completely transparent with all interested parties about why it was withdrawing. JE1 and Mr. Geller called Mr. Kamensky at approximately 4:07 PM ET. JE1 explained that Mr. Kamensky was an important relationship, and Jefferies would withdraw from making any bid for the Series B Shares. Jefferies, however, would also be transparent about why it was withdrawing. Specifically, Jefferies would be transparent about its reason for withdrawing with both its client who sought to purchase the shares and with the advisors for the Committee. Mr. Kamensky responded by thanking JE1 and Mr. Geller and saying he would always be grateful to them. After the call, Mr. Geller remarked to JE1 that Mr. Kamensky appeared not to hear or understand JE1's statement that they would be transparent about their reasons for withdrawing. Mr. Kamensky later confirmed to the United States Trustee that he did not hear the statement about being transparent on what led them to withdraw.

At 4:08 PM ET, during or immediately after his call with JE1 and Mr. Geller about the withdrawal, Mr. Kamensky contacted Mr. Bauer by Instant Bloomberg chat to share the news:

(2020-07-31 04:08:10 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

They are standing down

(2020-07-31 04:08:13 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

See me

(2020-07-31 04:08:15 PM EDT)

CCBAUER13 (MARBLE RIDGE CAPITAL)

Yeah

(2020-07-31 04:08:19 PM EDT)

CCBAUER13 (MARBLE RIDGE CAPITAL)

Thank goodness

(2020-07-31 04:08:22 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

He took the high roadf

(2020-07-31 04:08:28 PM EDT)

DKAMENSKY2 (MARBLE RIDGE CAPITAL)

Thank gd

(2020-07-31 04:08:52 PM EDT)

CCBAUER13 (MARBLE RIDGE CAPITAL)

He got the call from H

(2020-07-31 04:08:56 PM EDT)

CCBAUER13 (MARBLE RIDGE CAPITAL)

"stand down!!"

Shortly after their 4:07 PM ET call with Mr. Kamensky, JE1 and Mr. Geller contacted their original client for the purchase of the Series B Shares and told him they were withdrawing from making a bid. They explained they were withdrawing because of pressure from another client. JE1 and Mr. Geller then tried to contact Mr. Pachulski and Mr. Meghji. After an initial attempt to reach them by phone, Mr. Geller sent an email at 4:13 PM ET to Mr. Pachulski and Mr. Meghji requesting they call him back.

3. The Committee Learns of Mr. Kamensky's Actions

Mr. Pachulski alone eventually talked with JE1 and Mr. Geller at approximately 5:00 PM ET. After Mr. Geller explained that Jefferies was withdrawing from making a bid, Mr. Pachulski asked why. Mr. Geller explained that Jefferies was withdrawing because a significant client had asked it to do so. Mr. Pachulski asked if that client was a member of the Committee. Mr. Geller said yes. Mr. Pachulski asked if the client was Mr. Kamensky. Mr. Geller said yes. According to JE1, Mr. Pachulski responded by saying, "I've got a big problem." After the call concluded, Mr. Pachulski informed Mr. Meghji of Jefferies's withdrawal and its stated reason for doing so. Mr. Pachulski set a 6:00 PM ET conference call for Committee professionals to decide on the necessary steps in reaction to Mr. Kamensky's reported actions. In the meantime, Mr. Meghji conducted his

own follow up call with Mr. Geller, who confirmed the basic account he had provided Mr. Pachulski about Jefferies's withdrawal.

At the 6:00 PM ET conference call, the Committee professionals decided as a first step to reach out to Mr. Weisfelner, counsel for Marble Ridge, to determine if Jefferies's report about Mr. Kamensky's conduct was accurate. At approximately 7:00 PM ET, Mr. Pachulski and several other Committee professionals spoke to Mr. Weisfelner. Mr. Weisfelner responded that he knew nothing about the allegations and would call them back after contacting Mr. Kamensky. Mr. Kamensky confirmed to the United States Trustee that Mr. Weisfelner called him at this time and informed him that Jefferies had reported to Committee counsel that it was withdrawing from bidding after pressure from Mr. Kamensky. Mr. Weisfelner spoke again with Mr. Pachulski and other Committee professionals at approximately 7:30 PM ET. After speaking with Mr. Kamensky, he reported that Mr. Kamensky did contact Jefferies about its potential bid, but there was a misunderstanding about his intention in doing so. According to Mr. Weisfelner, Mr. Kamensky had told Jefferies to bid if it was serious. If it was not serious, it should back off to avoid disruption to the Neiman Marcus bankruptcy. Mr. Pachulski ended the call by stating that he would need to schedule an emergency meeting of the Committee without Marble Ridge or its attorneys to consider the Committee's next steps.

Meanwhile, Mr. Kamensky was trying to contact JE1. At 7:42 PM ET, he sent an Instant Bloomberg chat message to JE1 asking "Are you there?" JE1 got the messages and reported being available at 8:08 PM ET. Mr. Kamensky and JE1 soon thereafter began a phone conversation. According to JE1, Mr. Kamensky began the call by saying, "this conversation never happened." Disturbed by this opening, JE1 began to record the phone call. Through counsel, JE1 later voluntarily provided a copy of the recorded call, an initial rough transcript, and then a final

transcript to the United States Trustee. In the recorded portion of the call, Mr. Kamensky asked why JEI had told Committee counsel that Mr. Kamensky had threatened JE1 and asked if JE1 knew this could cause Mr. Kamensky to go to jail. JE1 responded that he had planned to bid, then Mr. Kamensky demanded Jefferies stand down to preserve their business relationship:

> Hold on. Hold on a second, Dan. Listen to me. And then you call me and you say, do not bid. It's going to be a relationship issue, and so I said okay. Dan's a good relationship. What he's asking me to do makes me a little bit uncomfortable.

Mr. Kamensky reiterated that he could go to jail and urged JE1 to agree that Mr. Kamensky asking Jefferies to stand down was just a large misunderstanding.

Mr. Kamensky also urged JE1 to now take part in the bidding process for the Series B Shares. JE1 denied any further interest in having anything to do with the matter. Mr. Kamensky responded:

> It's too late now. They're going to report this to the U.S. Attorney's Office, okay? They're reporting this to the U.S. Attorney's Office. This is -- this is -- it's, not like, not like you can't bid. The U.S. Attorney is going to investigate this. My position to them is this. I said to them, this a huge misunderstanding, okay, humongous misunderstanding and I told them -- the only thing I said was if you're not real don't bid and if they're real then they should bid. Because otherwise the U.S. Attorney is investigating this then, okay? They're going to report it, okay, and my position is -- is -- going to be look, this is was a huge misunderstanding. I never in a million years would have told them not to do that. I – all I told them was if they're not real they shouldn't bid.[9]

JE1 later explained to the United States Trustee that Mr. Kamensky was trying to get JE1 to agree to his account of their phone conversation earlier that day. In fact, there had been no misunderstanding between them. Mr. Kamensky had made no inquiry whether Jefferies was

[9] Quotations of the phone call are based on the transcript provided by JE1's counsel. The transcript matches the audio recording also provided by JE1's counsel.

"real," i.e. a serious bidder, and had certainly not said it should bid if Jefferies was "real." Mr. Kamensky had just demanded that Jefferies pull its bid.

In the call, JE1 again pushed back against the plausibility of Mr. Kamensky's explanation, reminding him that Mr. Geller had been on the call as well and heard what Mr. Kamensky actually said. He urged Mr. Kamensky to just recuse himself from the whole matter. Mr. Kamensky again responded with a plea for JE1 to adopt his version of their earlier conversations, stressing the dire consequences for Mr. Kamensky if JE1 did not. Mr. Kamensky also admitted to abusing his position as a member of the Neiman Marcus Committee:

> . . . [I]f you're going to continue to tell them what you just told me, I'm going to jail, okay? Because they're going to say that I abused my position as a fiduciary, which I probably did, right? Maybe I should go to jail. But I'm asking you not to put me in jail.

JE1 responded that there was no possibility of lying for Mr. Kamensky. Mr. Kamensky denied wanting JE1 to lie but kept urging JE1 to adopt his version of their earlier conversations.

JE1 again reiterated that Mr. Kamensky had pressured him to withdraw the bid to preserve their business relationship:

> I thought you were very upset about it, okay, and I thought that you -- I thought that you were basically pushing me very hard to not put a bid and I thought about it and frankly it's not even worth it. It's not even important enough for me. So that's why because of my relationship with you I said okay. I don't want anything to do with this.

Mr. Kamensky then pleaded with JE1 to agree that Mr. Kamensky said something he purportedly intended to say but never actually did—that Jefferies should bid if it was serious. He implied that adopting this position was necessary to preserve their relationship:

> I apologize. I apologize. I apologize, okay, and I'm telling you that what I intended to say, okay, is if you're not real don't bid but if you're real then you should bid, and, [JE1], for the relationship I would tell you that's exactly what I said and I apologize if I was upset or if it appeared as a threat.

He also repeated what he had set at the start of the call, "this conversation never happened," referring to his efforts to influence JE1 but not have anyone know about these efforts.

> But I'm telling you that is exactly what I intended to say and I'm just begging you to please appreciate that's what I meant to say and that this conversation never happened.

The United States Trustee questioned Mr. Kamensky concerning the above call recorded by JE1. Mr. Kamensky freely admitted he had made the call and said it was a serious mistake, one of the worst of his life. The United States Trustee played the audio recording of the call, and Mr. Kamensky verified it accurately captured his call with JE1. He stated he made the call out of fear and panic of the possible consequences of Jefferies's report to the Committee that he had pressured them to withdraw from bidding. He denied wanting JE1 to lie but said he was trying to "manage the message" by talking with him. His hope was that he and JE1 could find "common ground" around Mr. Kamensky's notion that the "calm" second half of their earlier call was meant to communicate that Jefferies should bid if it was serious, even though he never actually said that to JE1 and Mr. Geller during their first call that day. Mr. Kamensky admitted that his repeated statement that "this conversation never happened" was a recognition that attempting to influence JE1 might be considered improper. When questioned by the United States Trustee, Mr. Kamensky had no explanation for his use of the phrase "for the relationship" in his statement: "I'm telling you that what I intended to say, okay, is if you're not real don't bid but if you're real then you should bid, and, [JE1], for the relationship I would tell you that's exactly what I said."

G. Marble Ridge Resigns from the Committee on August 1

At 8:31 AM ET on August 1, in advance of an emergency Committee meeting set for 2:00 PM ET, Mr. Weisfelner emailed Committee counsel on behalf of Mr. Kamensky and Marble Ridge. He again advanced the "misunderstanding" explanation of Mr. Kamensky's conduct from

the day before, asserting that Mr. Kamensky had only contacted Jefferies to make sure it was truly committed to bidding, not to discourage a bid. Mr. Weisfelner, on Mr. Kamensky's behalf, asked the Committee professionals to assure Jefferies that it was strongly encouraged to submit a bid. Mr. Weisfelner mentioned Mr. Kamensky's continuing work on Marble Ridge's own cash out proposal. Finally, even though he believed Mr. Kamensky's conduct had been grossly misconstrued, Mr. Weisfelner stated that Marble Ridge would be resigning from the Committee as a way to resolve the issue in the best interests of all concerned.

At 1:15 PM ET, Mr. Weisfelner wrote to the United States Trustee to offer Marble Ridge's resignation from the Committee. In discussing the reasons for the resignation, Mr. Weisfelner provided the United States Trustee the substantially same "misunderstanding" explanation of Mr. Kamensky's July 31 conduct that he had provided to the Committee.

At the 2:00 PM ET emergency Committee meeting, given Marble Ridge's resignation, the Committee decided that counsel should promptly disclose Mr. Kamensky's conduct to the United States Trustee. Later that afternoon, Mr. Pachulski and Mr. Warner spoke by phone to Hector Duran, an attorney for the United States Trustee, and explained what they knew of the situation involving Mr. Kamensky and Marble Ridge. They advised Mr. Duran that they would provide him what they knew in writing and that the Committee would also disclose the situation to the Court.

H. Jefferies Renews Its Bid

Also on August 1, Jefferies decided to resume pursuit of its proposal to purchase Series B Shares. JE1 later explained to the United States Trustee that, given the turmoil following Jefferies's withdrawal, the business reasons behind the withdrawal no longer held. JE1 stressed that Jefferies's resumption of its proposal was not in response to Mr. Kamensky's request during

their phone call the prior evening that Jefferies bid in aid of his cover story. Instead, the renewed bid was motivated by Jefferies's own financial interest in a profitable transaction. During the morning of August 1, Mr. Geller and JE1 contacted Mr. Pachulski to inquire if the Committee would still be interested in a Jefferies cash out proposal for the Series B Shares. Mr. Pachulski said the Committee would be interested in a Jefferies proposal. He also asked Mr. Geller to reaffirm his explanation that Jefferies withdrew the day before in response to pressure from Mr. Kamensky. Mr. Geller did so. Mr. Pachulski asked if Mr. Kamensky had requested that Jefferies resume its bid. Mr. Geller responded that at the advice of counsel Jefferies could not provide any additional explanation beyond what it had already provided.

Committee counsel subsequently spoke with Mr. Sharp, Jefferies general counsel, who reported that Mr. Kamensky had phoned a Jefferies employee the evening of July 31, and "seemed concerned." This was apparently a reference to Mr. Kamensky's call with JE1 at approximately 8:08 PM ET. Mr. Sharp did not provide any other details. At the 2:00 PM ET Committee meeting that day, the Committee agreed to consider any renewed Jefferies cash out proposal.

I. The Court Orders the United States Trustee to Investigate Marble Ridge and Mr. Kamensky

On August 3, the Committee filed under seal an August 2 letter by Mr. Pachulski to United States Trustee attorney Hector Duran, laying out the facts about Mr. Kamensky and the Jefferies cash out proposal as the Committee understood them. Dkt. No. 1427. The Committee did not offer any conclusions as to Mr. Kamensky's conduct, but its narrative is consistent with the facts the United States Trustee has been able to establish during its subsequent investigation.

On August 4, Mr. Weisfelner, counsel to Marble Ridge Capital, filed under seal a declaration in his own name that provided an account of Mr. Kamensky's conduct ("Weisfelner

Declaration"). Dkt. No. 1432. Once again, Mr. Weisfelner advanced the "misunderstanding" explanation of Mr. Kamensky's actions. As discussed below, the Weisfelner Declaration in several material respects is not consistent with the facts that the United States Trustee has established during the subsequent investigation.

In response to these filings, the Court on August 5, ordered both the Committee's letter and the Weisfelner Declaration unsealed. The Court then required the United States Trustee "to file a statement of position within 14 days regarding the conduct of Marble Ridge and Mr. Kamensky in this case." The United States Trustee began work immediately.

J. The Committee is Currently Considering Cash Out Proposals from Marble Ridge and Jefferies

In the meantime, both Jefferies and Marble Ridge submitted cash out proposals to the Committee. Jefferies submitted a Letter of Intent to the Committee on August 2. Marble Ridge provided a letter proposal on August 3, and then a revised proposal on August 11. Although the proposals are complex, each offers a higher price per share than the twenty cents of Marble Ridge's original proposal. The United States Trustee understands that the Committee has not made a decision on any cash out proposal, and the Marble Ridge and Jefferies offers remain pending.

III. LEGAL ANALYSIS

When a creditor accepts appointment to an official creditors' committee in a chapter 11 case, it agrees to assume certain fiduciary duties to other creditors. *See Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 256 (3rd Cir. 2001) (noting that section 1103 of the Bankruptcy Code "impl[ies] a fiduciary duty on the part of members of a creditor's Committee"). Those duties include a duty of loyalty, a duty of care, and a duty of disclosure. *See In re Farrell*, 610 B.R. 317, 323 (Bankr. C.D. Cal. 2019). A committee member owes its duties to the

represented creditors collectively, rather than to particular creditors individually. *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 717, 722 (Bankr. S.D. N.Y. 1992).

Committee members differ from most other bankruptcy fiduciaries, however, in one important respect: committee members are not required to be disinterested, *see* 11 U.S.C. § 1102, and it is common for committee members to have individual economic interests that may be opposed to the debtor or to other creditors. *See In re Rickel & Assocs., Inc.,* 272 B.R. 74, 100 (Bankr. S.D.N.Y. 2002) (committee members are "hybrids who serve more than one master"). For this reason, a conflict of interest does not automatically prevent a creditor from serving on a committee—provided, however, that the creditor is otherwise able to exercise its fiduciary duties and provide adequate representation for the creditor body. *See In re First RepublicBank Corp.*, 95 B.R. 58, 61 (Bankr. N.D. Tex. 1988). In other words, committee members are not expected to abandon their personal interests, and are not prohibited from taking positions or actions that are adverse to other creditors or the estate outside the committee, so long as they do not take "unfair advantage" of their committee membership in order to do so. *In re El Paso Refinery, L.P.,* 196 B.R. 58, 75 (Bankr. W.D. Tex. 1996).

The United States Trustee has the statutory duty to monitor creditors' committees, is responsible for soliciting and appointing members to committees, and may reconstitute or remove members from committees if necessary. 28 U.S.C. § 586(a)(3)(E), 11 U.S.C. § 1102(a). In the United States Trustee's experience, the solicitation and appointment process itself can often forestall or mitigate many threats to the integrity of committees. Potential committee members are advised of their fiduciary duties in advance of their appointment, and potential members will be questioned extensively about any positions, interests, or status that may affect their behavior as fiduciaries before being appointed. Potential committee members are also advised of their

obligation to notify the United States Trustee of any changed circumstances that arise during the case that may affect their ability to serve. If there is doubt about a creditor's willingness or ability to act as a fiduciary, that creditor will typically not be appointed, and a creditor who violates these duties or becomes unable to perform those duties after appointment may be removed. *See In re America West Airlines,* 142 B.R. 901, 902 (Bankr. D. Ariz. 1992) (upholding United States Trustee's removal of creditor from committee).

IV. CONCLUSIONS

Although some details and interpretations remain in dispute, the substantial evidence collected to date clearly demonstrates that Mr. Kamensky breached his fiduciary duty to unsecured creditors on July 31, and his earlier conduct between July 4 and July 30 was problematic. After being told both of the existence of a rival bid and the identity of the bidder, Mr. Kamensky sought to exploit that information for his own benefit by contacting Jefferies and pressuring them to withdraw their initial bid, to the likely detriment of all other creditors.[10] In the course of those conversations with JE1, Mr. Kamensky improperly suggested to JE1 that he could prevent a successful Jefferies bid because of his role as Committee co-chair. Regardless of whether Mr. Kamensky actually had the power to ensure that the Committee rejected any Jefferies bid, this type of coercion by a Committee fiduciary is highly inappropriate. Moreover, Marble Ridge's initial representations regarding the conversations between Mr. Kamensky and Jefferies, which

[10] Marble Ridge's actions might have been prevented had the Court and the United States Trustee been notified that Marble Ridge intended to engage in a self-interested transaction as early as July 4. Wider awareness of Marble Ridge's intentions might have called into question its ability to continue serving on the Committee or at least led to more stringent procedures to avoid a breach of fiduciary duty.

minimized Mr. Kamensky's role in Jefferies's withdrawal of its initial offer and which suggested that Mr. Kamensky was surprised by that result, are inconsistent with the evidence regarding those same conversations, including Mr. Kamensky's own later testimony. His actions were a clear abuse of his Committee position and a breach of his duty.

As a number of courts have held—and, indeed, as Mr. Kamensky himself appears to have admitted in his conversation with JE1—his actions of July 31 are paradigmatic examples of a breach of a committee member's duties. *See Rickel,* 272 B.R. at 100 (committee member breaches its duty by using its position to monopolize negotiations, effectively freezing out other bidders, or by exploiting confidential information known only to it through its committee service in order to seize an advantage); *In re Refco Inc.,* 336 B.R. 187, 198 n.13 (Bankr. S.D.N.Y. 2006) ("a Committee member's fiduciary duties do not preclude it from representing its own interests, provided that in so doing it does not abuse its position on the Committee at the expense of the creditor class"). *See also In re Russo*, 762 F.2d 239, 243 (2d Cir. 1985) (directing bankruptcy court to consider whether asset sale was tainted due to former fiduciary's misuse of confidential information).

As this Court observed in its August 5 Order, effective committees are critical to a robust chapter 11 process, and any threats to their integrity and function must be resolved promptly and publicly:

> A creditors' committee in a large commercial case serves an especially important role in the bankruptcy process. A properly functioning committee adds transparency and public confidence to a complicated and often confusing process. The Court relies on a committee's views to add depth and balance to the myriad of commercial issues that it considers. Any threat that endangers this delicate balance must be resolved promptly and in a public manner.

Order, Dkt. No. 1442.

Although the issues discussed and conclusions drawn in this statement are supported by substantial evidence, this investigation was preliminary, and no party has had an opportunity to respond to or rebut the United States Trustee's statement. In the Court's order of August 5, the Court cited possible remedial actions, including the creditors' remedy of subordination of claims under 11 U.S.C. § 510(c).[11] To the extent the Court believes that further relief may be appropriate under these or any other provisions, such relief should be considered in a formal proceeding in open court so that the Court may hear and consider all relevant evidence.

Dated: August 19, 2020

Respectfully Submitted,

HENRY G. HOBBS, JR.
ACTING UNITED STATES TRUSTEE
REGION 7, SOUTHERN and WESTERN
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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic means on all PACER participants on this 19th day of August 2020.

/s/ Hector Duran
Hector Duran, Trial Attorney

[11] The Court also cited 18 U.S.C. § 152(6), and consistent with long-standing practice, the United States Trustee does not opine publicly about possible implications of title 18 in this statement.

United States Department of Justice

THE UNITED STATES ATTORNEY'S OFFICE
SOUTHERN DISTRICT of NEW YORK

U.S. Attorneys » Southern District of New York » News » Press Releases

Department of Justice

U.S. Attorney's Office

Southern District of New York

FOR IMMEDIATE RELEASE Wednesday, February 3, 2021

New York Hedge Fund Founder Pleads Guilty To Bankruptcy Fraud In Connection With Neiman Marcus Bankruptcy

Audrey Strauss, the United States Attorney for the Southern District of New York announced today that DANIEL KAMENSKY, the founder and manager of New York-based hedge fund Marble Ridge Capital ("Marble Ridge"), pled guilty to one count of bankruptcy fraud in connection with his scheme to pressure a rival bidder to abandon its higher bid for assets in connection with Neiman Marcus's bankruptcy proceedings so that Marble Ridge could obtain those assets for a lower price. KAMENSKY pled guilty before United States District Judge Denise Cote.

U.S. Attorney Audrey Strauss said: "Daniel Kamensky abused his position as a committee member in the Neiman Marcus Bankruptcy to corrupt the process for distributing assets and take extra profits for himself and his hedge fund. Kamensky predicted in his own words to a colleague: *'Do you understand…I can go to jail?'… 'this is going to the U.S. Attorney's Office.*' His fraud has indeed come to the U.S. Attorney's Office and now has been revealed in open court."

As alleged in the Complaint, the Information, and statements made in court:

DANIEL KAMENSKY was the principal of Marble Ridge, a hedge fund with assets under management of more than $1 billion that invested in securities in distressed situations, including bankruptcies. Prior to opening Marble Ridge, KAMENSKY worked for many years as a bankruptcy attorney at a well-known international law firm, and as a distressed debt investor at prominent financial institutions.

The Neiman Marcus Bankruptcy

Neiman Marcus, an American chain of luxury department stores with stores located across the United States, filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court") in May 2020. At the outset of the bankruptcy, Marble Ridge, through KAMENSKY, applied to be on the Official Committee of Unsecured Creditors (the "Committee") and was thereafter appointed to be a member of the Committee. As a member of the Committee, KAMENSKY had a fiduciary duty to represent the interests of all unsecured creditors as a group.

During the bankruptcy process, the Committee had negotiated with the owners of Neiman Marcus to obtain certain securities, known as MyTheresa Series B Shares (the "MYT Securities"), and ultimately, the Committee was successful in coming to a settlement to obtain 140 million shares of MYT Securities for the

benefit of certain unsecured creditors of the bankruptcy estate. In July 2020, KAMENSKY was negotiating with the Committee for Marble Ridge to offer twenty cents per share to purchase MYT Securities from any unsecured creditor who preferred to receive cash, rather than MYT Securities, as part of that settlement.

KAMENSKY's Fraudulent Scheme

On July 31, 2020, KAMENSKY learned that a diversified financial services company headquartered in Manhattan, New York (the "Investment Bank") had informed the Committee that it was interested in bidding a price between thirty and forty cents per share—substantially higher than KAMENSKY's bid—to purchase the MYT Securities from any unsecured creditor who was interested in receiving cash.

That afternoon, KAMENSKY sent messages to a senior trader at the Investment Bank ("IB Employee-1") telling him not to place a bid, and followed those messages up with a phone call with IB Employee-1 and a senior analyst of the Investment Bank ("IB Employee-2," and collectively the "Employees"). During that call, KAMENSKY asserted that Marble Ridge should have the exclusive right to purchase MYT Securities, and threatened to use his official role as co-chair of the Committee to prevent the Investment Bank from acquiring the MYT Securities. KAMENSKY also stated that Marble Ridge had been a client of the Investment Bank in the past but that if the Investment Bank moved forward with its bid, then Marble Ridge would cease doing business with the Investment Bank.

The Investment Bank thereafter decided to not make a bid to purchase MYT Securities and informed the legal advisor to the Committee of its decision. The Investment Bank further told the legal advisor they made that decision because KAMENSKY—a client of the Investment Bank—had asked them not to.

Advisors to the Committee informed counsel for Marble Ridge of their call with the Employees, and after speaking with KAMENSKY, counsel for Marble Ridge falsely informed the advisors that KAMENSKY had not asked the Employees not to bid, but instead had told them to place a bid only if they were serious. Later that evening, KAMENSKY contacted IB Employee-1 and attempted to influence what IB Employee-1 would tell others, including the Committee and law enforcement, about KAMENSKY's attempt to block the Investment Bank's bid for the MYT Securities. KAMENSKY said at the outset of the call, in substance, "this conversation never happened." During the call, KAMENSKY asked IB Employee-1 to falsely say that IB Employee-1 had been mistaken and KAMENSKY had actually suggested that the Investment Bank only bid if it was serious, and made comments including the following: "Do you understand…I can go to jail?" "I pray you tell them that it was a huge misunderstanding, okay, and I'm going to invite you to bid and be part of the process." "But I'm telling you…this is going to the U.S. Attorney's Office. This is going to go to the court." "[I]f you're going to continue to tell them what you just told me, I'm going to jail, okay? Because they're going to say that I abused my position as a fiduciary, which I probably did, right? Maybe I should go to jail. But I'm asking you not to put me in jail."

During a subsequent interview with the Office of the United States Trustee, which was conducted under oath and in the presence of counsel, KAMENSKY stated that his calls to IB Employee-1 were a "terrible mistake" and "profound errors in lapses of judgment."

After this series of events, Marble Ridge resigned from the Committee and has advised its investors that it intended to begin winding down operations and returning investor capital.

* * *

KAMENSKY, 48, of Roslyn, New York, pled guilty to one count of bankruptcy fraud, which carries a maximum sentence of five years in prison. Sentencing has been scheduled for May 7, 2021.

U.S. Attorney Strauss praised the work of the FBI. Ms. Strauss further thanked the Office of United States Trustee and the Securities and Exchange Commission for their cooperation and assistance in this investigation.

This case is being handled by the Office's Securities and Commodities Fraud Task Force. Assistant U.S. Attorneys Richard Cooper and Daniel Tracer are in charge of the prosecution.

Topic(s):
Bankruptcy

Component(s):
USAO - New York, Southern
U.S. Trustee Program

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Bankruptcy Fraud Prosecutions May Increase Post-Pandemic

By **Joel Cohen, Robert Klyman and Emma Strong** (May 19, 2020, 5:21 PM EDT)

Joel Cohen

Robert Klyman

Emma Strong

The COVID-19 crisis and the resulting disruption to business have adversely affected many corporate entities' financial stability and outlook. Even historically stable companies have been jolted into a new reality and may be evaluating options for restructuring their business in accordance with Chapter 11 of the Bankruptcy Code. In rarer cases, a company may opt to liquidate under Chapter 7.

In such circumstances, counsel, directors and executives of these corporate entities are well-served to understand the potential for criminal liability for fraudulent actions related to bankruptcy, and the attendant risk of costly government investigations, litigation expenses, fines and jail time. Although there has not been extensive historical application of these statutes to corporate entities, prosecutors and investigators invariably follow the money in their pursuit of alleged fraud and bankruptcy is thus a natural area of focus in a financial crisis.

Trends in Criminal Bankruptcy Fraud Prosecution

Historically, bankruptcy fraud charges have been brought primarily to prosecute individual bankruptcy filers, rather than corporate entities. Nonetheless, corporate officers and agents, including board members, could face liability under the bankruptcy fraud statutes.

Indeed, an article recently published in a U.S. Department of Justice bulletin suggests prosecutors should add charges of bankruptcy fraud to other criminal charges where applicable to strengthen their case and bolster admissibility of persuasive evidence, such as sworn testimony from defendants and sympathetic creditor victims and detailed financial histories submitted in connection with bankruptcy proceedings.[1]

Misuse of bankruptcy proceedings by legal and other advisers to hide assets, as well as to defraud potential bankruptcy candidates, may well surface as an investigative focus in the aftermath of the coronavirus-caused financial crisis.[2]

Regardless of whether bankruptcy fraud charges are filed, the existence of a bankruptcy can be the thin edge through which problematic activity is pursued. As investigators follow the flow of money, they may mine bankruptcy filings for evidence to strengthen existing cases or to bring new charges. This is

particularly so with respect to Ponzi schemes, the extent of which often surface once bankruptcy filings occur.[3]

Further, bankruptcy judges, receivers and trustees who reasonably believe a legal violation has occurred are required to report the possible violation to the U.S. attorney's office.[4] Similarly, members of the public can submit reports of suspected bankruptcy fraud to the DOJ and the U.S. Trustee Program.[5] Of course, an increase in bankruptcy filings can be expected to correspond to a greater incidence of referred or reported suspicions of bankruptcy fraud.

Companies should also be cautioned that communications with and work product by attorneys may be discoverable if the court finds there is a "reasonable likelihood [the attorney] either knew or was willfully blind" to the facts forming the basis of a bankruptcy fraud allegation against the client.[6]

Examples of Relevant Prosecutions and Settlements of Individuals

Often, charges brought against executives related to misconduct concerning a company nearing or in bankruptcy proceedings involve other charges, such as wire fraud, bank fraud and conspiracy.

For example, in May 2017, a former CEO of the electronics and appliance retailer Vann's Inc. was convicted of 170 counts, including bankruptcy fraud, and received a $2.4 million criminal forfeiture verdict as well as a more than five-year prison sentence. The defendant, in conjunction with Vann's former chief financial officer, was accused of establishing two shell companies as part of a real estate leaseback scheme. The jury found the defendant had committed bankruptcy fraud by making a claim for $2.4 million against Vann's estate on behalf of the shell companies after Vann's declared bankruptcy in 2012.[7]

Similarly, in 2016, the former president and CEO of PureChoice Inc. was sentenced to 22 years in prison for 11 counts, including three for bankruptcy fraud, arising out of an investment fraud scheme. As the scheme unraveled and victims began demanding payment, the defendant filed for personal bankruptcy and was ultimately charged with bankruptcy fraud for falsifying statements and concealing property in connection with the bankruptcy proceeding. The defendant also was ordered to pay over $22 million in restitution and $7.6 million in a forfeiture judgment.[8]

In some cases of alleged embezzlement and concealment of bankruptcy assets, prosecutors have declined to include bankruptcy fraud as a charge altogether, instead relying on the broader counts of mail fraud, embezzlement or money laundering.[9] Conversely, in other cases, bankruptcy is the only or one of two charges brought.

For example, in 2018, the owner of a number of gas stations pled guilty to bankruptcy fraud and was sentenced to 45 months in prison for "scrambling" his finances and destroying records to defraud his creditors. In 2012, the Bankruptcy Court had denied the defendant's request to discharge his debts because he had failed to retain business records that would enable the court to analyze his financial condition.[10]

Also in 2018, a husband and wife who had previously served as partners in a business venture were each sentenced to 50 and 27 months prison time, respectively, for tax evasion and bankruptcy fraud.[11] The couple filed for bankruptcy after attempting to settle over $600,000 in taxes due with the IRS.

However, at the same time, the couple caused their companies to pay substantial amounts of personal

expenses, including vacation home rental payments and a country club membership. After a jury trial, the defendants were sentenced to jail time and ordered to pay $1.6 million in restitution to the IRS and over $130,000 in a forfeiture money judgment.[12]

Risk of Securities Fraud Liability for Corporate Insiders During Financial Distress

Corporate insiders who trade company stock prior to the company filing for bankruptcy may face civil and criminal liability, as well as costs associated with defending against a U.S. Securities and Exchange Commission investigation. Indeed, the SEC has previously brought enforcement actions against insiders who traded securities before news of the company's financial difficulties or insolvency became public.[13]

In a recent press release, the SEC enforcement division acknowledged that due to the COVID-19 crisis, "a greater number of people may have access to material nonpublic information" and admonished corporate insiders to be "mindful of their of their obligations to keep this information confidential and to comply with the prohibitions on illegal securities trading."[14]

Multiple public officials have faced scrutiny and resulting reports to the DOJ and SEC regarding their trading of stock prior to disclosure of the extent and seriousness of the COVID-19 crisis.[15] Similar public scrutiny is likely to result if corporate insiders engage in significant or uncharacteristic securities transactions during this crisis. This risk is particularly heightened due to the SEC permitting delayed disclosure filing in light of disruptions to business caused by COVID-19 — thereby extending the duration of time in which information can be kept nonpublic.[16]

Potential Liability for Collusive Bidding on Bankruptcy Assets

Companies seeking to acquire assets of a bankrupt entity also should be aware of the risk of liability under the Sherman Antitrust Act (Title 15 of the U.S. Code) if they engage with competitors regarding the purchase of assets from the bankruptcy estate. Indeed, the DOJ has previously charged companies with violations of the Sherman Act for collusive bidding in a bankruptcy court auction.[17] The criminal penalties for a Sherman Act violation are severe — up to $100 million for a corporation and $1 million for an individual, along with up to 10 years in prison.[18]

Separately, the bankruptcy trustee can bring claims for civil liability against the purchaser under the Sherman Act during the bankruptcy court proceedings, in addition to claims under Section 363(n) of the Bankruptcy Code.[19] If a bankruptcy trustee fails to object to the sale during the bankruptcy proceedings, a later suit under the Sherman Act may be barred under res judicata, although a Section 363(n) claim will not.[20]

Relevant Bankruptcy Fraud Statutes and Penalties

Prosecutors looking to bring charges befitting the economic environment may be enticed by the many options bankruptcy fraud statutes offer to pursue what they perceive as financial wrongdoing. Bankruptcy fraud is most commonly prosecuted under Sections 152 and 157 of Title 18 of the U.S. Code.[21] Each imposes a maximum statutory sentence of five years.

In nine subparts,[22] Section 152[23] broadly criminalizes various actions prior to[24] and during bankruptcy proceedings, including knowingly and fraudulently[25] concealing assets, making false statements and withholding information from the bankruptcy trustee.[26] Paragraph 7 of Section 152

specifically covers transfers or concealment by an "agent or officer" of a corporation in or contemplating bankruptcy.

Section 157[27] criminalizes utilization of bankruptcy proceedings to further a broader fraudulent scheme.[28]

Sections 153 through 156[29] criminalize other less commonly prosecuted offenses — including embezzlement of bankruptcy estate assets, agreements to fix fees or compensation, and knowing disregard of bankruptcy rules and procedures.

Section 1519[30] imposes higher penalties — up to 20 years' imprisonment — for the destruction, alteration or falsification of records to interfere with an investigation or bankruptcy proceeding.

The penalties applicable to bankruptcy fraud convictions can be as severe as any financial crime. The sentencing guidelines provide a base offense level of six for violations under Sections 152 and 157 — where the maximum term of imprisonment is five years.[31]

However, the base offense level can be adjusted depending on certain characteristics of the offense.[32] Substantial financial loss, or intended loss, has the most significant increase in offense levels, up to 30 levels (resulting in a range of 108 to 405 months incarceration when combined with the base level) for losses over $550 million.[33] The sentencing judge is also obligated to order restitution to any identifiable victim, most commonly creditors of the bankruptcy estate.[34]

Conclusion

While investigators and prosecutors have rarely pursued criminal bankruptcy fraud allegations against companies and executives, the opportunities to do so are significant. The lack of prosecution could be a consequence of prosecutors' unfamiliarity with the criminal bankruptcy fraud statutes and investigating agents' preference for the traditionally more titillating fraud statutes to encompass the same conduct. These preferences can change quickly, especially if the DOJ or FBI focus on bankruptcy in the aftermath of the COVID-19 financial crisis.

These risks should be kept in mind when evaluating options for restructuring. Further, disgruntled former employees, such as those who may be laid off or furloughed due to COVID-19, increase the likelihood of a financially distressed company being reported to the U.S. Trustee Program. Even baseless reports — if investigated — could result in significant costs in reputational harm and defense expenses.

In light of the risk of criminal penalties and associated costs, counsel and directors of companies facing financial difficulties should seek competent guidance to navigate these concerns prior to initiating bankruptcy proceedings.

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[1] Charles R. Walsh, Why is a Bankruptcy Charge Valuable to Any Investigation, United States Attorneys' Bulletin (Mar. 2018), https://www.justice.gov/usao/page/file/1046201/download at 131.

[2] See, e.g., Paul Kiel, How to Get Away With Bankruptcy Fraud, ProPublica (Dec. 22, 2017), https://www.propublica.org/article/how-to-get-away-with-bankruptcy-fraud (acknowledging a lack of resources available for bankruptcy-related prosecutions, but quoting DOJ as stating USTP activities and "collective efforts within the Justice Department and with the wider bankruptcy community may result not only in an increase in referrals and prosecutions, but also in greater deterrence of bankruptcy crimes at the outset").

[3] See, e.g., https://www.justice.gov/usao-sdny/file/762811/download, https://www.justice.gov/usao-sdny/file/762821/download (sentencing Bernie Madoff to 150 years in prison and imposing a money judgment of $170 billion in connection with his Ponzi scheme, following appointment of a trustee to oversee liquidation of his corporation Bernard L. Madoff Investment Securities LLC pursuant to the Securities Investor Protection Act of 1970); https://www.justice.gov/archive/usao/nys/pressreleases/July09/dreiermarcsentencingpr.pdf (sentencing attorney Marc Dreier to 20 years in prison and ordering over $1 billion in restitution and forfeiture after he pleaded guilty to fraud related to his operation of a Ponzi scheme and following the bankruptcy of Dreier's firm, Dreier LLP).

[4] "Bankruptcy investigations. (a) Any judge, receiver, or trustee having reasonable grounds for believing that any violation under chapter 9 of this title or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans has been committed, or that an investigation should be had in connection therewith, shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed. Where one of such officers has made such report, the others need not do so.

(b) The United States attorney thereupon shall inquire into the facts and report thereon to the judge, and if it appears probable that any such offense has been committed, shall without delay, present the matter to the grand jury, unless upon inquiry and examination he decides that the ends of public justice do not require investigation or prosecution, in which case he shall report the facts to the Attorney General for his direction." 18 U.S.C. § 3057.

[5] https://www.justice.gov/ust/report-suspected-bankruptcy-fraud. The USTP — commonly referred to as the "watchdog" of the bankruptcy system — is a civil, litigating component of the U.S. Department of Justice, designed to protect "the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders—debtors, creditors, and the public." https://www.justice.gov/ust; see also 28 U.S.C. § 586. The USTP has a statutory duty to refer matters to the U.S. Attorney for prosecution, and has made over 2,000 such referrals annually since 2012. 28 U.S.C. § 586(a)(3)(F); see https://www.justice.gov/ust/bankruptcy-data-statistics/reports-studies (FY 2019 data not yet available).

[6] See In re Grand Jury Proceedings, G.S., F.S., 609 F.3d 909, 915 (8th Cir. 2010) (affirming that attorney

work product and communications related to pre-bankruptcy asset transfer transactions were discoverable under the crime-fraud exception).

[7] https://www.justice.gov/usao-mt/pr/former-ceo-vann-s-inc-sentenced-5-years-prison-0.

[8] https://www.justice.gov/usao-mn/pr/purechoice-founder-sentenced-22-years-prison-28-million-dollar-investment-fraud-scheme.

[9] E.g., https://www.justice.gov/usao-mdla/pr/former-chief-financial-officer-restaurant-chain-indicted-wire-fraud-embezzlement.

[10] https://www.justice.gov/usao-wdmi/pr/2018_0423_Vernier.

[11] The husband was charged with three additional crimes.

[12] https://www.justice.gov/usao-co/pr/stapleton-couple-sentenced-income-tax-evasion-and-bankruptcy-fraud.

[13] See, e.g., https://www.sec.gov/news/press-release/2012-2012-198htm (charging former bank executive and his son with insider trading when the son bought and sold shares of the bank's stock before and after information about the bank's asset sale became public); https://www.sec.gov/news/digest/1993/dig102893.pdf at 3–4 (referencing charges brought against the chairman of the board of J. Baker, Inc. for selling 200,000 shares of stock prior to disclosure that the company planned to close a significant number of its retail outlets).

[14] https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity.

[15] E.g., https://www.commoncause.org/press-release/doj-sec-ethics-complaints-filed-against-senators-burr-feinstein-loeffler-inhofe-for-possible-insider-trading-stock-act-violations/.

[16] https://www.sec.gov/rules/other/2020/34-88318.pdf.

[17] https://www.justice.gov/archive/atr/public/press_releases/1993/211588.htm (bringing Sherman Act and bankruptcy fraud charges against a Spanish company for conspiring to rig bids for an aircraft at a bankruptcy auction); see also United States v. Seminole Fertilizer Corp., No. 97-1507-CIV-T-17E, 1997 WL 692953, at *6 (M.D. Fla. Sept. 19, 1997) (final judgment on Sherman Act charges related to its alleged agreement with another company to provide bid support to enable the defendant to defeat a rival bid during a bankruptcy auction).

[18] 15 U.S.C. § 1.

[19] See 11 U.S.C. § 363(n) (permitting the avoidance of a sale "if the sale price was controlled by an agreement among potential bidders," along with the recovery of the difference in the value of the property and the price paid, along with costs, fees, and punitive damages); In re New York Trap Rock Corp., 160 B.R. 876, 881 (S.D.N.Y. 1993) ("§ 363(n) is in effect a supplementary antitrust law akin to § 1 of the Sherman Act (15 U.S.C. § 1) with its own separate jurisdictional groundwork and separate sanctions for violation)."), aff'd in part, vacated in part, 42 F.3d 747 (2d Cir. 1994).

[20] See In re International Nutronics, Inc., 28 F.3d 965 (9th Cir. 1994), cert denied, 513 U.S. 1016 (1994).

[21] While the commencement of a bankruptcy case imposes an "automatic stay" against most legal and administrative actions that could have been brought pre-bankruptcy against a debtor, the Bankruptcy Code expressly exempts from that automatic stay governmental criminal actions and claims. See 11 U.S.C. §§ 362(a), 362(b)(1).

[22] The nine subparts can constitute multiple counts, provided they are not based on the same set of facts. See, e.g., United States v. Roberts, 783 F.2d 767, 769 (9th Cir. 1985); United States v. Ambrosiani, 610 F.2d 65, 70 (1st Cir. 1979), cert. denied, 445 U.S. 930 (1980).

[23] "Concealment of assets; false oaths and claims; bribery. A person who—

(1) knowingly and fraudulently conceals from a custodian, trustee, marshal, or other officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor;

(2) knowingly and fraudulently makes a false oath or account in or in relation to any case under title 11;

(3) knowingly and fraudulently makes a false declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, in or in relation to any case under title 11;

(4) knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under title 11, in a personal capacity or as or through an agent, proxy, or attorney;

(5) knowingly and fraudulently receives any material amount of property from a debtor after the filing of a case under title 11, with intent to defeat the provisions of title 11;

(6) knowingly and fraudulently gives, offers, receives, or attempts to obtain any money or property, remuneration, compensation, reward, advantage, or promise thereof for acting or forbearing to act in any case under title 11;

(7) in a personal capacity or as an agent or officer of any person or corporation, in contemplation of a case under title 11 by or against the person or any other person or corporation, or with intent to defeat the provisions of title 11, knowingly and fraudulently transfers or conceals any of his property or the property of such other person or corporation;

(8) after the filing of a case under title 11 or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor; or

(9) after the filing of a case under title 11, knowingly and fraudulently withholds from a custodian, trustee, marshal, or other officer of the court or a United States Trustee entitled to its possession, any recorded information (including books, documents, records, and papers) relating to the property or financial affairs of a debtor,

shall be fined under this title, imprisoned not more than 5 years, or both."

[24] Acts prior to, but in contemplation of, a bankruptcy filing are sufficient to support a violation. United States v. Martin, 408 F.2d 949, 954 (7th Cir. 1969) (affirming convictions under prior version of Section 152 based on defendants' transfer of corporate assets prior to filing bankruptcy).

[25] The term "fraudulently" means that the act was done with the intent to deceive. United States v. Diorio, 451 F.2d 21, 23 (2d Cir. 1971), cert. denied, 405 U.S. 955 (1972).

[26] See also Stegeman v. United States, 425 F.2d 984, 986 (9th Cir. 1970) ("[Section 152] attempts to cover all the possible methods by which a bankrupt or any other person may attempt to defeat the Bankruptcy Act through an effort to keep assets from being equitably distributed among creditors.") (quoting 2 Collier on Bankruptcy 1151 (14th ed. 1968)).

[27] "Bankruptcy fraud. A person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so—

(1) files a petition under title 11, including a fraudulent involuntary petition under section 303 of such title;

(2) files a document in a proceeding under title 11; or

(3) makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under title 11, at any time before or after the filing of the petition, or in relation to a proceeding falsely asserted to be pending under such title,

shall be fined under this title, imprisoned not more than 5 years, or both." 18 U.S.C. § 157.

[28] See United States v. Milwitt, 475 F.3d 1150, 1155 (9th Cir. 2007) ("[T]he focus of § 157 is a fraudulent scheme outside the bankruptcy which uses the bankruptcy as a means of executing or concealing the artifice.").

[29] "(a) Offense.—A person described in subsection (b) who knowingly and fraudulently appropriates to the person's own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both.

(b) Person to Whom Section Applies.—

A person described in this subsection is one who has access to property or documents belonging to an estate by virtue of the person's participation in the administration of the estate as a trustee, custodian, marshal, attorney, or other officer of the court or as an agent, employee, or other person engaged by such an officer to perform a service with respect to the estate." 18 U.S.C. § 153 ("Embezzlement against estate").

"A person who, being a custodian, trustee, marshal, or other officer of the court—

(1) knowingly purchases, directly or indirectly, any property of the estate of which the person is such an officer in a case under title 11;

(2) knowingly refuses to permit a reasonable opportunity for the inspection by parties in interest of the documents and accounts relating to the affairs of estates in the person's charge by parties when directed by the court to do so; or

(3) knowingly refuses to permit a reasonable opportunity for the inspection by the United States Trustee of the documents and accounts relating to the affairs of an estate in the person's charge,

shall be fined under this title and shall forfeit the person's office, which shall thereupon become vacant." 18 U.S.C. § 154 ("Adverse interest and conduct of officers").

"Whoever, being a party in interest, whether as a debtor, creditor, receiver, trustee or representative of any of them, or attorney for any such party in interest, in any receivership or case under title 11 in any United States court or under its supervision, knowingly and fraudulently enters into any agreement, express or implied, with another such party in interest or attorney for another such party in interest, for the purpose of fixing the fees or other compensation to be paid to any party in interest or to any attorney for any party in interest for services rendered in connection therewith, from the assets of the estate, shall be fined under this title or imprisoned not more than one year, or both." 18 U.S.C. § 155 ("Fee agreements in cases under title 11 and receiverships").

"Offense.—If a bankruptcy case or related proceeding is dismissed because of a knowing attempt by a bankruptcy petition preparer in any manner to disregard the requirements of title 11, United States Code, or the Federal Rules of Bankruptcy Procedure, the bankruptcy petition preparer shall be fined under this title, imprisoned not more than 1 year, or both." 18 U.S.C. § 156(b) ("Knowing disregard of bankruptcy law or rule").

[30] "Destruction, alteration, or falsification of records in Federal investigations and bankruptcy. Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both." 18 U.S.C. § 1519.

[31] U.S.S.G. § 2B1.1(a)(2).

[32] U.S.S.G. § 2B1.1(b); see also United States v. Messner, 107 F.3d 1448, 1457 (10th Cir. 1997) (holding bankruptcy fraud constitutes a violation of judicial process warranting the imposition of a two-level sentence enhancement under Section 2F1.1. of the Sentencing Guidelines).

[33] U.S.S.G. § 2B1.1(b)(1); see also id. at Application Note 3 ("[L]oss is the greater of actual loss or intended loss."); https://www.ussc.gov/guidelines/2018-guidelines-manual/annotated-2018-chapter-5.

[34] 18 U.S.C. § 3663A(a)(1); see also U.S.S.G. § 5E1.1(a)(1). The amount of restitution will always, however, be limited to the victims' actual losses, not the intended losses relevant to sentencing. 18 U.S.C. §§ 3663A, 3664. A victim may receive more than its actual losses pursuant to a plea agreement. 18 U.S.C. § 3663(a)(3). A sentencing court is required to order full restitution "without consideration of the economic circumstances of the defendant." 18 U.S.C. § 3664(f)(1)(A).

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	
	:	Chapter 11
WAYPOINT LEASING HOLDINGS LTD., *et al.*,	:	Case No. 18-13648 (SMB)
	:	
Debtor	:	Jointly Administered
	:	
MACQUARIE ROTORCRAFT LEASING HOLDINGS LIMITED,	:	Adv. Proc. No. 19-01107 (SMB)
	:	
Plaintiff,	:	
	:	
- against -	:	
	:	
LCI HELICOPTERS (IRELAND) LIMITED,	:	
	:	
Defendant.	:	

MEMORANDUM DECISION GRANTING DEFENDANT'S MOTION TO DISMISS THE FIRST AMENDED ADVERSARY COMPLAINT WITH PREJUDICE

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STUART M. BERNSTEIN
United States Bankruptcy Judge

This dispute between two non-debtors arises from the section 363 sale of certain assets (the "WAC 9 Assets") owned by Waypoint Leasing Holdings Ltd. and its debtor affiliates (collectively, "Waypoint" or "Debtors") to non-party Lombard North Central plc ("Lombard"). The Plaintiff Macquarie Rotorcraft Leasing Holdings Limited ("Plaintiff" or "Macquarie") was the stalking horse bidder for substantially all of Waypoint's assets and ultimately, the disappointed bidder for the WAC 9 Assets. Macquarie now blames the loss of the sale and/or a $19.5 million break-up fee and an expense reimbursement capped at $3 million on the Defendant LCI Helicopters (Ireland) Limited ("Defendant" or "LCI").

Macquarie commenced this adversary proceeding seeking damages against LCI in its capacity as assignee of the Debtors and in its own right. (*See First Amended Adversary Complaint*, dated May 14, 2019 ("*AC*") (ECF Doc. # 7).[1] LCI moved to dismiss the *AC* with prejudice. While Macquarie has opposed LCI's motion, it has not

[1] "ECF" refers to the docket in this adversary proceeding. "ECF Main" refers to the docket in Waypoint's chapter 11 cases.

addressed the request for dismissal with prejudice or asked for leave to replead any dismissed claims. Furthermore, the *AC* represents Macquarie's second attempt to plead viable claims.[2] Accordingly, the *AC* is dismissed with prejudice for the reasons that follow.

BACKGROUND[3]

A. The Waypoint Bankruptcy and Sale Process

At all relevant times, Waypoint was engaged in the business of owning and leasing helicopters. The Debtors filed their chapter 11 petitions on November 25, 2018. (¶ 10.) Prior to the bankruptcy filing, the Debtors engaged in an out-of-court marketing process to sell substantially all of their assets.[4] (¶ 11.) LCI was involved in the early stages of the marketing process and signed a non-disclosure agreement ("NDA") on August 29, 2018 which enabled LCI to acquire confidential information from Waypoint relevant to the proposed sale. (¶¶ 11, 12.)[5]

The NDA imposed two limitations on LCI that figure into this dispute. The first limited LCI's use of the confidential information "solely for the purpose of evaluating and participating in discussions with the Company . . . ." (¶ 12; NDA § 2.) The second

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2 Macquarie filed the *AC* in response to LCI's motion to dismiss the original complaint.

3 The Background discussion is derived from the *AC* and the documents attached to and/or relied on in the *AC*. The notation "(¶ ___)" refers to the paragraphs in the *AC*.

4 The Debtors owned groups of assets segregated into "silos" called Waypoint Asset Cos., or "WACs." Each WAC had its own lenders whose claims were secured by the assets of that WAC. The WACs were differentiated by number, and the assets (or equity) involved in the sale included WACs 1, 2, 3, 5, 6, 8, 9 and 12. (*See Bidding Procedures* p. 3 (defined in the succeeding text).) This matter concerns only WAC 9.

5 A copy of the NDA is annexed to the *AC* as Exhibit A.

precluded contact with certain designated persons, including any "creditor . . . or other commercial counterparty of the Company or any subsidiary of the Company regarding the Company or its business [or] assets." (¶ 25; NDA § 4.) The NDA carved out contact and communications that "may occur in the ordinary course of [LCI's] business" on matters unrelated to LCI's possible transaction with Waypoint, (NDA § 4), and provided that nothing in the NDA "impair[ed]" LCI's "ability to conduct . . . business with any third parties in the ordinary course" so long as LCI did not "disclose or refer to" its potential transaction with Waypoint or confidential information obtained pursuant to the NDA. (NDA § 2(a).)

On December 7, 2018, Macquarie entered into a Stock and Asset Purchase Agreement ("Macquarie APA") with the Debtors to buy substantially all of Waypoint's assets, including the WAC 9 Assets, for $650 million. (¶ 15; ECF Main Doc. # 64, Ex. C).) Three days later, the Debtors filed their motion to establish bidding procedures and approve the sale. (*Motion of Debtors for Entry of Orders Approving: (I) (A) Bidding Procedures, (B) Bid Protections, (C) Form and Manner of Notice of Auction, Sale Transaction, and Sale Hearing, and (D) Procedures for the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (II) (A) Sale of Substantially all of the Debtors' Assets Free and Clear of Liens, Claims, Encumbrances, and Other Interests, (B) Assumption and Assignment of Certain Executory Contracts and Unexpired Leases, and (C) Related Relief*, dated Dec. 10, 2018 ("*Bidding Procedures Motion*") (ECF Main Doc. # 64); ¶ 16.) The *Bidding Procedures Motion* elicited objections from the Debtors' secured creditors, including Lombard, the creditor secured by a lien on the WAC 9 Assets. After further negotiations among the parties, the

Court entered the *Order Approving (A) Bidding Procedures, (B) Bid Protections, (C) Form and Manner of Notice of Cure Costs, Auction, Sale Transaction, and Sale Hearing, and (D) Date for Auction, if Necessary, and Sale Hearing*, dated Dec. 21, 2018 ("*Bidding Procedures Order*"). (ECF Main Doc. # 159; *see* ¶ 17.)

The bidding procedures attached as Exhibit 1 to the *Bidding Procedures Order* (the "*Bidding Procedures*") set up a process for third-party bidding and credit bidding. Because third parties and/or the secured parties could bid on a WAC-by-WAC basis, Macquarie had to allocate its $650 million bid among the eight WACs. (*See Bidding Procedures* p. 2.) After the deadline for third-party bids, the secured parties could credit bid in one of two prescribed forms. Macquarie was entitled to a breakup fee in the sum of $19.5 million plus an expense reimbursement of up to $3 million under the Macquarie APA, unless, *inter alia*, a transaction was effected through a credit bid. (*Bidding Procedures Order* ¶¶ 8, 10.) In addition, if Lombard made a credit bid for the WAC 9 Assets in the full amount of its claim, Macquarie could not submit a matching bid. (*Id.* ¶ 4.)

The *Bidding Procedures* also modified the "no contact" provisions in the NDAs that the secured creditors and prospective bidders, including Lombard and LCI, had signed. The secured parties could engage in discussions and negotiations with an entity to manage the assets upon the consummation of a successful credit bid ("Alternative Asset Manager") and were released from any restriction on "engaging in discussions or negotiations" under their agreements with the Debtors, retroactive to December 12, 2018, "*provided*, that the Debtors, WAC Lenders, WAC Facility Agent, and Credit Bidco shall, prior to any disclosure to any such Alternative Asset Manager of any confidential

information, agree (with each such party acting reasonably and in good faith) on the scope of information to be provided to such Alternative Asset Managers (taking into account commercial sensitivities and antitrust and other applicable law)." (*Bidding Procedures* p. 5.)

B. The Auction and Sale Hearing

No third party submitted a bid, leaving only Macquarie and the secured lenders as potential purchasers. Lombard submitted a credit bid for the WAC 9 Assets in the amount of 100% of its claim. (¶ 23.) The gravamen of the Plaintiff's claims is that Lombard entered into a secret deal with LCI in violation of the NDA and the *Bidding Procedures* to sell it the WAC 9 Assets following the consummation of the credit bid. (¶ 20.) In Macquarie's view, Lombard's bid was actually a joint, collusive bid by Lombard and LCI that deprived the Debtors of the opportunity to get a higher and better bid, prevented Macquarie from acquiring the WAC 9 Assets and deprived it of its break-up fee and expense reimbursement. (¶ 38.)

Evidence submitted by Lombard in support of the approval of its credit bid provided some evidentiary support for Macquarie's position. In response to Macquarie's limited objection, Lombard filed the affidavit of Ms. Jacqueline McDermott on February 11, 2019. It disclosed that Lombard was "discussing with its servicer a subsequent transaction pursuant to which the [WAC 9 Assets] would be recapitalized and sold to the servicer." (¶ 28.)

At the hearing the next day, Macquarie's counsel framed the issue succinctly: "what they're seeking to do is eliminate the breakup fee." (Transcript of Feb. 12, 2019

Hr'g ("Tr."), at 166:16-17 (ECF Main Doc. # 537) (cited in ¶¶ 29-31).) He did not object to the receipt of Ms. McDermott's affidavit as her direct testimony, (Tr. 163:14-22), and then subjected her to a vigorous cross-examination regarding Lombard's negotiations with servicers to sell the WAC 9 Assets following the consummation of the credit bid. She testified that from the beginning of Lombard's negotiations with Macquarie as the Debtors' proposed stalking horse bidder, Lombard made it clear that if Macquarie wanted to acquire the WAC 9 Assets, "they needed to pay par plus accrued interest." (Tr. 186:14-20.) Lombard was a lender, not a helicopter leasing company, (Tr. 194:24-195:5), and intended to sell the WAC 9 Assets at some point in the future. (Tr. 189:2-11; 194:3-5.) Lombard had some preliminary discussions with potential servicers, but the servicers did not have necessary information about the aircraft or the leases, Lombard did not disclose any confidential information about the aircraft or the leases, it had no agreement to sell the assets, and any sale discussions were premature. (Tr. 187:4-23; 188:22-189:1; 189:12-23; 192:20-194:23.)

Mr. Matthew Neimann of Houlihan Lokey, the Debtor's financial advisor, also took the stand and was cross-examined by Macquarie's counsel. He testified that Houlihan Lokey never consented to Lombard sharing information regarding anything other than servicing. (Tr. 225:15-23; *see* ¶ 30.)

After all parties rested, (Tr. 226:8-16), the Court heard closing arguments. Macquarie's counsel maintained that Lombard had violated the confidentiality and "no contact" provisions of its own non-disclosure agreement ("Lombard NDA") and had

entered into a collusive bidding agreement with LCI.[6] These actions deprived Macquarie of its break-up fee and precluded a finding that Lombard had acted in good faith under 11 U.S.C. § 363(m). When the Court questioned the sufficiency of the evidence of Lombard's breach of the confidentiality provisions of the Lombard NDA, (Tr. 243:19-244:6), Macquarie's counsel suggested that the Court should allow it a brief period of discovery. (Tr. 245:3-4.) When the attention turned to the "no contact" provision and the hypothesis that Lombard would not have bid but for the agreement to resell the WAC 9 Assets to LCI, Macquarie's counsel again suggested that more discovery might be in order. (Tr. 248:16-21.)

The Court rejected Macquarie's belated request for discovery. The possible violation of the NDA and collusive bidding had been raised by Macquarie in its objection to the sale of the WAC 9 Assets to Lombard. (*See Limited Objection of Macquarie Rotorcraft Leasing Holdings Limited Relating to WAC 9 Credit Bid Transactions and Related Form of Purchase Agreement and Sale Order*, dated Feb. 5, 2019 ("*Macquarie WAC 9 Sale Objection*") (ECF Main Doc. # 339).) In addition, the sale hearing was an evidentiary hearing under the Court's Local Bankruptcy Rule 9014-2(c), and the process was expedited by its very nature. (Tr. 248:22-249:3.) Macquarie never sought expedited discovery.

The Court ruled from the bench at the conclusion of the hearing. (Tr. 250:8-253:3.) It first ruled that Lombard, not Lombard and/or LCI, was the credit bidder for the WAC 9 Assets and Macquarie was not entitled to a break-up fee based on Lombard's

[6] Although potential third-party bidders like LCI and secured creditors like Lombard signed slightly different NDAs, (Tr. 214:20-23), the material terms were substantially the same.

successful credit bid. (Tr. 250:8-16.) The Court also concluded that there was no evidence that Lombard had shared any confidential information with any servicers, including LCI. (Tr. 250:24-251:9.)

The "no-contact" provision of the Lombard NDA was a different story. The evidence showed that Lombard had discussed the possibility of a future sale of the WAC 9 Assets with LCI. However, the Court discounted this possible "technical violation" of the Lombard NDA because it did not affect the bidding process. (Tr. 251:9-12.) Furthermore, Lombard did not act in bad faith when it started to look around for a subsequent purchaser. Lombard was a lender that intended to liquidate its collateral and get paid back. It did not want to incur the costs of insuring the aircraft and paying a servicer. (Tr. 251:12-21.)

The final ruling concerned Macquarie's objection to the scope of the release that the Debtors were giving to Lombard because Macquarie would be acquiring certain of the Debtors' claims under the Macquarie APA. The Court observed that the release was consistent with the *Bidding Procedures Order* except that it now was more limited because it excepted claims based on willful misconduct and gross negligence. (Tr. 251:21-252:1.) If Macquarie wanted to sue Lombard as the Debtors' successor arguing that Lombard had engaged in the type of conduct carved out of the release, it was free to do so:

> And you can make the argument, Mr. Edelman [Macquarie's counsel], that if you've gotten that claim and somebody knowing violated, I guess, a provision restricting the use of confidential information, they engaged in willful misconduct but that's for another day.

(Tr. 252:2-6.)

The Court signed the order approving the sale of the WAC 9 Assets to Lombard pursuant to their credit bid the next day. (*Order (I) (A) Approving Purchase Agreement Among Debtors and Successful Credit Bidder, (B) Authorizing Sale of Certain of Debtors' Assets Free and Clear of Liens, Claims, Encumbrances, and Other Interests, and (C) Granting Related Relief, and (II) Authorizing Debtors to Take Certain Actions With Respect to Related Intercompany Claims in Connection Therewith*, dated Feb. 13, 2019 ("*Lombard Sale Order*") (ECF Main Doc. # 441).) The *Lombard Sale Order* included findings that Lombard's credit bid complied with the *Bidding Procedures Order* and it was the successful bidder for the WAC 9 Assets (*Lombard Sale Order* ¶ G), that Lombard was a good faith purchaser under section 363(m) and had "complied with the provisions of the Bidding Procedures Order, including compliance in all material respects with confidentiality obligations and restrictions under . . . any applicable . . . non-disclosure agreement," and neither the Debtors nor Lombard had "engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under section 363(n) of the Bankruptcy Code." (*Id.* ¶ J.) The Court also found that the sale process resulted in the "highest and best value" for the WAC 9 Assets, (*id.* ¶ H), and was binding on, among others, the Debtors, Lombard and "any affected third parties." (*Id.* ¶ 35.)

Macquarie asserts, upon information and belief, that LCI subsequently purchased the equity of the WAC 9 Assets from Lombard on March 7, 2019. (¶¶ 35-36.) According to section 3.01 of the Amended and Restated Equity and PPN Purchase Agreement attached to and approved by the *Lombard Sale Order*, the purchase price for the WAC 9 Assets as of the expected closing date of February 15, 2019, was $60,464,373.77 plus

€33,588,431.00, corresponding to the amounts owed by the Debtors to Lombard on the U.S. Dollar tranche and Euro tranche, respectively, under the parties' credit agreement. (*Lombard Sale Order*, Ex. A, § 3.01.) The Court takes judicial notice that as of the close on February 15, 2019, the Euro was equal to $1.1292. Accordingly, the amount of Lombard's credit bid and the purchase price for the WAC 9 Assets was $98,392,430.06, rounded up to $98.4 million.

The Court signed the order approving the sale of certain other assets to Macquarie on February 14, 2019. (*Order (I) Approving Purchase Agreement Among Debtors and Macquarie, (II) Authorizing Sale of Certain of Debtors' Assets Free and Clear of Liens, Claims, Encumbrances, and Other Interests, (III) Authorizing Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection Therewith, and (IV) Granting Related Relief*, dated Feb. 14, 2019 ("*Macquarie Sale Order*") (ECF Main Doc. # 444).) The *Macquarie Sale Order* provides, among other things, that any damages flowing from violations of the *Bidding Procedures* or *Bidding Procedures Order* "arising from intentional misconduct" are preserved, and upon the closing, were assigned to Macquarie pursuant to the terms of the Macquarie APA. (*Macquarie Sale Order* ¶ 42.)

B. This Adversary Proceeding

Macquarie's *AC* asserts three claims. Count I, asserted in its capacity as assignee of the Debtors, alleges that LCI breached the confidentiality and "no contact" provisions in its NDA with the Debtors through its improper contact with Lombard regarding the sale of the WAC 9 Assets and injured the Debtors "by depriving the Debtors of obtaining potential competing cash bids for the WAC 9 assets and the additional value that such

bids may have realized." (¶ 43.) Count II, asserted in Macquarie's own right, contends that LCI tortiously interfered with its business relationship with the Debtors under the *Macquarie APA*, and but for LCI's interference, Macquarie would have purchased the WAC 9 Assets or earned a break-up fee. (¶¶ 46, 49, 51.) Count III, asserted both in Macquarie's own right and in its capacity as assignee of the Debtors, alleges that LCI colluded with Lombard to control the sale price of the WAC 9 Assets in violation of 11 U.S.C. § 363(n).[7] (¶¶ 55, 57, 58.)

LCI's *Memorandum of Law in Support of LCI Helicopters (Ireland) Limited's Motion to Dismiss*, dated May 3, 2019 ("*Motion to Dismiss*") (ECF Doc. # 6) and *Reply Memorandum of Law in Further Support of LCI Helicopters (Ireland) Limited's Motion to Dismiss*, dated May 17, 2019 ("*Suppl. Motion to Dismiss*") (ECF Doc. # 9), assert that all of Macquarie's claims should be dismissed with prejudice for failure to state a claim. In the main, LCI contends that Count I for breach of the NDA fails to allege damages. (*Motion to Dismiss* p. 20.) Count II fails to plead the necessary elements of a claim for tortious interference with business relations, namely, the existence of a business relationship that LCI intentionally interfered with, malice or improper means of interference, and damages. (*Id.* pp. 23-25.) Finally, Macquarie lacks standing to assert a claim for violation of 11 U.S.C. § 363(n). (*Suppl. Motion to Dismiss* pp. 9-10.) The limited exception that allows unsuccessful bidders to challenge the "intrinsic fairness" of a transaction does not apply here, where Macquarie agreed to the

[7] Macquarie may have abandoned Counts I and III at oral argument. At the hearing, counsel for Macquarie stated: "[I]f in fact the record demonstrates that Macquarie's allocation was substantially less than the credit bid, we would focus the Court on the tortious interference claim." (Audio Recording of June 20, 2019 Hr'g, at 10:47:25 a.m.) As discussed in the succeeding text, Macquarie's bid for the WAC 9 Assets was substantially less than Lombard's credit bid.

condition in the *Bidding Procedures Order* that it could not match a 100% credit bid made by Lombard. (*Id.* p. 10.) Even if Macquarie had standing to bring it, the claim is not supported by any facts. (*Id.* p. 11.) Finally, Macquarie is raising the same allegations that the Court heard and rejected when it approved the sale of the WAC 9 Assets to Lombard and Count III is, therefore, barred by collateral estoppel. (*Motion to Dismiss*, pp. 25-29; *Suppl. Motion to Dismiss*, pp. 10-11.)

Macquarie asserts in opposition that the claims in the *AC* were not actually decided at the February 12 hearing, but rather, were expressly preserved by the Court. (*Macquarie Rotorcraft Leasing Holdings Limited's Objection to LCI Helicopters (Ireland) Limited's Motion to Dismiss*, dated June 7, 2019 ("*Objection*"), pp. 17-18 (ECF Doc. # 10).) Moreover, collateral estoppel should not apply because Macquarie did not have a "full and fair opportunity to litigate" in that proceeding. (*Id.* pp. 19-20.) Macquarie asserts that the Court should not consider the numerous facts outside the *AC* raised by LCI in its *Motion to Dismiss* and *Suppl. Motion to Dismiss*. (*Id.* pp. 11-13.) Macquarie also argues that its claims are adequately pleaded in the *AC* and are not subject to a heightened pleading standard, that it has both direct and derivative standing under the *Macquarie Sale Order* to assert a claim under section 363(n), and that it should be entitled to proceed to discovery. (*Id.* pp. 2-3, 14-17, 35-36.)

DISCUSSION

A. Jurisdiction

The claims asserted by Macquarie, though based in part on the pre-petition NDA, arise out of the sale of the WAC 9 Assets in this Court pursuant to the *Bidding Procedures Order* and the *Macquarie Sale Order*. Accordingly, Macquarie's claims

arise in Waypoint's chapter 11 cases or, in the case of Count III, under the Bankruptcy Code, and this Court has subject matter jurisdiction under 28 U.S.C. §§ 157(a) and 1334(b) and the *Amended Standing Order of Reference,* No. M 10-468, 12 Misc. 00032 (S.D.N.Y. Jan. 31, 2012). Macquarie has consented to the entry of final orders and judgments by this Court, (¶ 5), and contends that "LCI irrevocably and unconditionally consented to submit to the exclusive jurisdiction of this Court for any lawsuits, actions, or other proceedings arising out of or relating to the NDA." (¶ 7 (citing NDA § 10).)

B. Standards Governing the Motion

In order to 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.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). While the Court must accept all well-pleaded factual allegations as true, conclusory statements do not suffice. *Id.* "Determining whether a complaint states a plausible claim for relief will . . . be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Id.* at 679. "[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct," it fails to show that the pleader is entitled to relief. *Id.* (citing Fed. R. Civ. P. 8(a)(2)).

In ruling on a motion to dismiss under Rule 12(b)(6), the Court may also consider "documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint." *DiFolco v. MSNBC Cable L.L.C.*, 622 F.3d 104, 111 (2d Cir. 2010). If a document is not incorporated into a complaint by reference, "the court may nevertheless consider it where the complaint 'relies heavily upon its terms and effect,'

thereby rendering the document 'integral' to the complaint." *Id.* (quoting *Mangiafico v. Blumenthal*, 471 F.3d 391, 398 (2d Cir. 2006) (quoting *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152-53 (2d Cir. 2002))).

To consider such an integral document, there must be no dispute about "the authenticity or accuracy of the document" or "the relevance of the document." *DiFolco v. MSNBC Cable L.L.C.*, 622 F.3d at 111 (quoting *Faulkner v. Beer*, 463 F.3d 130, 134 (2d Cir. 2006)). The *AC* attaches the NDA and incorporates by reference and/or relies upon numerous pleadings and orders from the Waypoint bankruptcy cases, including the *Bidding Procedures Motion*, the *Bidding Procedures Order*, the *Bidding Procedures,* the testimony at the February 12, 2019 hearing memorialized in the transcript, and the *Macquarie Sale Order*. The Court may consider these documents in connection with the *Motion*. In addition, the *AC* discusses at length Lombard's acquisition of the WAC 9 Assets but ignores the *Lombard Sale Order*. The authenticity and relevance of the *Lombard Sale Order* is not open to question. It was executed by the Court, filed on the docket and memorializes the Court's findings that form the basis of LCI's collateral estoppel defense. Accordingly, I will also consider the *Lombard Sale Order*.

C. Count I: Breach of the NDA

Macquarie brings Count I as assignee of the Debtors alleging a breach of the NDA and stands in the Debtors' shoes. The NDA is governed by New York law, (NDA § 10), and under New York law, a claim for breach of contract must allege "(1) the existence of an agreement, (2) adequate performance of the contract by the plaintiff, (3) breach of contract by the defendant, and (4) damages." *Eternity Glob. Master Fund Ltd. v.*

Morgan Guar. Tr. Co. of N.Y., 375 F.3d 168, 177 (2d Cir. 2004) (quoting *Harsco Corp. v. Segui*, 91 F.3d 337, 348 (2d Cir. 1996)). "Without a clear demonstration of damages, there can be no claim for breach of contract." *Milan Music, Inc. v. Emmel Commc'ns Booking, Inc.*, 829 N.Y.S.2d 485, 486 (N.Y. App. Div. 2007). A complaint that fails to demonstrate how an alleged breach caused damage to the plaintiff is "fatally deficient." *Gordon v. Dino De Laurentiis Corp.*, 529 N.Y.S.2d 777, 779 (N.Y. App. Div. 1988); *see also Int'l Bus. Machines Corp. v. Dale*, No. 7:11-CV-951 (VB), 2011 WL 4012399, at *4 (S.D.N.Y. Sept. 9, 2011) ("The fatal aspect of defendant's counterclaim is her inability to show damages."). Allegations of damages must consist of more than "boilerplate," and "the pleadings must set forth facts showing the damage upon which the action is based." *Gordon v. Dino De Laurentiis Corp.*, 529 N.Y.S.2d at 779.

Macquarie asserts that LCI breached the NDA by contacting Lombard about the purchase of the WAC 9 Assets following the consummation of Lombard's successful credit bid. (¶¶ 27-29.) Assuming this to be true, Macquarie has failed to allege how those contacts damaged the Debtors. The *AC* speculates that the collusive bidding arrangement between Lombard and LCI induced Lombard to make a credit bid it would not have otherwise made and thus deprived "the Debtors of obtaining potential competing cash bids for the WAC 9 assets and the additional value that such bids may have realized." (¶ 43.)

Assuming that LCI breached the NDA, the suggestion that the Debtors were damaged defies common sense. The WAC 9 Debtors owed Lombard approximately $98.4 million secured by the WAC 9 Assets. Secured creditors typically make credit bids to protect their collateral from a sale at a depressed price. *RadLAX Gateway Hotel, LLC*

v. Amalgamated Bank, 566 U.S. 639, 644 n.2 (2012). In this case, Lombard credit bid the full amount of the debt. To suggest that it would not have made a credit bid but for LCI's prompting to prevent a sale at a depressed price belies the Supreme Court's observation in *RadLAX* and ignores the entire purpose of the right to credit bid codified in 11 U.S.C. § 363(k).

The *AC* does not allege that Macquarie's cash bid for the WAC 9 Assets was higher, a critical piece of information in determining if the Debtor was damaged, or that Macquarie intended to pay anything more which, in any event, seemed unlikely. Ms. McDermott testified that Macquarie could have purchased Lombard's claim for par plus interest, *i.e.*, the amount of Lombard's credit bid. Had it done so, it could have made its own credit bid. Curious about Macquarie's bid, the Court asked Macquarie's counsel at oral argument what portion of its $650 million bid it had allocated to the purchase of the WAC 9 Assets. Counsel did not know but eventually informed me that Macquarie had allocated 13.2%, or $85.8 million. (ECF Doc. # 13.) In other words, Lombard outbid Macquarie by roughly $13 million to prevent a sale to Macquarie at a depressed price, precisely what Bankruptcy Code § 363(k) is designed to do.

It is equally implausible that a third party would have stepped in and made an offer higher and *better* than Lombard's credit bid. First, the deadline for third-party bids had expired before Lombard made its credit bid and the Debtors had not received any third-party bids. Second, even if a third party could still bid, its bid would have had to exceed Lombard's credit bid by at least $22.5 million. A third party purchase of the WAC 9 Assets would have triggered the *Debtors'* obligation to pay Macquarie a $19.5 million break-up fee plus as much as $3 million as an expense reimbursement. Thus, a

third party would have had to bid at least $121 million for the WAC 9 Assets in order for its bid to be higher *and better* than Lombard's credit bid. The suggestion that there were "potential competing cash bids for the WAC 9 assets" in an amount necessary to benefit the Debtors' estates, especially when a third party could have presumably purchased Lombard's secured claim for $98.4 million, exceeds the bounds of wishful thinking.

Accordingly, Count I is dismissed with prejudice.

D. Count II: Tortious Interference with Business Relations

Macquarie, suing in its own right, alleges in Count II that LCI tortiously interfered with its business relations with the Debtors under the Macquarie APA and the various documents governing the bidding. In essence, the collusion between Lombard and LCI prevented Macquarie from acquiring the WAC 9 Assets or, in the event of a successful third-party bid, the $19.5 million break-fee plus the expense reimbursement that the Debtors would have owed.

To state a claim for tortious interference with business relations under New York law,[8] "four conditions must be met: (1) the plaintiff had business relations with a third party; (2) the defendant interfered with those business relations; (3) the defendant acted for a wrongful purpose or used dishonest, unfair, or improper means; and (4) the defendant's acts injured the relationship." *Catskill Dev., L.L.C. v. Park Place Entm't*

[8] Both parties cite to New York law on the claim alleging tortious interference with business relations. (*Objection* pp. 28-34; *Motion to Dismiss* pp. 22-25.) Therefore, the Court "is not required to conduct a choice of law analysis *sua sponte*, and instead may apply the state law assumed by the parties in their papers." *Henneberry v. Sumitomo Corp. of Am.*, 415 F. Supp. 2d 423, 440, n.7 (S.D.N.Y. 2006) (citing *Lehman v. Dow Jones & Co.*, 783 F.2d 285, 294 (2d Cir. 1986) (Friendly, J.)).

Corp., 547 F.3d 115, 132 (2d Cir. 2008). Where the plaintiff and defendant are competitors, the plaintiff faces a high bar. "The existence of competition may often be relevant, since it provides an obvious motive for defendant's interference other than a desire to injure the plaintiff; competition, by definition, interferes with someone else's economic relations." *Carvel Corp. v. Noonan*, 818 N.E.2d 1100, 1104 (N.Y. 2004). If the defendant is a competitor, but "there has been no breach of an existing contract, but only interference with prospective contract rights," the plaintiff must show that the defendant's conduct was not "lawful," in other words, that it amounted to "a crime or an independent tort." *Id.* at 1103. Such "'[w]rongful means' include physical violence, fraud or misrepresentation, civil suits and criminal prosecutions, and some degrees of economic pressure; they do not, however, include persuasion alone although it is knowingly directed at interference with the contract." *Id.* at 1104 (citation omitted). "When a defendant has acted with a permissible purpose, such as 'normal economic self-interest,' wrongful means have not been shown, even if the defendant was 'indifferent to the [plaintiff's] fate.'" *16 Casa Duse, LLC. v. Merkin*, 791 F.3d 247, 262 (2d Cir. 2015) (quoting *Carvel*, 818 N.E.2d at 1103). Thus, a competitor that interferes with the plaintiff's prospective business relations through persuasion to advance its own economic interests does not use the wrongful means necessary to sustain the claim. *NBT Bancorp Inc. v. Fleet/Norstar Fin. Grp., Inc.*, 664 N.E.2d 492, 497 (N.Y. 1996); *Guard-Life Corp. v. S. Parker Hardware Mfg. Corp.*, 406 N.E.2d 445, 449 (N.Y. 1980); *Krinos Foods, Inc. v. Vintage Food Corp.*, 818 N.Y.S.2d 67, 68 (N.Y. App. Div. 2006).

Macquarie expected to earn a break-up fee and an expense reimbursement if a third party outbid it. It contends that the collusive bidding arrangement did just that.

According to the *AC*, LCI "acted with malice by dishonestly, unfairly, and improperly breaching its obligations under the NDA" and "by dishonestly, unfairly, and improperly circumventing the Court-ordered bidding procedures," (¶ 48), and that "LCI's conduct targeted Macquarie, its relationship with Debtor, and its anticipated purchase of the WAC9 assets." (¶ 49.) These alleged breaches prevented Macquarie from "fully and fairly participating in the WAC9 asset sale process, deprived Plaintiff of the benefit of completing the acquisition of said assets under the Macquarie APA, and prevented Plaintiff from receiving the court-ordered breakup fee to which it otherwise was entitled." (¶ 51.) Macquarie further asserts that LCI's conduct was "fraudulent, wanton, malicious, or willful in complete disregard of Plaintiff's rights." (¶ 53.)

When the *AC* is stripped of its conclusory allegations, the insufficiency of Count II is laid bare. Macquarie acknowledges that LCI is engaged in the business of leasing aircraft, (¶ 9), and hence, was Macquarie's competitor. If LCI induced Lombard to sell it the WAC 9 Assets for its own economic benefit it did not use wrongful means. Macquarie does not allege that LCI engaged in "physical violence, fraud or misrepresentation, civil suits [or] criminal prosecutions." *Carvel Corp. v. Noonan*, 818 N.E.2d at 1104. Accordingly, Count II is legally insufficient and is dismissed with prejudice.

E. Count III: Violation of Bankruptcy Code § 363(n)

Section 363(n) grants a trustee or debtor in possession the power, *inter alia*, to recover the difference between the sale price and the market value where "the sale price

was controlled by an agreement among potential bidders." 11 U.S.C. § 363(n).[9] The term "control" means more than causing "an incidental or unintended impact on the price; it implies an intention or objective to influence the price." *Lone Star Indus., Inc. v. Compania Naviera Perez Companc, S.A.C.F.I.M.F.A. (In re New York Trap Rock Corp.)*, 42 F.3d 747, 752 (2d Cir. 1994). In other words, "[t]he influence on the sale price must be an intended objective of the agreement, and not merely an unintended consequence, for the agreement among potential bidders to come within the prohibition of § 363(n)." *Id.* Generally, such prohibited collusive agreements are secret agreements that have not been disclosed to the court. *Kabro Assoc. of West Islip, LLP v. Colony Hill Assoc. (In re Colony Hill Assocs.)*, 111 F.3d 269, 277 (2d Cir. 1997) (citing *In re Sasson Jeans, Inc.*, 90 B.R. 608, 610 (S.D.N.Y. 1988) (court was "hard pressed" to find bad faith when challenged relationship between bidder and debtor "was fully disclosed to the Bankruptcy Court")).

While section 363(n) only grants the right to bring a claim to a trustee or debtor in possession, an unsuccessful bidder may have standing to challenge the actions of a successful bidder that "destroyed the 'intrinsic fairness' of the sale transaction so that it was not a good faith purchaser." *Id.* at 274. To challenge the intrinsic fairness of a sale, the disappointed bidder must allege "that the sale was tainted by fraud, bad faith,

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9 The complete text of 11 U.S.C. § 363(n) is as follows:

> The trustee may avoid a sale under this section if the sale price was controlled by an agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

collusion, deceit, mistake or unfairness." *Wallach v. Kirschenbaum*, No. 11 CV 0795 (SJF), 2011 WL 2470609, at *4 (E.D.N.Y. June 16, 2011) (citing *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 388 (2d Cir. 1997) and *In re Colony Hill Assocs.*, 111 F.3d at 274).

Macquarie lacks standing to assert a claim under section 363(n) as assignee of the Debtors. The *Macquarie Sale Order*, on which Macquarie relies, assigns the Debtors' rights to damages flowing from "violations of the Bidding Procedures and/or the Bidding Procedures Order arising from intentional misconduct" to Macquarie pursuant to the terms of the Macquarie APA. (*Macquarie Sale Order* ¶ 42.) The Debtors did not assign any rights granted under the Bankruptcy Code, specifically, rights under section 363(n). Even if Macquarie had standing, it has not alleged that the Debtors were damaged by the alleged collusion for the reasons already stated. Put simply, Lombard outbid Macquarie, the only other bidder.

Nor can Macquarie challenge the "intrinsic fairness" of the Lombard sale in its own right based on the same allegations of collusion between LCI and Lombard. In objecting to the proposed sale to Lombard, Macquarie argued that Lombard and LCI had colluded. As a result, Lombard was not entitled to a finding that it acted in good faith and Macquarie was entitled to a break-up fee and expense reimbursement. Following an evidentiary hearing at which Macquarie availed itself of the opportunity to cross-examine Ms. McDermott and Mr. Neimann, the Court found that "[a] fair and reasonable opportunity to object to, and be heard with respect to, the Sale Motion and the Sale Transaction has been given to all Persons entitled to notice pursuant to the Bidding Procedures Order," (*Lombard Sale Order* ¶ D), "the Debtors conducted a fair

and open sale process[,] the sale process and the Bidding Procedures were non-collusive, duly noticed, and provided a full, fair, and reasonable opportunity for any entity to make an offer to purchase the [WAC 9 Assets]," (*id.* ¶ H), the agreements governing the sale "were negotiated, proposed, and entered into by the Debtors and [Lombard] in good faith, without collusion, and from arms'-length bargaining positions," Lombard "is a 'good faith purchaser' within the meaning of section 363(m) of the Bankruptcy Code" and "complied with the provisions of the Bidding Procedures Order, including compliance in all material respects with confidentiality agreements," the purchase price "was not controlled by any agreement among potential bidders," and "[n]either the Debtors nor [Lombard] have engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under section 363(n) of the Bankruptcy Code." (*Id.* ¶ J.) All affected third parties, including Macquarie, were bound. (*Id.* ¶ 35.) Macquarie did not appeal from the *Lombard Sale Order* which is final.

Macquarie's challenge to the "intrinsic fairness" of the sale is based on the same allegations it pressed at the Lombard sale hearing, constitutes an impermissible collateral attack on the *Lombard Sale Order* and is barred by the doctrine of collateral estoppel.[10] Federal principles of collateral estoppel, which are applied "to establish the

[10] Macquarie argues that collateral estoppel is inapplicable because the Court left for another day any claims based on intentional or willful misconduct. (*Objection* p. 17.) Macquarie mischaracterizes the Court's ruling which related to the release that the Debtors were proposing to give Lombard. Because Macquarie was to receive an assignment of certain rights from the Debtors upon the consummation of its own purchase, it was concerned about a potential release of those rights. The Debtors' release of Lombard excepted claims based on willful misconduct or intentional fraud. (*See Lombard Sale Order* ¶ 28.) The claims left for another day referred to claims by Macquarie, as the Debtors' assignee, against Lombard based on intentional wrongdoing. As far as the Court is aware, Macquarie has not brought such claims

preclusive effect of a prior federal judgment," prohibit a party from relitigating an issue where "'(1) the identical issue was raised in a previous proceeding; (2) the issue was actually litigated and decided in the previous proceeding; (3) the party had a full and fair opportunity to litigate the issue; and (4) the resolution of the issue was necessary to support a valid and final judgment on the merits.'" *Ball v. A.O. Smith Corp.*, 451 F.3d 66, 69 (2d Cir. 2006) (quoting *Purdy v. Zeldes*, 337 F.3d 253, 258 & n. 5 (2d Cir. 2003)).

The issue of whether Lombard acted in good faith or colluded with LCI was raised by Macquarie, litigated at length during the February 12 sale hearing and decided against Macquarie. Macquarie objected to the sale of the WAC 9 Assets to Lombard based, *inter alia*, on the breach of the Lombard NDA, contending that Macquarie was entitled to a break-up fee because the Lombard credit bid was actually a joint venture with LCI. It cross-examined Ms. McDermott at length on this point. As noted, the Court found, among other things, that Lombard acted in "good faith" and "without collusion," the purchase price "was not controlled by any agreement among potential bidders," and Lombard had not "engaged in any conduct that would cause or permit the Purchase Agreement to be avoided or costs and damages to be imposed under section 363(n) of the Bankruptcy Code." (*Lombard Sale Order* ¶ J.) Macquarie never appealed. If Lombard did not improperly collude with LCI, LCI did not improperly collude with Lombard, and Count III constitutes an impermissible collateral attack on the *Lombard Sale Order*.

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and cannot show that anything Lombard did hurt the Debtors for the reasons stated. Furthermore, the release in the *Lombard Sale Order* had nothing to do with LCI or Macquarie's own claims.

GAF Holdings, LLC v. Rinaldi (*In re Farmland Indus., Inc.*), 408 B.R. 497 (B.A.P. 8th Cir. 2009), *aff'd on other grounds*, 639 F.3d 402 (8th Cir. 2011), is directly on point. There, the plaintiff (GAF) had been disqualified as a bidder at an earlier bankruptcy auction. The bankruptcy court approved the sale to a third party, Coffeyville Resources. The order approving the sale included findings that Coffeyville made the highest and best offer, the sale procedures had been properly followed, GAF was not a qualified bidder, the consideration was fair and reasonable and the transaction was negotiated in good faith and without collusion. GAF did not object to or appeal the sale order. *Id.* at 501.

GAF subsequently learned that Coffeyville had offered the debtor's executive vice president a lucrative position if it acquired the debtor's assets and thereupon filed a motion under Federal Civil Rule 60(b) and Federal Bankruptcy Rule 9024 to vacate the sale order as a product of collusion. After discovery and a hearing, the bankruptcy court denied the motion. The bankruptcy court's findings reiterated in some detail that the process was fair and open, untainted by any prospective employment of the debtor's executive vice president and GAF had the opportunity to speak to anyone it chose and conduct due diligence. *Id.* at 501-02. GAF did not appeal the denial of its Rule 60(b) motion, or the subsequent bankruptcy court order that authorized an amendment to the sale order and reaffirmed its findings, including that the assets were purchased in good faith and absent a stay pending appeal, would be entitled to the protection of 11 U.S.C. § 363(m). *Id.* at 502.

Three years later, GAF commenced an adversary proceeding alleging misconduct on the part of various individuals and entities connected with the sale and seeking

damages based on claims sounding in intentional interference with business expectancy and conspiracy. *Id.* The defendants moved to dismiss on a variety of grounds, and the bankruptcy court granted the motion concluding that the lawsuit was an impermissible collateral attack on the sale order and failed to state a claim. *Id.*

The Bankruptcy Appellate Panel affirmed on several grounds, including collateral estoppel. In order for the bankruptcy court to have entered a judgment for GAF, it would have been necessary to review issues it had already decided and overrule its prior findings. *Id.* at 506. GAF had the right to oppose the prior sale order, had unsuccessfully litigated its grievances through its Rule 60(b) motion and never appealed the sale order or the order denying the Rule 60(b) motion. *Id.* at 506-507. The issues presented in GAF's tortious interference action were the same as those that had already been litigated and determined by the bankruptcy court in its prior orders. *Id.* at 506-07. Accordingly, GAF's actions were barred by collateral estoppel. *Id.* at 508.

Macquarie's section 363(n) claim is barred for the same reasons. Macquarie's theory is that Lombard interposed a 100% credit bid based solely on its agreement with LCI to sell the WAC 9 Assets after it consummated the sale from Waypoint. Thus, their collusive agreement controlled the price of the auction of the WAC 9 Assets. To grant relief to Macquarie under section 363(n), the Court would have to conclude, contrary to its prior findings, that the sale was unfair, the purchase price was controlled by an agreement between potential bidders and Lombard acted in bad faith. Accordingly, Macquarie's section 363(n) claim is precluded by collateral estoppel. Moreover, the cases it cites in opposition to the applicability of collateral estoppel are distinguishable. *E.g.*, *In re Gen. Motors LLC Ignition Switch Litig.*, No. 14-MD-2543 (JMF), 2016 WL

4480093, at *2 (S.D.N.Y. Aug. 24, 2016) (refusing to give offensive collateral estoppel effect to a bankruptcy court order that on its face stated it was to have "no force or applicability in any other legal proceeding"); *Elletson v. Riggle (In re Riggle)*, 389 B.R. 167, 175 (D. Colo. 2007), as amended (Aug. 15, 2007) (applying Colorado collateral estoppel law to a state court judgment); *Compagnie des Bauxites de Guinee v. L'Union Atlantique S.A. d'Assurances*, 723 F.2d 357, 361 (3d Cir. 1983) (concluding that collateral estoppel did not apply where the issue had not been actually litigated, but was determined against the party as a discovery sanction); *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 331 & n. 15 (1979) (referring to circumstances where offensive collateral estoppel may be unwarranted).

Finally, Macquarie argues that it did not have a "full and fair opportunity" to litigate in that proceeding because it did not have time to conduct discovery or develop a full record. (*Objection* pp. 19-20.) The argument lacks merit. At the time of the *Bidding Procedures Order* in December 2018, Macquarie still believed that it would acquire the WAC 9 Assets because Lombard was not in the business of leasing helicopters and would not necessarily interpose a 100% credit bid. (¶¶ 21, 22.) On January 23, 2019, however, three weeks before the sale hearing, the Debtors announced that they had received a 100% credit bid from Lombard for the WAC 9 Assets. *(Notice and Identities of Successful Credit Bidders*, dated Jan. 23, 2019, ¶ 7(b) (ECF Main Doc. # 297); *see* ¶ 24.) Two weeks later, and one week before the sale hearing, Macquarie filed the *Macquarie WAC 9 Sale Objection*. It asserted, *inter alia*, that its right to a break-up fee was not affected if a lender and a third party had formed a joint venture to purchase the assets, (*Macquarie WAC 9 Sale Objection* ¶¶ 2, 4 (first bullet point)), and

had "raised these concerns to both representatives of the Debtors and to representatives of the Buyer." (*Id.* ¶ 4 (hanging paragraph).) Macquarie did not seek discovery or a postponement of the hearing.

Macquarie received Ms. McDermott's declaration a day before the hearing confirming contact with a servicer and discussions about a possible future sale. Macquarie did not ask for expedited discovery to take her deposition before the hearing or a continuance prior to the hearing. Macquarie accepted her declaration as her direct testimony and cross-examined Ms. McDermott at length about the contacts with LCI. It was only after all sides rested and during closing arguments at which the Court expressed some skepticism about the evidence supporting Macquarie's objection that Macquarie's counsel suggested that some discovery and a delay might be in order. The Court denied the request for the reasons already stated. Furthermore, sales in bankruptcy often happen on an expedited basis, but expedition does not deprive a sale order of its collateral estoppel effect. *Official Committee of Unsecured Creditors v. CIBC Wood Gundy Ventures, Inc. (In re Temtechco, Inc.)*, No. 95-00596, 1998 WL 887256, at *16 (Bankr. D. Del. Dec. 18, 1998) (ruling that collateral estoppel and *res judicata* barred relitigation of issues that were tried and decided at an expedited sale hearing that occurred three weeks after the chapter 11 petition date).

In this case, Macquarie was a party to the February 12 sale hearing and had a full and fair opportunity to litigate its objections to the sale of the WAC 9 Assets to Lombard based on its alleged collusion with LCI. The Court overruled those objections and found that Lombard was a good faith purchaser that did not impermissibly collude with LCI. Although aggrieved by the result — it lost its $19.5 million break-up fee and an expense

reimbursement possibly worth $3 million — Macquarie never appealed from the *Lombard Sale Order* which is final. Macquarie's *AC* raises the same collusion issues that were rejected by the Court and memorialized in the *Lombard Sale Order*, and as such, Macquarie's Count III claims asserted as assignee and in its own right are also barred by collateral estoppel.

Accordingly, Count III is dismissed with prejudice.

The Court has considered Macquarie's remaining arguments and concludes that they lack merit. Settle order.

Dated: New York, New York
September 10, 2019

/s/ *Stuart M. Bernstein*
STUART M. BERNSTEIN
United States Bankruptcy Judge

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

In re:	Chapter 11
BJ Services, LLC, *et al.*[1]	Case No. 20-33627 (MI)
Debtors.	(Jointly Administered)
	Ref. Docket No. 160

GACP FINANCE CO., LLC'S POST-HEARING BRIEF

GACP Finance Co., LLC, in its capacity as collateral agent (the "Agent"), respectfully files this post-hearing brief regarding the Debtors' proposed sale of certain of the Agent's collateral (the "Subject Collateral") to Alamo Pressure Pumping, LLC ("Alamo").

INTRODUCTION

1. On August 21, 2020, the Court conducted a hearing (the "Sale Hearing") with respect to, *inter alia*, the Debtors' proposed sale of certain equipment (an incomplete fracturing set) to Alamo, during which time the Court requested additional briefing from the Agent and the Debtors with respect to whether the Court could approve the Debtors' proposed sale to Alamo despite the Agent's higher credit bid. As discussed in more detail below, the Court previously authorized the Agent to credit bid up to $190 million at the Auction, the Agent submitted the highest and best bid for the Subject Collateral at the Auction, and the Court should deny the proposed sale to Alamo and instead confirm the Agent's bid as the winning bid for the Subject

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: BJ Services, LLC (3543); BJ Management Services, L.P. (8396); BJ Services Holdings Canada, ULC (6181); and BJ Services Management Holdings Corporation (0481). The Debtors' service address is: 11211 Farm to Market 2920 Road, Tomball, Texas 77375.

Collateral. Moreover, the Debtors' purported reason for accepting the lower Alamo bid over the Agent's higher bid – the mere *potential* to create or save 10 jobs – is both speculative and legally insufficient to overcome the Agent's higher credit bid. The Agent agrees that saving jobs is a laudable public policy, however, there are several other public policies involved in bankruptcy cases, including confidence of investors and credit markets, that also should be recognized.

ARGUMENT

A. The Agent's Right to Credit Bid

2. Section 363(k) of the Bankruptcy Code provides a secured creditor with a statutory right to credit bid at a sale of its collateral, which may only be limited by the Court "for cause".

3. In this case, the Agent sought and obtained clarification of its right to credit bid, which resulted in the Court's order permitting the Agent to credit bid at the Auction:

> Furthermore, notwithstanding anything to the contrary set forth in these Bidding Procedures, the Prepetition Equipment Term Loan Agent shall: (i) have the right to credit bid all or a portion of its prepetition secured claims up to a maximum amount of $190,000,000, without prejudice to the actual allowable amount of such claims; and (ii) be deemed to be a Qualified Bidder and shall not be required to provide any cash deposit, asset purchase agreement, due diligence materials, or any other materials as a condition to its participation at the Auction, and may participate in the Auction with respect to the Assets.

See Order (I) Approving the Bidding Procedures With Respect to Certain of the Debtors' Fracking Equipment and Intellectual Property, (II) Scheduling an Auction and a Sale Hearing, (IV) approving the form and Manner of Notices Related Thereto, (V) Approving Contract Assumption and Assignment Procedures, and (VI) Granting Related Relief, Docket No. 223, at Exhibit 2, Section E (the "Bid Procedures").[2] Importantly, the Bid Procedures go on to direct that, "nothing contained in [the] Bidding Procedures (including, without limitation, the Bid Assessment Criteria)

[2] The Agent holds a secured claim in excess of $200 million as of the Petition Date and the Debtors have stipulated to the validity of the Agent's liens on the Agent's collateral, including the Subject Collateral. *See Second Interim Order (I) Authorizing Debtors to Use Cash Collateral Pursuant to Section 363(c) of the Bankruptcy Code; (II) Granting Adequate Protection to the Prepetition ABL Secured Parties for the Use Thereof; (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001(b); and (IV) Granting Related Relief (Dkt. 261) at ¶ 4(f); (Dkt. 88 ¶ 4(f)).*

shall be used to modify or negate a Secured Creditor's right to credit bid, or to condition such right on the sale of assets that do not constitute such Secured Creditor's collateral." *Id*., at Section G.

4. The Court's prior order is law of the case and conclusively establishes the Agent's right to credit bid at the Auction. Assuming, *arguendo*, that it is not, in evaluating whether "cause" exists to deny a secured creditor's right to credit bid under section 363(k), courts typically look at: (i) whether the secured interest is subject to a *bona fide* dispute at the time of the sale, including disputes as to the validity or amount of the lien; (ii) whether the secured creditor is exerting pressure on the debtor or other potential purchasers in an attempt to manipulate the sale price; and (iii) whether the secured creditor has engaged in inequitable conduct, such as fraud, collusion, or a purposeful chilling of bidding to reduce the market value of the assets. *See, e.g., In re CS Mining, LLC*, 574 B.R. 259, 283-85 (Bankr. D. Utah 2017); *In re: Aéropostale, Inc.*, 555 B.R. 369, 415 (Bankr. S.D.N.Y. 2016); *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55, 60 (Bankr. D. Del. 2014). None of the factors relied upon by Courts to limit credit bidding are present here.

B. The Agent Submits the Highest Bid at the Auction

5. On August 19, 2020, the Debtors commenced an auction (the "Auction") with respect to, *inter alia*, the Subject Collateral. Alamo's bid of $1 million[3] for the Subject Collateral was the opening bid. When Mr. Shah of Simmons announced the bidding for the Subject Collateral would occur in $100,000 increments, and asked whether there were any bids for $1.1 million, the Agent submitted a credit bid in that amount. Alamo subsequently announced that it would "pass", and Mr. Shah announced that the Agent had submitted the highest bid. *See* Exhibit A.

[3] According to the Agent's appraiser, Alamo's bid was between 28% to 33% of the value of the Subject Collateral.

C. The Alamo Asset Purchase Agreement and the Illusory Obligation to Hire Employees

6. On August 20, 2020, the Debtors filed their *Notice of Winning Bidders* (the "Auction Notice"), and to the Agent's surprise,[4] announced for the first time that they had selected the lower Alamo bid for the Subject Collateral. *See* Docket No. 401. The Auction Notice stated that the Debtors selected the lower Alamo bid because it allegedly had the "potential" to provide jobs to certain of the Debtors' *former* employees. *Id*. at n. 3. However, the Alamo purchase agreement relied upon during the Auction contains no covenant to retain or hire any of the Debtors' current or former employees. *See* Auction Notice, Exhibit C. Instead, apparently sometime after the Auction on the small lots concluded, off the record, and without providing any notice to the Agent or other potential bidders, the Debtors and Alamo allegedly agreed to modify the Alamo purchase agreement to insert a provision related to employees (the "Alleged Alamo APA").[5] The Agent does not believe that the Debtors filed an amended agreement prior to the Sale Hearing, or that any such agreement was ever introduced as evidence at the Sale Hearing. In short, the agreement and the covenant to hire employees are illusory.

7. Either way, unlike the agreement for the cementing business (which requires that purchaser to extend offers of employment to hundreds of the Debtors' employees), the Alleged Alamo APA merely provides that Alamo will "consider in good faith extending offers of employment to at least 10 employees of Seller and such other employees (including former employees)."[6]

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[4] The Bid Procedures required the Debtors to announce whether the Debtors had identified an overbid as being higher or otherwise better to the previous bid during the auction, and to describe to all Qualified Bidders the material terms of any new bid and the value attributable to the bid so Qualified Bidders would have the opportunity to bid against it. *See* Bid Procedures, at G(iii)(d). That did not occur here.

[5] *See* Debtors' Brief in Support of the Sale Transactions and Response to Objections [Docket No. 416] (the "Debtors' Brief"), at n.8.

[6] *Compare* Cementing APA [Docket No. 401-1] at Section 6.3 with alleged Alamo provision quoted in Debtors' Brief at n.8 (emphasis added).

8. In other words, the Alleged Alamo APA does not preserve jobs, it merely provides that Alamo will consider hiring a minimal number of employees (10) if it later determines that it is "necessary or advisable".[7] Further, the Debtors presented the Court with no evidence that hiring a former employee equates to any benefit to the Debtors' estates.

9. In conducting the sale process, the Debtors are "duty bound" to maximize the value of their estates." *Commodity Futures Trading Com'n v. Weintraub*, 471 U.S. 343, 352 (1985). The Agent is not aware of any case where a court approved a lower bid over a higher credit bid merely because the lower bidder said it would "consider" hiring a few people. Instead, that proposition is contrary to the requirement that Debtors maximize the value of their estates and respect secured creditors' rights under the Bankruptcy Code and applicable law. *See also RadLAX Gateway Hotel v. Amalgamated Bank*, 566 U.S. 639 (2012) (recognizing importance of credit-bid rights and holding that debtors could not circumvent bank's credit bid rights under a plan by allegedly providing the "indubitable equivalent" in form of cash generated by auction).

CONCLUSION

10. The Court must reject the Debtors' request to give away the Agent's collateral to a lower bidder for the alleged purpose of potential job creation. If debtors are permitted to circumvent secured creditor rights and remedies merely by alleging that jobs might be saved, the lending markets would be thrown into chaos and far more jobs would be lost than saved. Jobs are best created and preserved when the value of a debtor's assets are maximized (here, by confirming the Agent's higher bid), and when secured creditors' rights are protected so they can continue to lend money to businesses that employ people. Nothing in the Bankruptcy Code permits the Debtors to sell the Agent's collateral to Alamo under these circumstances.

[7] The Subject Collateral is not in use and no employees currently work that equipment. If Alamo has the need to hire employees it can do so without purchasing the Subject Collateral.

Respectfully submitted,

Dated: August 24, 2020

DLA PIPER LLP (US)

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CERTIFICATE OF SERVICE

I certify that on August 24, 2020, I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

/s/ Noah M. Schottenstein
Noah M. Schottenstein

Exhibit A

MR. DAN MCGUIRE: Yes, we have. We will not be bidding.

MR. SHAH: I'm going to go through all the lots one more time before we move on to the credit bids.

We'll start with Alamo again. Once again, 8 frac pumps, some ancillary equipment, and we have a bid at a million dollars. We're going to lower the bid increment to 100,000 given the small lot size to see if there's any interest.

Do I have 1.1?

MR. STUART BROWN: This is Stuart Brown.

We will credit bid 1.1.

MR. SHAH: Do I have 1.2? Alamo, I'm looking at you.

RJ, are you on?

MR. SIKES: Yes, sir, we're on. I think we're going to pass at this time.

MR. SHAH: Okay. 1.1 going once, going twice, three times, we'll move on.

Looking at the Baker Hughes lot, we'll start with the cementing equipment at $1 million. Do I have -- similarly, it's a small lot, so we'll go 100 grand increments.

Do I have 1.1?

PROCEEDINGS

MR. ALTMAN: We're going back on the record on the auction in the BJ Services case following up on the auction from yesterday.

Sanjiv, I will turn it over to you with the note that all bidders will be deemed to have continued to abide by the -- I'm getting a lot of feedback here -- to the same statements that they made yesterday with respect to not collusive bidding, being a good faith purchaser, and participating in the auction in good faith.

MR. SHAH: Thank you very much. Sanjiv Shah with Simmons Energy.

Just to recap the bids from yesterday. We have the Alamo package, 1.1 million with the agent credit bid, and 1 million from Alamo. I'm only going to go through the top two bids by aggregate value for each package.

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

In re:	)	Chapter 11
BJ SERVICES, LLC, *et al.*,[1]	)	Case No. 20-33627 (MI)
Debtors.	)	(Jointly Administered)

DEBTORS' BRIEF REGARDING PUBLIC POLICY CONSIDERATIONS AS "CAUSE" UNDER 11 U.S.C. §363(k) AND RELATED MATTERS

The above-captioned debtors and debtors in possession (collectively, the "Debtors") respectfully state the following in support of this brief (this "Brief"):

Background

1. Pursuant to the Bidding Procedures Order and the Auction Notice,[2] the Debtors held an Auction on August 19 and 20, 2020. At the Auction, Alamo Pressure Pumping, LLC ("Alamo") submitted a $1 million cash bid for certain equipment (the "Equipment"). GACP Finance Co., LLC, in its capacity as agent under the Debtors' prepetition equipment term loan (the "Agent"), submitted a $1.1 million credit bid for the Equipment (the "Credit Bid").

2. At the Sale Hearing, the Court asked whether it could approve the cash sale to Alamo in light of the Credit Bid and requested that the Debtors and Agent provide briefing related

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: BJ Services, LLC (3543); BJ Management Services, L.P. (8396); BJ Services Holdings Canada, ULC (6181); and BJ Services Management Holdings Corporation (0481). The Debtors' service address is: 11211 Farm to Market 2920 Road, Tomball, Texas 77375.

[2] *See Order (I) Approving the Bidding Procedures with Respect to Certain of the Debtors' Fracking Equipment and Intellectual Property, (II) Scheduling an Auction and a Sale Hearing, (IV) Approving the Form and Manner of Notices Related Thereto, (V) Approving Contract Assumption and Assignment Procedures, and (VI) Granting Related Relief* [Docket No. 223] (the "Bidding Procedures Order") and the *Notice of Sale and Revised Sale Deadlines, Auction, and Hearing Date* [Docket No. 330] (the "Auction Notice"). Capitalized terms used but not defined herein have the meaning ascribed to such terms in the Bidding Procedures Order and the Auction Notice.

thereto, including as to whether public policy considerations (such as saving jobs) can constitute "cause" to limit the Agent's right to credit bid under 11 U.S.C. § 363(k).

3. As part of its bid, Alamo indicated that it would extend offers of employment to at least ten of the Debtors' former or current employees to support the utilization of the Equipment in its operations.[3] In contrast, the Credit Bid offers no employment opportunities for the Debtors' employees or others. Given the nominal difference in value between the competing bids, the Debtors determined in their business judgment that the jobs created and saved as part of the Alamo bid made it a higher and better bid than any credit bid and selected Alamo as the Winning Bidder for the Equipment.

Argument and Authorities

A. The Alamo Bid is the Highest and Best Bid and Should be Approved.

4. Even if it does not limit the Agent's right to credit bid for cause, the Court should approve the sale to Alamo as the highest and best bid. As the Debtors laid out in their brief in support of the sale, it is indisputable that the Court is not required to approve the highest monetary

[3] Alamo's Asset Purchase Agreement, section 4.7 (as amended on August 23, 2020), provides: "Purchaser covenants and agrees that it will extend an offer of employment to at least 10 former or current employees of Seller and will consider in good faith extending offers of employment to such other employees (including former employees) of Seller as may be necessary or advisable to support the utilization of the Purchased Assets in Purchaser's operations…. In furtherance of the foregoing, Purchaser covenants and agrees that to the extent an employee (or former employee) of Seller is a candidate for employment and all other candidates for employment have substantially comparable qualifications and expertise as determined by Purchaser in good faith, Purchaser shall select extend an offer of employment to such employee or former employee of Seller over such other comparable candidate." Prior to the Amendment, this section provided that Purchaser would "consider in good faith extending offers of employment" to Debtors employees and, in the choice between "comparable candidate[s]," choose one of the Debtors' current or former employees. The amendment firms up this commitment.

bid.[4] *See Debtors' Brief in Support of the Sale Transactions and Response to Objections* [Docket No. 416] at ¶¶ 22 – 23.

5. At least one court has expressed dismay at a debtor's choice to approve a higher monetary bid over a bid that saves jobs. In *In re After Six, Inc.*, 154 B.R. 876, 882 (Bankr. E.D. Pa. 1993), the Court went out of its way to note that preservation of jobs should be considered when evaluating competing bids. The *After Six* court was confronted with two bids for the debtor's assets: the higher bid of $7.1 million did not preserve jobs but was supported by the debtor; the lower bid of $5 million offered the prospect of continued employment and was supported by the creditors' committee. *Id.* at 879 - 80.[5] While the Court ultimately approved the sale to the higher bidder in deference to the debtor's business judgment and the "great monetary gap," it lamented the decision and expressed "no doubt that, in an appropriate setting, a bankruptcy court . . . could appropriately award a bid to a lower bidder, when that lower bidder had other factors, including even an element as lacking in direct economic impact as 'societal needs,' in its favor." *Id.* at 882. The Court noted, "[o]ne of the underlying rationales for the enactment of Chapter 11 is its potential to preserve jobs for the employees." *Id*. at 884. The Court chastised the debtor for failing to more heavily weigh the consideration of its employees' wellbeing: "It is disturbing to perceive a [debtor] which appears to accord so little consideration to this element." *Id.*

6. Here, the appropriate outcome is clear. The net benefit in the Debtors' business judgment of naming Alamo's bid as the Winning Bid is that at least ten current or former employees of the Debtors will have a job operating the Equipment during one of the direst

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[4] The Debtors have been unable to find any case law stating that the "highest and best" consideration should be modified in the context of credit bids.

[5] The employees' union also offered to waive its claim in the event the lower bid was approved, thus providing additional value estimated at no more than $1.2 million. *Id.* at 880.

economic crises in the nation's history. These jobs will provide wages to feed families, pay medical bills, support local industry, and address "societal needs." These jobs may also help employees avoid personal bankruptcy in these trying times. In contrast, the only net benefit to the Debtors' estate of the Credit Bid is that the Debtors will owe approximately $100,000 less to the Agent (or 0.053% of the $190,000,000 of outstanding debt).

7. Furthermore, a sale satisfies section 363(f)(3) of the Bankruptcy Code when the sale price meets or exceeds the *value* of the property to be sold. *Debtors' Brief in Support of the Sale Transactions and Response to Objections* at ¶¶ 42 – 43. The Court recognized that the Debtors ran a "fair auction." Accordingly, the price obtained represents a market price for the assets and justifies the release of liens because "the price at which such property is to be sold is greater than the aggregate value of all such liens on such property." *See* 11 U.S.C. § 363(f)(3).

B. Cause Exists to Reject the Credit Bid.

8. The Court has ample discretion to decide what constitutes cause under 11 U.S.C. § 363(k). Section 105(a) authorizes the Court to use its equitable powers where the Bankruptcy Code is silent, including to determine cause. *See* 11 U.S.C. § 105(a). Indeed, cause is "intended to be a flexible concept enabling a court to fashion an appropriate remedy." *In re NJ Affordable Homes Corp.*, No. 05-60442 (DHS), 2006 WL 2128624, at *16 (Bankr. D.N.J. June 29, 2006). Accordingly, cause must be determined on a case-by-case basis. *In re CS Mining, LLC*, 574 B.R. 259, 283 (Bankr. D. Utah 2017). Courts have articulated myriad factors when determining cause under section 363(k). Often, courts evaluate the secured creditor's conduct when assessing cause, considering whether the secured creditor engaged in "inequitable conduct," "inappropriate behavior," collusion, or "any other actions designed to chill the bidding or unfairly distort the sale process." *In re Aéropostale, Inc.*, 555 B.R. 369, 416 (Bankr. S.D.N.Y. 2016).

i. Public policy considerations can constitute "cause" for accepting a lower cash bid over a higher credit bid.

9. As explained by the Third Circuit, "[a] court may deny a lender the right to credit bid ***in the interest of any policy advanced by the Code***." *In re Phila. Newspapers, LLC*, 599 F.3d 298, 316 n.16 (3d Cir. 2010) (emphasis added), *as amended* (May 7, 2010).[6] "Intrinsically, acting 'for cause' looks to the court's equity powers that allow the court to balance the interests of the debtor, its creditors, and the other parties of interests in order to achieve the maximization of the estate and an equitable distribution to all creditors." *In re RML Dev., Inc*., 528 B.R. 150, 155 (Bankr. W.D. Tenn.2014) (citations omitted). The Court may deny credit bidding when allowing it would reduce the overall benefits to the estate. *In re CS Mining, LLC*, 574 B.R. 259, 283 (Bankr. D. Utah 2017).

10. As the Supreme Court has recognized, protecting employees is one of the central policies advanced by the Bankruptcy Code. *See, e.g.*, *Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (noting that one of Congress' purposes in enacting Chapter 11 was to allow businesses to "revive . . . and thereby preserve jobs."); *see also* 11 U.S.C. § 507(b)(4) (awarding priority status to certain employee wage claims). Accordingly, the Court can rely on its equitable powers to advance the public policy interest of job creation by limiting the Agent's right to credit bid "for cause" under section 363(k) of the Bankruptcy Code. This is particularly urgent in today's economic environment.

11. Moreover, other provisions of the Bankruptcy Code indicate that public policy should be considered in sales of assets under section 363. Section 1506 provides that bankruptcy

[6] *See also In re Tempnology, LLC*, 542 B.R. 50, 69 (Bankr. D.N.H. 2015), *aff'd sub nom. Old Cold, LLC*, 558 B.R. 500 (B.A.P. 1st Cir. 2016), *aff'd sub nom. In re Old Cold LLC*, 879 F.3d 376 (1st Cir. 2018) (same); *In re Aéropostale, Inc.*, 555 B.R. 369, 417 n.31 (Bankr. S.D.N.Y. 2016) (same); *In re Free Lance-Star Publ'g Co.*, 512 B.R. 798, 805 (Bankr. E.D. Va. 2014) (same); *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55, 60 (Bankr. D. Del. 2014).

courts may refuse to take action that would be "manifestly contrary to the public policy of the United States." 11 U.S.C. § 1506. In turn, section 1520(a)(2) provides that upon entry of a recognition order in a chapter 15 proceeding, section 363 applies automatically. 11 U.S.C. § 150(a)(2). It is clear that Congress intended that all sales of assets in a chapter 15 proceeding be reviewed under a public policy framework. There is no reason to believe that Congress intended section 363 to be tempered by public policy considerations solely in chapter 15. Rather, sections 1520(a)(2) and 1506 make clear in the chapter 15 context what was already intended to be applicable in chapter 11.

ii. The Agent engaged in inequitable conduct and inappropriate behavior and the credit bid was not authorized when submitted.

12. As described in the objection filed at Docket No. 415 (the "First Out Objection"), the Agent did not have the right to credit bit at the Auction as doing so was in direct violation of the Agreement Amongst Lenders (as described in the First Out Objection). The Agent effectively admitted as much by paying the first out lender to satisfy its claim during the Sale Hearing.

13. The Debtors asked the Agent for the Agreement Amongst Lenders for months, but the Agent refused to provide it. The reason is now abundantly clear; the Agent was hiding from the Debtors that it did not have the right to credit bid. Accordingly, when the Agent bid at the Auction, it did not have legal authority to do so, misleading the Debtors and all other parties. This inequitable and inappropriate conduct was unequivocally designed to "unfairly distort the sale process" and is further grounds to limit the Agent's right to credit bid "for cause."

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WHEREFORE, the Debtors respectfully request that the Court approve the sale to Alamo and grant such other relief as the Court deems appropriate under the circumstances.

Houston, Texas
August 24, 2020

/s/Paul D. Moak

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4834-4032-1736

Certificate of Service

I certify that on August 24, 2020, I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

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Symposium Issue: The Role of Equity in the Bankruptcy Court

Jay Lawrence Westbrook[a1]

*203 EQUITY IN BANKRUPTCY COURTS: PUBLIC PRIORITIES

For a lawyer, "equity" is an enormous word. Far beyond a technical reference to a group of courts in England, it evokes broad notions of fair consideration of all the values and circumstances that should be weighed in rendering a judicial decision. It is often used in contrast to strict legal rules, especially those in statutes. Its multiple appearances in the Bankruptcy Code, without any definition, suggest a Congressional realization that bankruptcy jurisdiction uniquely sweeps across nearly every part of our law and applies to a great variety of circumstances, defying adequate anticipation in the statute.

This paper discusses the aspects of equity in bankruptcy that relate to societal interests ("public interests"[1]) in the confirmation of plans and other decisions made in Chapter 11 cases. It corresponds to a concern I have long expressed about the lack of focus on public interests in bankruptcy courts and bankruptcy scholarship, together with the frequent assumption that Chapter 11 is entirely about negotiations among private commercial interests.[2]

Public interests should guide decisions in bankruptcy cases and often do. However, for various reasons, including the "plain meaning" approach to statutory interpretation, its impact is less than transparent. Instead, it is often equity that is invoked as a vehicle for decisions actually fashioned on a public interest. Whether we believe the impact of a particular public interest claim is legitimate or not, we should want it to be clearly revealed in court decisions. ***204** That goal could be greatly advanced if public interest provisions were inserted in the Bankruptcy Code, joining its numerous references to "equity" as an additional illumination of the complex interactions of conflicting interests in Chapter 11 proceedings.

To achieve results that reflect a transparent balancing of private interests and public interests, this paper suggests that Congress should enact:

1. Provisions that authorize the courts to consider specific non-commercial interests, like employment in the community; and

2. Provisions that empower the court in every Chapter 11 case to consider public interests not just by "doing equity" between interested parties, but by including equitable consideration of the interests of society as a whole when interpreting and applying the Bankruptcy Code (the "Code").[3]

Equity plays three roles in this discussion:

1. It has provided cover for public interest decisions under the Code; to that extent it defeats transparency.

2. Its frequent use in the Code reflects the fact that Congress understands that the very nature of Chapter 11 bankruptcy means that many different interests converge in complex and novel ways and the courts require a proportionate flexibility.

3. The fact that the flexibility of equity has not been abused should quiet fears that public interest provisions in the Code will result in judges pursuing unconstrained ideological agendas.

I. BACKGROUND

The phrase "doing equity" is used both specifically and generally. In its specific application, it is used to argue that the special circumstances of the ***205** case before the decision maker require exceptional treatment. That is not the sort of equity discussed here. By contrast, a general claim for equitable treatment frequently relies upon one or more interests of the public not legitimated by a specific reference in the relevant statute, including the examples discussed in this article.

Equity is often thought of as granting discretion, but in the second sense it reflects the broad sweep of policies that arise in Chapter 11, a type of proceeding that compares to ordinary civil litigation as a city compares to a single street. As Professor Jacoby has it: "Bankruptcy is crisis management for individuals, business entities, and even governments. The entities that file for bankruptcy come in all shapes and sizes, as do their troubles."[4] I think it is realization of that fact that has led to equity's multiple appearances in the Code. Unfortunately, under that heading the public interests that influence decisions are too often unarticulated or vague, leaving a decision to be understood as an exercise of undefined discretion, "the equities of the case."

The concern for public interests of various sorts is necessary to the correct interpretation and application of bankruptcy law. Modern reorganization law represents a singular challenge of reconciling a range of public interests of various sorts with important private interests.[5] The duty to engage in that balancing in turn relates to the tension between the impossibility of drafting legislation anticipating all the material elements of a future decision amid the complexities of a Chapter 11 proceeding and the need to take account of those elements that turn out to be relevant to that decision. For that reason, accountability requires that the necessary balancing of public and private interests should be a transparent element of any important decision.

I propose that the statute should articulate the important place of multiple public interests, withdrawing them from their reliance on "equities" as a basis for application.[6] Such a provision would not dictate a result in a given ***206** case, but would require a decision maker concerned with a public interest to explain the relevance of that public interest to the outcome of the decision. By its explicit authorization of a public interest analysis, the statute would relieve the pressure applied by the "plain meaning" rule[7] to obscure a purposive reading of the statute based upon relevant public interests.

This paper begins with a summary of conflicting frames for Chapter 11, from a view of bankruptcy law as having little substantive content and having as its overarching purpose the promotion of private bargaining, on the one hand, to a perspective that accounts for general public interests that may be undervalued and not necessarily represented by claims in the conventional sense, on the other.

A general theme is that the "bargaining among interests" framing of Chapter 11 as an institution risks deflecting parties, as well as courts, from undervalued public interests.[8] Yet a substantial part of the justification for reorganization has been to serve public interests like preservation of jobs and economic stability.[9] Advancement of these and other public interests has had an important role in the support of Chapter 11 in Congress, but they are not specified in the statute and thus confront the plain-meaning dogma.

II. PRIVATE AND PUBLIC INTERESTS

A. The Debate

I start by describing the existing landscape. It is nicely introduced by the debate between Professors Elizabeth Warren and Douglas Baird in the late

Eighties.[10] In general, it framed the divergence between a narrow view of ***207** Chapter 11 designed to provide a procedure for private bargaining and one that identified a host of relevant public policies -policies that must be balanced against private interests and among themselves as well.[11]

Baird put forward the idea that bankruptcy law should be regarded as a relatively narrow field. For him, the purpose of bankruptcy was limited to adjusting the preexisting entitlements created by other laws.[12] Bankruptcy should not create independent entitlements[13] but should provide procedures for allocating scarce resources according to preexisting rights in an orderly way. In a later work, he characterized himself and others who take this view as "proceduralists," because they regard bankruptcy as a purely procedural statute.[14] The approach is also a form of "rights talk" in commercial law because it assumes that bankruptcy is an allocation process based on preexisting rights.

Warren, on the other hand, claimed that bankruptcy is a necessary occasion for applying a number of different public policies, including issues like the treatment of future mass tort claimants and toxic waste sites.[15] She did not regard federal bankruptcy law as bound in every instance to make the same distributional decisions that state law or federal law would apply outside of bankruptcy.[16] For her, once circumstances create a general default and there are too few resources to satisfy all concerned, the policy landscape may be ***208** fundamentally changed, and bankruptcy must reflect that change.[17] That modification process is a part of bankruptcy law and policy.

Baird would regard these nonprocedural questions as properly governed by other laws and related policies, which the bankruptcy courts simply apply when appropriate.[18] If there is a decision to be made that involves those other policies, the bankruptcy courts should modify the nonbankruptcy results as little as possible.[19] Ideally, bankruptcy law should not matter except in a limited procedural way.[20] Combining this narrow view of bankruptcy policy with the plain meaning rule, which can be understood to imply that a policy or rule must be explicit in a statute, has the effect of greatly narrowing the number of public interests that can be recognized in bankruptcy.

B. Private Bargaining

There is one bankruptcy policy that is universally agreed: the maximization of the debtor's value available for stakeholders.[21] Following the Baird approach, a number of scholars came to see that policy as being the central purpose of bankruptcy law, if not the only one.[22] Baird's approach fits nicely with Professor Jackson's seminal article[23] that hypothesized a bargain among creditors as the test for a good bankruptcy rule: would such an approach be agreed among creditors in advance as the best way to maximize value? However, that approach required a quasi-Rawlsian veil of ignorance, because each ***209** real creditor would prefer adoption of the bargain most beneficial to that creditor. That line of reasoning then led to the contractualist debate that lasted almost a decade.

The contractualists, led by Dean Rasmussen, sought to make the Jacksonian hypothetical contract an actual one.[24] By inserting a provision in a company's corporate charter, a private system of bankruptcy would be adopted by contract. Each subsequent

creditor would become bound by that system, replacing the Code for resolution of the debtor's financial distress.[25] The role of bankruptcy was solely to serve as a mechanism for executing the bankruptcy contract, with very limited substantive provisions.

The contractualist system did not get very far on its own, but by the early 2000s it was working quite smoothly in a number of cases. In those cases, the control necessary for the effective privatization of financial distress was achieved by means of a dominant security interest.[26] With a dominant security interest, a creditor could have effective control of the debtor business and could impose a private system of sale or reorganization of the distressed business. In effect, the dominant security interest privatized the bankruptcy process. Recent empirical work suggests that about half of the Chapter 11 cases filed in Southern New York and Delaware had that level of ***210** control.[27]

Much more recently, Professor Anthony Casey has offered an evolved and sophisticated theory of bankruptcy within the Law and Economics school.[28] I cannot do it justice here, but Casey's careful analysis modifies the analytical thread described above, especially in narrowing it. His central contribution is to identify what he understands to be the ultimate goal of bankruptcy law: to resolve problems he characterizes as "hold-ups," a situation where bankruptcy law is used to "extract value" from other creditors without paying a proportionate price.[29] His conclusion is that bankruptcy provides a forum for negotiating the prices to be paid for such extractions and thus permits resolution of the parties' incomplete contracts with the minimum loss of value.[30]

At the end of the day, however, even Casey's more flexible and realistic analysis leaves us with a system that exists fundamentally to resolve private commercial disputes in essentially private civil actions, with bankruptcy providing the vehicle to promote the making of bargains to resolve those disputes.[31] In that framework, public interests will be largely unaddressed.[32] Whether or not that result is justified is still very much subject to question.[33]

***211 C. Public Interests**

Other scholars took up ideas similar to those of Warren, including consideration of public interests in bankruptcy of two sorts: i) the public interest in ensuring that proper weight is given to various private interests, especially underrepresented private interests ("neglected interests"); and ii) public interests that are broader than private interests ("broader interests"). They believed both sorts of interests are often under-identified in bankruptcy decisions and given too little weight in the results.

Where a private interest is involved (e.g. especially serious tort claims), the public interest may require that the claim be given more effective weight in the outcome of a *particular* case than its simple legal status (just another unsecured claim). On the other hand, a broader public interest can exist unconnected to the holder of a specific interest or stake in a proceeding. The consideration of such interests may have a special importance in the context of reorganization.

Thus, there are three categories of interests that might receive consideration in a Chapter 11 proceeding: private commercial interests, neglected private interests, and broader public interests. Secured lenders would present a private commercial interest, the debtor's employees a neglected private noncommercial interest, and the community a public interest.

Of course, all aspects of bankruptcy policy rest on public interests, starting with the public interest in predictably enforced commercial obligations and procedures that aid commercial parties in adjusting successfully to financial distress. The private interests of various other stakeholders in a bankruptcy will be supported by claims of public interests as well as moral and commercial fairness. For example, society benefits if employees receive priority for their wages because otherwise the best ones will desert troubled businesses, ensuring failure of the business and leaving society with truly desperate workers. The interest supported--some priority for the workers in a business in financial distress--is a private interest supported by those public interests, among others. They are private, despite their value to society, because they create rights that belong to and are asserted by private persons.

1. ***Public Interests in Neglected Private Interests***

In general, scholars on the Warren side of the debate have identified private interests that are under-represented in most proceedings. Some have proposed appointment of specific representatives for the unrepresented and the statute has sometimes been amended to do that.[34] They have argued the ***212** public interest required that those private interests should be given due weight in many bankruptcy decisions. Two of the most important discussions of undervalued public interests were published in the 1990s and early 2000s, at the same time when scholars of corporate law were championing various community and noneconomic interests as worthy of recognition as part of the legal duties of corporations.[35]

a. Under-Weighted Traditional Claims

Professor Block-Lieb addressed the question of various claims, economic or noneconomic, that deserve greater weight in bankruptcy, especially Chapter 11. In a direct response to the contractualists, she rejected the notion that bankruptcy law should exist in a corporate-credit silo, rigidly separate from other social and economic concerns:

> Moreover, neolibertarian analysts are wrong to describe bankruptcy provisions, such as those that protect employees' labor claims, retirees' claims for medical and health benefits, and state and federal environmental claims, as having no public policy purpose other than the redistribution of bankruptcy losses from favored creditors to general unsecured creditors. Bankruptcy provisions such as these represent social and political determinations to protect broad-based policy interests in a bankruptcy case. In some instances, like those involving pension, labor and environmental claims, these public policy determinations are not unique to the Bankruptcy Code, but previously were identified in other federal legislation. These protections should be viewed, not as provisions intended to redistribute wealth among creditors affected by a firm's bankruptcy, but as provisions reinforcing in bankruptcy important cultural, social and political interests that have been identified outside of bankruptcy. Thus, even when bankruptcy protections of this sort can be said to increase the cost of commercial credit, it is in no way clear that the failure to minimize debt-capital costs represents a failure to maximize social welfare. With many bankruptcy protections, the failure to minimize the cost of credit ***213** means only that the maximization of social welfare involves a complex balancing of society's competing interests.[36]

In that context, she directly took on the idea that bankruptcy, especially Chapter 11, must be a simple tool for financial adjustment among creditors anointed with priority by nonbankruptcy law. When any two sets of policies bear upon a decision or process--including environmental damage, patent protection, or the rights of mass tort victims--conflicting public interests in a Chapter 11 proceeding must be accommodated and prioritized in the context in which they are found. Indeed, the procedural role of bankruptcy in centralizing legal conflict is universally accepted,[37] which necessarily assumes an application of a host of often conflicting public policies. The many implications of that proposition go well beyond this paper, but it permits us to put to one side any claim that Chapter 11 can avoid that sort of weighing of competing public concerns. And the bankruptcy context may change the balance.

b. Private Interests without Claims

Going a step farther, Professor Martin has raised a number of “noneconomic” interests of persons that deserve “standing” in bankruptcy cases but might be denied an opportunity to participate under rules focused on a party's traditional bankruptcy claims.[38] I think of them as “nonclaim” issues.[39] One of her examples was that of nursing home patients being forced to relocate by the debtor's desire to convert the facility to a more profitable use. They would have a substantial interest but perhaps no traditional claim. Adoption of Martin's proposal would ensure the standing of the patients to raise issues that affect them. The

statute has since been amended to address some of the concerns her article identified where the debtor is a health care business.[40] This new provision goes beyond giving standing to the patients by permitting the appointment of a representative to protect their interests and in the process may create at least some substantive rights in bankruptcy for the patients.

Martin identifies several other exemplary instances in which unrepresented ***214** constituencies should be given standing.[41] Each of them presents parties with nonclaim interests who are concerned about the effects a sale decision in a Chapter 11 proceeding would have on them. In each case, the question is whether their interests should be weighed against maximizing the value returned for creditors.

One private interest imbued with public interests is employment. It would be difficult not to agree that jobs and the lot of workers are important interests in our society. They are recognized in a host of ways. Two examples in the Code are the priorities in distribution among unsecured creditors for unpaid wage claims and limitations on the rejection of collective bargaining contracts.[42] Both have received extensive attention.

Beyond protection of wages and benefits in a Chapter 11 case, there are broader public interests in the maintenance of employment generally. Politicians regularly promise jobs and expend substantial public resources in attempting to provide and protect them.[43] Chapter 11, as a proceeding, has been a special focus of this public interest.[44] From the Great Depression onward, reorganization has been justified in substantial part as preserving jobs as well as asset values.

Around the globe there is a wave of bankruptcy reform, and Chapter 11 is by far and away the most important influence on those reforms. Its interest to national reformers has rested on its intended preservation of employment values at least as much as on maximization of asset values. Yet somewhere along the line the literature and many of the cases suggest that we in the United States have lost our emphasis on the role of Chapter 11 in preserving jobs.

One striking omission of employee interests from bankruptcy court consideration is found in the choice of competing plans. The Code permits more than one proposed Chapter 11 plan to be submitted to creditors.[45] If both plans are accepted by creditor votes, the court must choose the one to confirm. ***215** [46] Yet it appears courts do not generally consider employment or other broad public interests when presented with competing plans both of which have been voted acceptable by the requisite majorities of creditors.[47] In particular, future employment for existing workers is not among the factors found in the pick-a-plan cases, although such cases would seem to be an obvious spot to reflect the fact that employment is an important value in American reorganization practice, especially given that the creditors have said either plan will do. In a few cases, courts seem to acknowledge that future employment for current workers is a legitimate plus factor for a reorganization plan, but without any suggestion that it would be a tiebreaker in an otherwise close case.[48]

In the related category of similar bids in a §363 sale, Professor Martin describes a hypothetical "*Fancy Pants*" case:[49]

> In the context of a section 363 sale, the debtor receives two competing bids for its manufacturing business, which produces suits and tuxedos. One bidder, a competitor, has offered $5 million for the plant and other assets and intends to permanently close the plant in order to eliminate competition and enhance its own market share. This is the offer that the debtor has accepted. A competing bid has been received from another bidder, who operates a similar facility abroad. This bidder has offered $4,600,000 for the same assets, but intends to operate the business at this location, using the existing labor force. The employees argue that the $4,600,000 bid is the best overall bid because it will save jobs, but they have no contracts or unpaid claims. Under ***216** the majority view of standing, the employees have no right to be heard on any issue in the case.[50]

She argues that the workers in such a case should have standing to be heard on which bid to accept;[51] the higher bid should not be automatically accepted when the difference in the two bids is relatively small and the negative impact on the employees is substantial.[52] She accepts that a larger difference in creditor return might trump the interest of the employees in future employment, but argues that the workers should be given standing to make their case.[53] She says that when the bids are relatively close "balancing becomes necessary."[54] I agree, but it might be necessary and appropriate to go further.

The right to stand up and argue for consideration of an employee interest could be relatively shallow without a provision in the Code mandating consideration of public interests--just what I propose below. A specific public interest in employment in the community is one solution, but there are a large number of public interests relevant to bankruptcy cases. The Code would be impossibly long (and legislative recognition impossibly delayed) if each of them had to be spelled out in the statute. Thus, we have a need for a general provision establishing a place for neglected private interests in bankruptcy.

A choice between two bidders with bids that differed little in amount but considerably in their appeal to various beneficiaries was presented by a sale of a senior residential housing property in southern New York.[55] Effects on creditors may have been marginal one way or the other. The primary stakeholders had private interests that were not purely financial. As the court admitted, there was no institutional decision or democratic vote to which the court's burden of choice could be shifted. The court had to choose among various values, primarily private ones, that were not purely financial, although the decision would also make a difference in the financial positions ***217** of the stakeholders, who were residents and former residents of the home. That is, the parties themselves made it clear that their preferences were guided by factors beyond the merely financial. The decision is a prototype for such cases, regardless of result, and may also show how a decision could be made in the Fancy Pants or similar cases.

2. *Broader Public Interests*

Other public interests relevant to a given Chapter 11 do not generate rights tied to specific interests of parties to the case. These interests may be among arguments made to support the rights of particular persons, but they are not rights of those persons in particular. I offer two illustrations.

a. Control of a Chapter 11 Proceeding

Professor Jonathon Lipson wrote two articles on the subject of structured dismissal discussing the *Jevic* case.[56] One of the articles focused on the Court's vindication of the absolute priority rule, as did most of the other *Jevic* commentary, although with a focus on "process values."[57] The other one, discussed here, elaborated its *Jevic* analysis through the *LifeCare*[58] case, a dismissal in the Third Circuit similar to *Jevic* but not tested by its holding.[59] The focal point was the exercise of control of a Chapter 11 proceeding by a secured creditor.[60]

Lipson's argument is that permitting a dominant secured creditor to arrange a structured dismissal as in *LifeCare* gave effective control of the public proceeding to a single creditor interest: "[I]t would appear that their priority rights, and the fact that they were undersecured, gave them control of the decision whether, and how, to sell or reorganize, and thus of the key moments of the case."[61] That control could permit the dominant creditor to achieve results it could not obtain outside of bankruptcy while permitting it to evade various inconvenient challenges[62] that otherwise exist within a bankruptcy case.[63] His analysis thus permits an enlarged reading of *Jevic* to forbid such ***218** control as against the public interest in an orderly, transparent, and fair bankruptcy procedure under court supervision. That reading of *Jevic* both identifies one broad public interest requiring protection and points more generally to the need for consideration of public interests in interpretation and application of bankruptcy law.

In my reading of Lipson's *LifeCare* analysis, the broad public interest he identifies is distinct from the interest of retaining certain rule-bound constraints like the absolute priority rule, although it is necessary to protection of that rule. Court control broadly preserves the power of Congress to set policy goals in bankruptcy. No set of rules can meaningfully enforce Congressional economic and financial policy if a private interest can take *de facto* control of the procedure.

That control interest was not directly related to any property right of the objecting creditor in *Jevic* or *LifeCare*. It was asserted by the objecting creditor, but not as a property right or as part of ownership of an unsecured claim as such. While in each case the objector's standing to assert the public interest did derive from a pecuniary claim against the debtor, the public interest asserted was not linked to a property interest as such. It is well-settled that no unsecured creditor has a property interest in the estate.[64] At most, the creditor had an opportunity to assert a general public interest and that sort of public interest, not the creditor's claim, was the one Lipson identifies as following from the Supreme Court's holding in *Jevic*.[65] Although in an adversary system it may be necessary for a public interest to be identified to the court by a party if it is to receive decisive attention, its relevance to a public interest should not turn on its relationship to that party.

b. Community Interests: The Art of Detroit

Professor Melissa Jacoby has given us an insightful commentary about the Detroit municipal bankruptcy.[66] The lessons to be learned may apply to commercial cases as well. In a Chapter 9 proceeding, there are many opportunities for public interests to be implicated in a host of different decisions, but some of those decisions can also arise in Chapter 11 cases of all kinds, especially where private companies are large and perform activities that ***219** greatly affect the functioning of society as a whole. Both high tech companies and other sorts of businesses fall into that category and therefore may present public interest issues much like those in the Detroit bankruptcy. The resolution of their financial difficulties may transcend their balance sheets.[67]

The most dramatic aspect of the Detroit bankruptcy (despite strong competition for that title) was the "Grand Bargain" that settled the case and permitted confirmation of a plan. Two major pieces of that solution led to the rescue of the magnificent collection of the Detroit Institute of Art ("DIA") and the substantial amelioration of the losses suffered by the city's vulnerable pensioners. The first is an example of a broad public interest beyond the scope of private interests, commercial or otherwise, while the second is a private interest imbued with a public one. Their linkage in the Detroit bankruptcy illustrates how very different interests can become intertwined in any large reorganization, crossing the boundaries of expectation and the different spheres of human activity. In so doing, they highlight the reality of a broad array of interests that must be reconciled by creative lawyers and judges, among others, in Chapter 11.

The story has been told by lawyers and law professors (notably Jacoby), museum experts,[68] pension experts,[69] municipal bond financiers,[70] and others.[71] In very brief summary, the city was the holder of legal title (or something like that) to a world-class art collection, including many of the usual suspects from the 19th Century.[72] Among major complications were valuations of the art varying by a billion dollars or so, turning like all valuations upon a host of assumptions and, shall we say, perspective.[73] Many creditors were looking to those assets to argue that they should receive more from the estate. The threat of sale was a powerful incentive for the City, and for many Michiganers not directly connected with Detroit, to care deeply ***220** about the potential disposition of the collection. Not surprisingly, there was serious litigation about the nature of the City's ownership under various agreements going back to the last century. As usual, that litigation served as the legal backdrop to any resolution of the status of the collection.

At the same time, the City's pensioners had a favored place in the Michigan constitution, but not in the Code. They risked a much lower place in the distributional pecking order in bankruptcy. Like tort creditors, they enjoyed the strong sympathy and support of nearly everyone, but no statutory preference from Congress. Other creditors had legally plausible--albeit legally muddy-- claims to priority.[74]

Into this hall of anomalies stepped Judge Rhodes, the presiding bankruptcy judge,[75] and Judge Rosen of the Detroit district court.[76] Using the leverage granted created by a shrewd use of statutory powers and deft exercise of diplomatic skills, this team, together with many other citizens, art lovers, union officials, and deal-seeking lawyers developed the Grand Bargain.[77] Within the Grand Bargain, they used a combination of donations from foundations[78] and hardball settlement agreements extracted from reluctant creditors[79] to i) greatly reduce the sacrifices demanded from pensioners while ii) separating the DIA from the City's financial fortunes forever more.[80] The result demonstrates vividly the power of public interests and teaches us important lessons.

The mechanism that achieved this result used public donations through the DIA to enable additional funds for the pensions in exchange for a release of the DIA from property of the estate.[81] Such a strange combination of duties and obligations would be hard to diagram on a law school whiteboard, yet it was achieved. It seems to me the result cannot be understood without recognizing the impact of the two public interests--the public interest in protecting pensioners as much as possible and the interest of the community ***221** in the art collection. Yet neither of those interests are found in the Code and each of them was subject to strong legal challenge by the property interests that were asserted by commercial creditors, including bondholders and lenders. It is telling that these commercial interests decided to compromise rather than duke it out in court.

Some might argue that the result sprang from improper or extralegal coercion. Someone with my perspective might instead suggest that if the legally relevant public interests of the community and the pensioners were given due weight, they might have prevailed in a litigation showdown.[82] That is, a judge sitting in the universal proceeding that is a Chapter 11 bankruptcy, binding the debtor, its stakeholders, and society *in perpetuam,* could and should give substantial weight to interests such as these public interests. That is a controversial assertion and I do not have the knowledge of the case that would permit me to defend it at length, but I think it should be an important example for a legislative agenda recognizing public interests.[83]

Up to now, it remains unclear that public interests are regarded as legitimate elements of decisions. Instead, in the face of the plain meaning rule and the lack of specific language in the statute recognizing the weight to be given public interests, judges may feel precluded from explicitly addressing those interests. As a result, judges may be forced either to ignore these interests or to give them weight only implicitly and perhaps without saying what they have done. I strongly suspect both things are happening. If the public interests have an influence that is substantial but invisible, much important accountability is lost even if the results are correct. My point is not to claim that the art-pension part of the Grand Bargain was right or wrong, but to argue that an explicit statutory recognition of the community's public interests could have permitted a transparent consideration of those interests on the merits. As things stand in the Code, that transparency may not be possible. If not, it should be, and could be, if the statute were amended as recommended ***222** here.[84]

The Detroit pensioners constituted a private interest arguably given too little weight in the Code as compared to the impact it would realistically have on this specific proceeding. The DIA was a community interest, an interest that might or might not have technical legal weight based on nonbankruptcy law but was much on the minds of important actors. Both interests were supported in the case by what might be called “silent” priorities based on deep moral and social commitments likely to be given some effect one way or another. Under the rule of law, we would want their effect to be expressly recognized, perhaps followed by an illuminating debate over the weight, if any, each should have been given. A key point is that the creditors who settled in the Detroit case must have thought it likely those interests would have considerable weight, whether or not acknowledged.

III. PROPOSALS

I believe Congress should consider adopting a provision that would instruct the courts acting in Chapter 11 cases to take account of public interests that would be materially affected by a decision. That instruction could have two aspects. The first would be a general duty to consider public interests in a bankruptcy proceeding. The second would be the identification of certain specific public interests that the courts should consider, if relevant. Both provisions would allow the court to weigh each public interest as it deems appropriate and provide an explanation for its reasoning. If the legislator were concerned about imposing too great a

burden on the courts, these duties could be limited to those raised by the court or by a party, although for this purpose "party in interest" should include parties who have a genuine and material stake of a nonclaim nature like the one asserted by the workers at Fancy Pants or community leaders in Detroit.

This approach could be divided into two stages. Congress could first adopt a more general provision to consider public interests, with the secondary long-term purpose that the general provision could serve as a device for identifying specific interests that deserve particular statutory protection. Over a period of time, experience as to particular public interests would reveal ***223** the need for a special provision for those interests. That would parallel the adoption process for § 332 (protection of consumer privacy)[85] and § 333 (protection of patients in health-care businesses),[86] a broad public interest and a type of private interest respectively that were adopted in the wake of industry developments and litigation illustrating new issues.

The language of equity, in all of its variants,[87] has not been widely abused in the one-hundred-twenty-year history of the modern American bankruptcy laws, suggesting a similar restraint would exist in the use of a public-interests provision. The generic language in 11 U.S.C. § 105 of the Code is often cited in discussions about, and attempts to encourage, a bankruptcy court to utilize its equitable powers, but the Code is filled with the language of equity. Limiting the results of a computer search of the Code to substantive usages of the word, we found nineteen uses of a variant of the term equity in eleven sections of the Code.[88] I would guess that the Code has more instances of such a broad term than most statutes, yet there are few examples of use of the term equity to expand unreasonably the existing powers of the court, at least in the reported cases. The appellate courts have kept a tight rein even where the bankruptcy courts have occasionally sought to invoke those powers.[89]

***224** Consider some of the eighteen occurrences of "equity" outside §105. Take, for example, 11 U.S.C. § 552 of the Code. It defines the extent to which a security interest remains effective after the filing of the petition. Section 522(a) cuts it off at that moment, but nonetheless §552(b) extends the security interest to post-petition proceeds of a pre-petition security interest. The proceeds section obviously protects a crucial property right for secured creditors in bankruptcy cases, yet the section ends with a potentially devastating caveat, limiting the after-acquired security interest "to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise."[90] Holy Grant Gilmore![91] It is hard to think of a broader extension of broad judicial power over a property interest, yet I am unaware of any claim that this power has been widely abused or that any abuse would not be adequately policed by the appellate bench.

Generally, a court exercises this authority with caution. Within its scope, power over security interests under 11 U.S.C. §552 has more profound potential for use or abuse than §105. The application of these statutes without widespread claims of abuse is a strong counter example--and by no means the only one--to any assertion of a parade of horribles based on the use of public interests provisions that might be added to the Code. To the contrary, having support in the Code from a public interest provision would encourage courts to surface these concerns and weigh them transparently, rather than strain to consider them in an oblique way.

IV. CONCLUSION

Chapter 11 is very much a vehicle for resolution of competing private obligations in a market economy, but that is not the only way in which this ***225** public mechanism is designed to serve public interests. It should have an additional tool to give judges the flexibility that a broad and universal proceeding like Chapter 11 requires for resolution of numberless possible scenarios. Given current fashions in statutory construction, we should explicitly provide in the Code for the consideration of other public interests in applying its provisions. Rather than tucking that consideration under the heading of "equity," we should embrace a transparent inclusion of societal interests in the resolution of financial distress. It is already there, hit or miss. It only remains to name it.

Footnotes

a1 Benno C. Schmidt Chair of Business Law, The University of Texas School of Law. I am grateful to Jonathon Lipson for some very helpful comments. I greatly appreciate the research supporting this paper by Alan Williams Texas '19; and Stephen Barry, Christopher Wawro and Christopher Weil, all Texas '20. I also learned a lot from the other papers presented and the commentary from our "senators." I claim any mistakes.

1 I emphasize the plural here--public interests--to avoid the notion that there is a singular public interest to be considered rather than a host of such interests that must be balanced among themselves and with private interests.

2 *See* Jay Lawrence Westbrook, *Commercial Law and the Public Interest*, 4 Penn. St. J.L. & Int'l Aff. 445, 445 (2015) (noting that the success of contractualist ideas have "forced to the background notions of broader social interests and the significant secondary effects of commercial law rules, leaving the policy debates focused largely on competing claims of efficiency and injustice to the immediate parties to an activity or transaction").

3 *See* discussion *infra* Section III; *see also* 11 U.S.C. § 1165 (2018) (mandating consideration of "the public interest in addition to the interest of the debtor, creditors, and equity security holders" when applying various Code provisions dealing with railroads); Julie A. Veach, Note, *On Considering the Public Interest in Bankruptcy: Looking to the Railroads for Answers*, 72 Ind. L.J. 1211, 1214-18 (1997) (discussing the history of railroad reorganizations); *id.* at 1228 (recommending that bankruptcy courts "weigh the benefits of allowing [public interest] groups to be heard against the costs in delay and confusion on the proceeding"); Alan Williams, Taking Chapter 11 Public 1-5 (May 2019) (unpublished memo) (on file with author) (discussing the areas of bankruptcy where consideration of the public interests may be appropriate, including deciding between competing plans, lifting the stay, confirming the plan, and granting injunctions). *See generally* Karen Gross, Failure and Forgiveness: Rebalancing the Bankruptcy System, 215 (1997) (especially Chapter 13, titled "Which Communities Matter within the Bankruptcy System?").

4 Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 Penn. L. Rev. 1715 (2018) (hereafter Jacoby, *Hybridity*). Professor Markell describes "the broad reach of bankruptcy over every aspect of a debtor's financial life." Bruce A. Markell, *Courting Equity in Bankruptcy*, 94 Am. Bankr. L.J. 227, 253 (2020).

5 *See generally* Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization After* Jevic, 93 Wash. L. Rev. 631 (2018) [hereinafter Lipson, *The Secret Life of Priority*]. Professor Casey discusses the problem of complexity in creating a need for reorganization. Anthony J. Casey, *The New Bargaining Theory of Corporate Bankruptcy and Chapter 11's Renegotiation Framework*, 1 (Mar. 16, 2019), https://ssrn.com/abstract=3353871 ("incomplete contracting"). Professor Karen Gross was a pioneer in elaborating the public interests in bankruptcy law and the suggestions in this paper owe a great deal to her work. *See generally* Gross, *supra* note 3. A recent article by Professor Jacoby persuasively describes Chapter 11 as a partnership between public and private values. Jacoby, *Hybridity*, supra note 4, at 1719.

6 *See* Nathalie Martin, *Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In*, 59 Ohio St. L.J. 429 (1998); Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. Ill. L. Rev. 503 (2001). The Congressional history of the examiner provision (1104) explicitly discusses the public interest. *See, e.g.*, Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 Am. Bankr. L.J. 1, 2 (2010) ("Congress created examiners to provide "special protection for the large cases having great public interest ... to determine fraud or wrongdoing on the part of present management.") (quoting 124 Cong. Rec. S17403-34124 daily ed., Oct. 6, 1978 (quoted in Collier on Bankruptcy, App. 14.4(f)(iii) (15th ed., Rev 2002)) (statement of Senator DeConcini)).

7 Absent the rare exception in which the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters, the plain meaning is conclusive. United States v. Ron Pair Enters., 489 U.S. 235, 242 (1989); *see, e.g.*, *In re* Vill. at Camp Bowie I, L.P., 710 F.3d 239, 245 (5th Cir. 2013) ("the Bankruptcy Code *must* be read literally, and congressional intent is relevant only when the statutory language is ambiguous") (emphasis in original). For a critique of the rule, see for example, William Baude & Ryan D. Doerfler, *The (Not So) Plain Meaning Rule,* 84 U. Chi. L. Rev. 539 (2017).

8 I am happy nonetheless to reaffirm, as my favorite casebook has long proclaimed, Chapter 11 as "an invitation to a negotiation." Elizabeth Warren, Jay Lawrence Westbrook, Katherine Porter & John Pottow, The Law of Debtors and Creditors 359 (7th ed. 2014)

(emphasis omitted). Nothing in this paper challenges the central role of Chapter 11 in facilitating private bargains required by financial distress. The theme here is that public interests also need a place at the table.

9 *See e.g.*, Herman M. Knoeller, *Reorganization Procedure Under the New Chandler Act*, 24 Marq. L. Rev. 12, 12 (1939) (the reorganization provisions of the Chandler Act "embodie[d] the new social economic concept of reorganization and the rehabilitation of the debtor and his business as a going concern, instead of the liquidation, distribution, and stoppage of business with the consequent loss to the debtor, creditors, employees, and the public generally").

10 *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775 (1987) [hereinafter Warren, *Bankruptcy Policy*]; Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. Chi. L. Rev. 815 (1987) [hereinafter Baird, *Loss Distribution*].

11 Professor Casey has recently posted a nicely nuanced balancing of the two views. *See infra* Section II.B.

12 A standard citation for this idea is *Butner v. United States*, 440 U.S. 48 (1979), where the Supreme Court held that bankruptcy courts should look to state law to determine whether a security interest extends to rents and profits under the Bankruptcy Act, not some federal rule of equity. *Id*. at 53-54. The Court acknowledged, however, that federal bankruptcy law preempts "state laws to the extent that they conflict with the laws of Congress, enacted under its constitutional authority [under U.S. Const. art. I, § 8, cl. 4]." *Id*. at 54 n. 9. In the Bankruptcy Code, Congress expressed its clear intent to alter parties' preexisting entitlements and these alterations have been upheld as constitutional. 11 U.S.C. § 507 (2018); Warren, *Bankruptcy Policy*, *supra* note 10, at 786 n. 20.

13 Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 101, 103 (1984); Baird, *Loss Distribution*, *supra* note 10, at 827.

14 Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 Yale L.J. 573, 576-77 (1998).

15 Warren, *Bankruptcy Policy*, *supra* note 10, at 786-87. Jacoby captures the point beautifully: "In addition to basic capital structure problems, bankruptcy dockets and courtrooms contain allegations of sexual harassment, race discrimination, systemic financial risk, First Amendment issues, toxic and defective products (medical devices, airplanes, and automobiles), global warming litigation, and pyramid schemes." Jacoby, *Hybridity*, *supra* note 4, at 1716.

16 For Warren, the different policy decisions between bankruptcy law and state collection law reflect the differing factual contexts in which bankruptcies and state collection actions arise. Warren, *Bankruptcy Policy*, *supra* note 10, at 782. State collection law must address the case of a single default where repayment might have little effect on other creditors' repayment prospects, whereas bankruptcy law must address the case of widespread default where a collapsing debtor is unable to repay some (or all) creditors in full. *Id*. at 781-82, 785.

17 Warren illustrates that change by comparing the narrower Holmesian view of contract law with the broader views of debtor-creditor law. *Id*. at 778-79. She notes that "[w]ithout the refined and balanced system of debtor-creditor law--which includes a well-developed concept of bankruptcy--contract law itself would look very different, and its enforcement would be considerably more constrained." *Id*. at 779.

18 Baird, *Loss Distribution*, *supra* note 10, at 822-23.

19 *Id*.

20 *Id*. at 824. The discomfort with bankruptcy law among a group of important bankruptcy scholars is striking. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751, 755 (2002) [hereinafter Baird & Rasmussen, *The End of Bankruptcy*]; Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673, 674-75 (2003) [hereinafter Baird & Rasmussen, *Chapter 11 at Twilight*]; Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (1986). The comparison might be to antitrust scholars who regularly inveigh for minimum regulation of cartels. *See* Maurice E. Stucke, *Should the Government Prosecute Monopolies*, 2009 U. Ill. L. Rev. 497 (2009); Christopher R. Leslie, *Trust, Distrust, and Antitrust*, 82 Tex. L. Rev. 515 (2004); Robert M. Spann & Edward W. Erickson, *The Economics of Railroading: The Beginning of Cartelization and Regulation*, 1 Bell J. Econ. & Mgmt. Sci. 227 (1970).

21 Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 Tex. L. Rev. 795, 821 n. 94 (2004) [hereinafter Westbrook, *Control of Wealth*]; Jonathan C. Lipson, *Controlling Creditor Control:* Jevic *and the End (?) of* LifeCare, 27 Norton J. Bankr. L. & Prac. 563, 565 n. 25 (2018) [hereinafter Lipson, *Controlling Creditor Control*].

22 *See, e.g.*, Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 Va. L. Rev. 155, 155 (1989) ("The cornerstone of the creditors' bargain is the normative claim that prebankruptcy entitlements should be impaired in bankruptcy only when necessary to maximize net asset distribution to the creditors as a group. ...").

23 Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857 (1982).

24 *See, e.g.*, Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 Tex. L. Rev. 51, 53-54, 100-107 (1992); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 Yale L.J. 1807, 1850 (1998); *see also* Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 Harv. L. Rev. 775 (1988). For empirical critiques of these views, see Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 Mich. L. Rev. 603 (2009) [hereinafter Warren & Westbrook, *The Success of Chapter 11*]; Elizabeth Warren & Jay Lawrence Westbrook, *Contracting out of Bankruptcy: An Empirical Intervention*, 118 Harv. L. Rev. 1197 (2005) [hereinafter Warren & Westbrook, *Contracting out of Bankruptcy*]; Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 Am. Bankr. L.J. 499 (1999) [hereinafter Warren & Westbrook, *Financial Characteristics of Businesses in Bankruptcy*]; Elizabeth Warren & Jay Lawrence Westbrook, *Searching for Reorganization Realities*, 72 Wash. U. L. Q. 1257 (1994) [hereinafter Warren & Westbrook, *Searching for Reorganization Realities*]; Teresa A. Sullivan, *Methodological Realities: Social Science Methods and Business Reorganizations*, 72 Wash. U. L. Q. 1291 (1994).

25 Rasmussen, *supra* note 24, at 53-54, 66. There were a number of difficulties with this system. Perhaps the most important difficulty was the fact that deemed consent did not work for tort claims and other nonconsensual creditors. Often contractualists simply threw up their hands as to bankruptcy treatment of nonconsensual claims, sometimes bestowing on them a special bankruptcy priority just to avoid the issue. Warren & Westbrook, *Searching for Reorganization Realities*, *supra* note 24, at 1261-62; *see* Schwartz, *supra* note 24, at 1810 n. 15; Rasmussen, *supra* note 24, at 67; *see also* Lynn M. LoPucki, *Contract Bankruptcy: A Reply to Alan Schwartz*, 109 Yale L.J. 317, 341 (1999) ("The principal problem in attempting to apply this theory in the context of bankruptcy is that most creditors' interests are too small to warrant their active, knowledgeable participation."); Lynn M. LoPucki, *Reorganization Realities, Methodological Realities, and the Paradigm Dominance Game*, 72 Was. U. L. Rev. Q. 1307, 1309 (1994) (noting that a failure to address issues surrounding tort victims "makes further analysis impossible.").

26 Westbrook, *Control of Wealth*, *supra* note 21. At least one empirical test for a dominant security interest is one in which secured creditors obtain security interests in substantially all of a debtor's assets. *Id.* at 796; *see* Baird & Rasmussen, *The End of Bankruptcy*, *supra* note 20; Baird & Rasmussen, *Chapter 11 at Twilight*, *supra* note 20.

27 Unpublished data from the Business Bankruptcy Project (2014 Chapter 11 cases in Delaware and New York). *See* also Jay Lawrence Westbrook, *Secured Creditor Control and Bankruptcy Sales: An Empirical View*, 2015 U. Ill. L. Rev. 831 (2015) (cases filed in 2002).

28 *See* Casey, *supra* note 5, at 20-37. Casey refers to his theory as the New Bargaining Theory of corporate bankruptcy. He puts forward both a normative and a descriptive claim. His normative claim is that the proper purpose of a bankruptcy system is to solve specific contracting problems that result from the uncertainties of financial distress. His descriptive claim is that Chapter 11 provides the renegotiation framework needed to solve those contracting problems.

29 Ultimately, that formulation risks question-begging, because "extraction" implies violation of an entitlement that surely has to come from nonbankruptcy law. But Casey is aware of these sorts of difficulties, and this is not the place to explore them. Generally, he wants to limit bankruptcy law to "bankruptcy stuff," but does not tell us very clearly how to distinguish it from other stuff. *See id.* at 42-45.

30 *See id.* at 20 (Casey argues that Chapter 11 attempts to minimize the destruction of value by providing a "structured bargaining space" where procedural and substantive constraints minimize the ability and incentive to "deviat[e] from the welfare maximizing course of action.").

31 *See supra* notes 5 & 6 (discussing scholarly views on the recognition of Chapter 11's public source and public concerns).

32 Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 Tex. L. Rev. 673 (2018); Charles J. Tabb, *Of Contractarians and Bankruptcy Reform: A Skeptical View*, 12 Am. Bankr. Inst. L. Rev. 259 (2004). This point

illuminates a central truth about the relationship of these public policy issues to venue and the enforcement of a bankruptcy decision in other jurisdictions: enforcement should be consistent with the deep public policies of the enforcing jurisdiction. Within a federated republic, venue rules should avoid the risk that a court might be required to enforce a judgment from another court with little real-world contact with the effects of that judgment. The point is even more profoundly cogent internationally. This paper is not the place to expound on it, but its logic requires the connection to be stated.

33 *See generally*, Warren, *Bankruptcy Policy*, *supra* note 10; Baird, *Loss Distribution*, *supra* note 10.

34 Professor Nathalie D. Martin has proposed amending the Bankruptcy Code to provide to employees a representative to protect their interests in matters affecting their future employment. Martin, *supra* note 6, at 478-79. *See infra* Part II.C.1. Professor Jonathan C. Lipson has raised concerns about how creditors are currently represented through committees, noting that committee members may hold both priority and general unsecured claims, creating conflicts of interest. Lipson, *The Secret Life of Priority*, *supra* note 5, at 675-676.

35 *See* Janis Sarra, *Corporate Governance Reform: Recognition of Workers' Equitable Investments in the Firm*, 32 Can. Bus. L.J. 384 (1999); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999); Gross, *supra* note 3, at 215.

36 Block-Lieb, *supra* note 6, at 529 (footnotes omitted).

37 *See generally* Warren, *Bankruptcy Policy*, *supra* note 10, at 785-89 (noting in detail that bankruptcy law seeks to maximize returns to present and future creditors by providing a centralized forum to resolve disputes); Baird, *Loss Distribution*, *supra* note 10, at 815 (agreeing with Warren's view of bankruptcy's function in this respect).

38 Martin, *supra* note 6, at 464-77 (noting that the Code does not consider the rights of workers or neighbors who would be affected by the disposition of property within the bankruptcy estate).

39 Casey stated possible examples of this sort of interest by asking whether it was possible to create a bankruptcy system which would consider an employee's interest in continued employment, a consumer's interest in low cost goods, and a government's interest in the continued collection of tax revenues. Casey, *supra* note 5, at 14.

40 *See* 11 U.S.C. §§ 333, 101(27A) (2018).

41 They included neighbors of a business to be sold to a strip joint and employees of a factory. Martin, *supra* note 6, at 432; *see* discussion *infra* Section III.

42 11 U.S.C. §§ 507(4), 1113.

43 Indeed, fairly often a distressed firm has benefited substantially from public investments in a way that may or may not be protected by legal interests in favor of the government. Often the reason for the investment was the preservation or creation of jobs.

44 *See* H.R. Rep. No. 95-595, at 220 (1977) ("The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, *provide its employees with jobs*, pay its creditors, and produce a return for its stockholders .... It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.") (emphasis added); *see also* Warren, *Bankruptcy Policy*, *supra* note 10, at 788; Martin, *supra* note 6, at 444 n. 63.

45 Section 1121(c) allows any party in interest to file a competing plan once one of three conditions is satisfied. *See* 11 U.S.C. § 1121(c)(1)-(3).

46 Section 1129(c) specifically provides that only one plan may be confirmed but provides no criteria for choosing among creditor-approved plans.

47 The only requirement that § 1129 places on the court is that it "shall consider the preferences of creditors and equity security holders in determining which plan to confirm." 11 U.S.C. § 1129(c). Courts are quick to note that this only requires the courts to consider the preferences, not necessarily obey them. *In re* Internet Navigator Inc., 289 B.R. 128, 131-32 (Bankr. N.D. Iowa 2003) (citing *In re* River Village Assocs., 181 B.R. 795, 807 (E.D Pa. 1995)). Instead, many courts use a four-factor test when confronted with competing plans: 1) the type of plan; 2) the treatment of creditors and equity security holders; 3) the feasibility of the plan; 4) the preferences

of creditors and equity security holders. *In re Internet Navigator Inc.*, 289 B.R. at 131 (citing *In re* Holley Garden Apartments, Ltd., 238 B.R. 488, 493 (Bankr. M.D. Fla. 1999)); *see also In re* TCI 2 Holdings, LLC, 428 B.R. 117, 182 (Bankr. D.N.J. 2010).

48 It is rare for future employment issues even to be mentioned, as one court did in a senior-living-home case where two plans had been approved by creditors, noting "neither Merrill Gardens nor Encore has expressed any wish or intent not to reemploy employees who currently provide services at [debtor]." *In re* Orchards Village Invs., LLC, No. 09-30893, 2010 WL 143706, at *22 (Bankr. D. Or. Jan. 8, 2010).

49 Her hypothetical case presents a sale, presumably under or in connection with a plan. Martin, *supra* note 6, at 468-70.

50 *Id*. at 463-64 (footnotes omitted).

51 She discusses the work of Professor Joseph Singer. *Id*. at 478-97. His work illustrates the effect of the idea that no interest should be considered unless supported by a preexisting entitlement. For him, a public interest can be considered in bankruptcy only if it is a property interest recognized outside of bankruptcy or, at a minimum, as a preexisting limitation on a property interest, along the lines of something like a "public use" restriction on the operation of a lodging house under common law. I would resist the idea that a nonbankruptcy property interest or use-restriction must be identified in order to be given consideration in bankruptcy, although the existence of a legal interest or limitation of course supports the claim that a public interest requires it.

52 Not to speak of the multiplier impact on the community in question in terms of the loss of jobs and the likely increases in public burdens. There is always a trade-off between flexibility and predictability. That tradeoff can be weighed in cases like this one, where the risk to predictability is greater where the gap between the two values is large and minor where it is small.

53 Martin, *supra* note 6, at 477.

54 *Id*. at 470.

55 *In re* HHH Choices Health Plan, LLC, 554 B.R. 697 (Bankr. S.D.N.Y. 2016)

56 Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).

57 Lipson, *The Secret Life of Priority*, *supra* note 5, at 631.

58 *In re ICL Holding Co, Inc.*, 802 F.3d 547 (3d Cir. 2015).

59 Lipson, *Controlling Creditor Control*, *supra* note 21, at 564-65.

60 *Id*. at 564.

61 *Id*. at 570.

62 Lipson suggests that one effect of the dismissal in LifeCare was to escape the prospect of a fraudulent conveyance action that would have adversely affected the DIP lender. *Id*. at 573-74.

63 Westbrook, *Control of Wealth*, *supra* note 21, at 843-44. Several authors in the Illinois secured credit symposium, *supra* note 27, made the point that secured creditors should not enjoy the benefits of the bankruptcy stay and yet ignore the underlying policies of bankruptcy law, which fits nicely with the ruling in *Jevic*. The general public interest provision that I propose to be added to the Code would make it more likely public interests would be noticed and considered. It would also provide statutory authority to enforce public interests not separately identified in the Code, just as the current equity provisions are read to do implicitly.

64 *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 588 (1935) (explaining "the position of a secured creditor, who has rights in specific property, differs fundamentally from that of an unsecured creditor, who has none ..."); *In re* Garland Corp., 6 B.R. 456, 462-63 (B.A.P. 1st Cir. 1980) (noting that "an unsecured claim confers no right in specific property ....").

65 As discussed below, absent identification of a public interest sua sponte by the court, it must be raised by a party in interest in the case, but that is a procedural constraint and not a limitation on the relevance or salience of such a claim. One illustrative example is a public interest claim raised by a UST who automatically has standing.

66 Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 Yale J. on Reg. 55 (2016) [hereinafter Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*]. Her research included many hours of virtual attendance at the large number of hearings in the case.

67 PG&E is the obvious recent non-tech example. Katherine Blunt & Russell Gold, *PG&E Files for Bankruptcy Following California Wildfires*, Wall St. J. (Jan. 29, 2019), https://www.wsj.com/articles/pge-files-for-bankruptcy-following-california-wildfires-11548750142.

68 Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, *supra* note 66, at 79 n. 174.

69 *Id*. at 80 n. 176.

70 *Id*. at 79-80 n. 175.

71 *See Id*. at 79 n. 170 (City Council President); *id*. at n.171 (Mayor); *id*. at n. 172 (City Emergency Manager).

72 *See generally* Randy Kennedy, *Grand Bargain Saves the Detroit Institute of Arts*, N.Y. Times (Nov. 7, 2014), https://www.nytimes.com/2014/11/08/arts/design/grand-bargain-saves-the-detroit-institute-ofarts.html; Matthew Dolan, *In Detroit Bankruptcy, Art was Key to the Deal*, Wall St. J. (Nov. 7, 2014), https://www.wsj.com/articles/in-detroit-bankruptcy-art-was-key-to-the-deal-1415384308; Daniel Fisher, *How Detroit Saved Its Art Collection From the Bill Collectors*, Forbes (Nov. 7, 2014), https://www.forbes.com/sites/danielfisher/2014/11/07/how-detroit-saved-its-art-collection-from-the-bill-collectors/#4cd603ec10a5.

73 Mark Stryker, *Fight over DIA value resumes in court next week*, Det. Free Press (Sept. 25, 2014), http://usat.ly/1peLFKa; Nathan Bomey & Mark Stryker, *Detroit's art treasures to be focus of hearing*, Det. Free Press (Jan. 21, 2014), http://usat.ly/1mqsuLL.

74 It is striking that a society can be as lawyered up and as thoroughly stuffed with laws as ours and yet have apparent legal entitlements so unclear as these and moral entitlements so unsupported by law. The Detroit case is a dramatic demonstration of those facts, but not a rare one.

75 Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, *supra* note 66, at 73.

76 *Id*. at 74.

77 *Id*. at 84-85.

78 *Id*. at 85.

79 Nathan Bomey, John Gallagher & Mark Stryker, *How Detroit Was Reborn: The Inside Story of Detroit's Historic Bankruptcy Case, ch. 12, Pensioners agree to a once unthinkable concession*, Det. Free Press (Nov. 9, 2014), http://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/09/detroitbankruptcy-rosen-orr-snyder/18724267/ (describing a last minute concession from the city's pensioners to accept a 34 percent cut for civilian pensioners, a 10 percent cut for police and fire pensioners, and a waiver of future claims against the city); *id*. at *ch. 8, The Christmas Eve Massacre - a deal is rejected* (describing a $125 million dollar reduction in the settlement amount paid to banks holding claims against the city).

80 Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, *supra* note 66, at 71.

81 *Id*. at 84-85.

82 There was similar criticism in the *Nortel* case. *See* Jay Lawrence Westbrook, *Nortel: the Cross-Border Insolvency Case of the Century* 8 J. Int'l Banking & Fin. Law 498 (2015) (noting that the legally sound decision to treat the proceeds of the asset sales as belonging to no single entity in the Nortel bankruptcy was subjected to the criticism that the courts were straining to help pensioners over bondholders as a matter of equity). As I commented there, "Compassion is admittedly hard to stamp out, but in this case, there are strong reasons to think that the best answer was the right answer as well." *Id*. at 498.

83 Professor Jacoby, perhaps the leading academic expert on the Detroit case, suggests alternative priorities for many Detroiters. For example, some of them faced massive water bills from leaks near their houses for which they were not responsible. No foundation money for them. Joe Guillen & Matt Helms, *Detroiters testify about water shutoffs, lack of aid*, Det. Free Press (Sept. 22, 2014), https://www.freep.com/story/news/local/detroit-bankruptcy/2014/09/22/bankruptcy-water-hearing/16045643/. Of course, there is a

longstanding moral question choice between the poor and the culture of a community. Should citizens support the ballet or give their available funds to the homeless? There are many such questions that will not be answered in this paper. My central contention is that judges should announce whether they have considered these competing interests.

84 Professor Coordes makes the insightful point that bankruptcy is among the few federal laws that do not have an administrative agency making substantive rules (although the US Trustees office comes closest to that). That is another important reason for applying equity in the broadest sense or, better still, making public interests explicit in the Code. Laura N. Coordes, *Narrowing Equity in Bankruptcy*, 94 Am. Bankr. L.J. 303 (2020). She offers a helpful discussion of a doctrine called "the equity of the statute" that may serve as a useful bridge to such a provision. *Id*. at 315-18. On the other hand, Professor Markell captures how difficult it is for the courts to employ "inherent powers" or other doctrines to address important questions not covered by an explicit statutory provision and not offering a clear discretion. Markell, *supra* note 4, at 238 n.62.

85 Congress added § 332 following the Federal Trade Commission's actions against Toysmart.com, LLC ("Toysmart"). *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No., 109-8, § 231, 119 Stat. 23, 72-73 (2005) (amending 11 U.S.C. § 363(b)(1)(B) and adding 11 U.S.C. § 332). Toysmart was an online retailer that sold children's toys during the dot-com boom. Toysmart collected vast amounts of personal information about its customers including names, addresses, billing information, and birthdays. *See FTC Announces Settlement With Bankrupt Website, Toysmart.com, Regarding Alleged Privacy Policy Violations*, FTC: Press Release (July 21, 2000), https://www.ftc.gov/news-events/press-releases/2000/07/ftc-announces-settlement-bankrupt-website-toysmartcom-regarding. The information was collected under a privacy policy; however, in bankruptcy, Toysmart attempted to sell the information to the highest bidder. *See* Complaint for Permanent Injunction and Other Equitable Relief at Ex. 1, *Fed. Trade Comm'n v. Toysmart.com, Inc.*, No. 00-11341 (D. Mass. July 23, 2004). The case ultimately settled, and the terms of the settlement provided the framework for § 332. *See* Michael St. Patrick Baxter, *The Sale of Personally Identifiable Information in Bankruptcy*, 27 Am. Bankr. Inst. L. Rev. 1, 8 (2019).

86 Congress adopted § 333 in response to a scandal in which a bankrupt nursing home closed its doors in the middle of the night without giving its residents or their families any notice. Erin Masin, *The Patient Care Ombudsman: Taking Cost Out of Patient Care Considerations*, 26 Emory Bankr. Dev. J. 91, 93-95 (2009). The provision requires the court to appoint a patient care ombudsman to "monitor the quality of patient care and to represent the interests of the patients" in bankruptcies involving a "health care business." 11 U.S.C. § 333 (2018).

87 We used the search term "equit!" (equity, equitable, etc.) in the text of the Code and found it in forty-seven sections. (Interestingly, "inequit!" (inequity, inequitable, etc.) returned zero results.)

88 This was our count after we omitted "equitable interest," "equitable proceeding," and "equity security," "net equity," and similar usages.

89 A recent illustration is found in *Law v. Siegel*, 571 U.S. 415 (2014) (bankruptcy court may not use its equitable powers to surcharge an exemption of the debtor to allow the recovery of $500,000 in attorneys' fees arising from debtor fraud). In our public presentation of these papers, Kenneth Klee used my pick-aplan example to suggest that it would be difficult to conduct appellate review of decisions based on a broad public interest provision in the statute. Transcript of Symposium on "Equity in The Bankruptcy Court" at the National Conference of Bankruptcy Judges (October 31, 2019), *in* 94 Am. Bankr. L.J. 344-45 (2020) [hereinafter Transcript]. I think there, and elsewhere in our jurisprudence, that sort of review should be routine. Faced with a decision in the bankruptcy court choosing a plan based on future employment of current workers, an appellate court that disagreed might say "The public interest in employment is no doubt great, but Congress in sections 1113-1114 has preferred successful reorganization to employee rights and there is no reason to think it would have made a different choice here, so consideration of that factor--as opposed to weighing the number of votes or which is the most feasible plan--misapplies the statute." Merits aside, that would be a straightforward and transparent judicial act, leaving lawyers, the Supreme Court and Congress clear about the ground for decision. Lawyers would have a useful predictive tool and the Court and Congress would be well positioned to adopt or reject that decision, making things just as they should be.

90 11 U.S.C. § 552(b)(1). Professor Dick found in her survey of bankruptcy judges a pronounced emphasis on caution in using equity powers. Dick, *supra* note 84, at 275; Transcript, *supra* note 89, at 340 ("So the judges who participated in my study are being extremely thoughtful and measured in their exercise of their discretionary powers.").

91 *See generally* Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 Ga. L. Rev. 606 (1981); Grant Gilmore, Security Interests in Personal Property (1965). *See also supra* note 3 (noting the broad public interest standard in § 1165 of the Code).

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