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ABI BATTLEGROUND WEST 2021 CROSSFIRE PANEL

I. The Importance of "Chutzpah" in the PG&E Case

Should Bankruptcy Judges be bound by the *Cardelucci* case with respect to interest rates in a solvent case?

- Judge Montali decided in the PG&E case that he did not have the "chutzpah" to go against Ninth Circuit precedent from the 2002 *Cardelucci* case. Following *Cardelucci*, the court applied a fixed federal rate to the claims instead of the higher rates in the noteholders' pre-Chapter 11 contracts. The Ninth Circuit B.A.P. affirmed Judge Montali.

- The difference the between the parties' proposed interest rates in unsecured debt alone would have been approximately $500 million.

- Since the PG&E decision, the courts have split on this issue. Judge Louise D. Adler in San Diego held that unsecured creditors of a solvent debtor in chapter 11 are only entitled to post-petition interest at the lower federal judgment rate, not at the higher contract rate or state judgment rate. Judge Adler disagreed with Judge Marvin Isgur of Houston, who had ruled a few months earlier in October, 2020, that the survival of the so-called solvent debtor exception entitles creditors of a solvent debtor to receive interest at the higher contract rate.

Pro: Ninth Circuit precedent and the Bankruptcy Code are clear that the fixed federal rate is the correct interest rate for unsecured claims against a solvent company. As Judge Montali stated, the rule in the seventeen years since *Cardelucci* is clear: unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition contracts call for higher or lower rates. Nor is that rule limited to impaired claims.

Con: *Cardelucci* did not involve unimpaired classes. A class cannot be considered unimpaired if it is not getting exactly what it bargained for in the prepetition contract.

Cases:

In re Pacific Gas & Electric Co., 610 B.R. 308 (Bankr. N.D. Cal. 2019).

Onink v. Cardelucci (In re Cardelucci), 285 F.3d 1231 (9th Cir. 2002)

In re Ultra Petroleum Corp., No. 16-03272, 2020 WL 6276712 (Bankr. S.D. Tex. 2020)

In re Cuker Interactive, LLC, 622 B.R. 67 (Bankr. S.D. Cal. 2020)

Topic: The Cannabis Conundrum

II. Issue: Should a Court confirm a plan of reorganization when a cannabis business is involved?

Pro – Yes (*Leslie Cohen*):

A. Trend and public policy favors "yes"

Though a "Schedule I" controlled drug[1] (absurdly scheduled alongside heroin) per the Controlled Substances Act (CSA) since 1970[2] [Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, as amended], the acceptance of cannabis is undergoing a major shift, with states paving the way (and they have been since Oregon was the first to decriminalize medical marijuana in 1973). Recently, California passed MAUCRSA [Medical and Adult Use Cannabis Regulation and Safety Act] in 2017 to allow (with heavy elements of local control) for adults to not only use medicinal marijuana, but small amounts recreationally as well.

The federal government has indicated a de-prioritizing a marijuana investigations and prosecutions despite cannabis remaining a "Schedule I" substance; the Department of Justice guidance in at least five memoranda on the subject have hardly clarified things, but the trend is undoubtedly toward prosecutorial discretion in line with higher-priority crimes.[3] In 2015, Congress passed the Rohrabacher-Farr Amendment (renewed annually[4]) to amend the Commerce, Justice, Science, and Related Agencies Appropriations Act of 2016, to allocate already limited federal resources towards prosecution of extremely dangerous persons, such as terrorists, rather than enforcement of laws against individuals using marijuana for medical purposes or those related businesses.

In the Agricultural Improvement Act of 2018, hemp (and THC found in hemp) was excluded from the definition of marijuana in the CSA, in an effort to clarify how the FDA will regulate the use of CBD oil under the Food, Drug & Cosmetic Act (and Public Health Service Act).

On June 7, 2018, Senator Elizabeth Warren introduced Senate Bill 3032, the Strengthening the Tenth Amendment Through Entrusting States Act ("STATES Act"). This bill, "eliminates regulatory controls and administrative, civil, and criminal penalties under the Controlled

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[1] 21 C.F.R. §1308.11 Schedule I; 21 U.S.C. §§ 801 *et seq*.

[2] An early twentieth century attempt to effective make marijuana illegal, the "Marihuana Tax Act of 1937" was ruled unconstitutional by the Supreme Court in 1969 in *Leary v. United States*, 395 U.S. 6 (1969) and repealed with the passage of the CSA in 1970.

[3] Ogden Memo, October 19, 2009; Cole Memo (First), June 29, 2011; Cole Memo (Second), August 29, 2013; Cole Memo (Third), February 14, 2014; Sessions Memo, January 4, 2018. The Sessions Memo did not rescind a related report of February 14, 2014, issued by the Treasury Department, entitled "Department of Treasury Financial Crimes Enforcement Network Guidance."

[4] In 2019, the House passed the Blumenauer Amendment, which extends the Rohrabacher – Farr Amendment by "prohibiting the Department of Justice from interfering with state cannabis programs." This would affect the FY 2020 budget for federal agencies as outlined in H.R. 3055 – Further Continuing Appropriations Act, 2020, and Further Health Extenders Act of 2019. However, the Senate Appropriations Committee did not include the amendment in the FY 2020 budget (but did pass the Rohrabacher – Farr Amendment for the FY 2020).

Substances Act for marijuana-related conduct and activities that are authorized by state or tribal law, subject to specified exceptions."

The trend at both the federal and state level is overwhelmingly on the side of legalization, and as a result a great deal of not just cannabis business but cannabis *related* businesses have cropped up. Are we prepared to call *all* of these business owners *criminals*?

In 2019, Congressman Ed Perlmutter introduced H.R. 1595: Secure and Fair Enforcement Banking Act of 2019 ("SAFE Act") to the House of Representatives. This bill "generally prohibits a federal banking regulator from penalizing a depository institution for providing banking services to a legitimate marijuana-related business." This bill was passed by the House and is at the Senate Committee on Banking, Housing, and Urban Affairs. Thus, there has even been federal moves to make it easier for cannabis-related businesses to deal with banks (who historically have exhibited some of the same hesitance that some in the bankruptcy community may feel). Are we really going to say banks can deal with marijuana but federal courts are ill-equipped to do so?

The conservative apprehension of the U.S. Trustee should not trump the will of the people expressed in state and federal legislation. So if we are talking about *should* than absolutely. *Can* is an equally interesting question, and the landscape shifted dramatically after a 2019 decision out of the Ninth Circuit: *Garvin*.

Supporting Cases:

Garvin v. Cook Invs. NW, No. 18-35119, 2019 WL 1945280 (9th Cir. May 2, 2019)

B. Can the court confirm a plan involving a marijuana-based business in the 9th Circuit? Yes after *Garvin*

Though it has been called a "boogeyman of bankruptcy jurisprudence," marijuana is not necessarily unique in that it presents a difficult case of bankruptcy courts wrestling with violations of non-bankruptcy law.[5] Still, while courts have exhibits varying levels of hesitance, the tide may be changing. While precedent thus far seems well established that, currently, bankruptcy courts cannot facilitate relief for *direct* cannabis businesses (such as dispensaries, cultivators), the same broad prohibition cannot be said after the Ninth Circuit's 2019 decision in *Garvin*. *Garvin v. Cook Invs. NW*, No. 18-35119, 2019 WL 1945280 (9th Cir. May 2, 2019). There, a Washington debtor-landlord (one of several real estate holding companies) proposed a chapter 11 plan of reorganization which included rent received from a company that cultivated cannabis in compliance with Washington state law. The U.S. Trustee objected to the plan, citing 11 U.S.C. § 1129(a)(3): "[t]he court shall confirm a plan only if all of the following requirements are met … [t]he plan has been proposed in good faith and not by any means forbidden by law." Though the debtor agreed to amend the plan to segregate rents, it admitted it would still collect rents from the tenant. The Trustee did not renew a dismissal motion, but still challenged the plan on the grounds

[5]"It is worth noting, however, that bankruptcy courts have a long history of considering cases involving debtors whose activities and operations have included past, present and possibly ongoing violations of applicable non-bankruptcy, civil and criminal laws." *In re CW Nevada LLC*, 602 B.R. 717, 728, FN 25 (Bankr. D. Nev. 2019).

it was not confirmable because of the rents derived from an "illegal enterprise." The Ninth Circuit disagreed with the U.S. Trustee:

> Whether the Amended Plan was confirmable depends on whether § 1129(a)(3) forbids confirmation of a plan that is proposed in an unlawful manner as opposed to a plan with substantive provisions that depend on illegality, an issue of first impression in the Ninth Circuit. . . . [W]e conclude that § 1129(a)(3) directs courts to look only to the proposal of a plan, not the terms of the plan."[6]

Calling it a "straightforward question of statutory interpretation," the Ninth Circuit plainly summarized the "problem with the Trustee's theory is that it ignores the plain text of § 1129(a)(3), which directs bankruptcy courts to police the means of a reorganization plan's *proposal*, not its substantive provisions." [emphasis in original] According to *Garvin*, the Code in §1129(a)(3) is concerned with the proposal of the plan, not its contents, a proposition that is already finding traction.[7]

So, depending on the scope of the involvement, §1129(a)(3) is not a bar to confirmation. As the Washington District Court noted, "bankruptcy courts are neither regulatory nor criminal courts."[8]

The *Garvin* court acknowledged "that some bankruptcy courts have accepted the Trustee's interpretation." They take a hard-line approach, saying for instance that "§ 1129(a)(3) forecloses any possibility of this Debtor obtaining confirmation of a plan that relies in any part on income derived from a criminal activity." *In re Rent-Rite Super Kegs W. Ltd.*, 484 B.R. 799, 809 (Bankr. D. Colo. 2012). There are others beyond those mentioned by *Garvin*. In *In re Arm Ventures, LLC*, 564 B.R. 77 (Bankr. S.D. Fla. 2017), the debtor, a commercial building owner, sought to lease to a medical marijuana facility, which the court ruled as illegal and in "bad faith" – however, the court declined to dismiss the case due to significant non-insider unsecured claims, and permitted the secured lender relief from the automatic stay to foreclose). In *In re Way to Grow, Inc.*, Case No. 18-14330-MER, Dkt. No. 379 (Bankr. D. Co. Dec. 14, 2018), a debtor who sold indoor hydroponic supplies sought to expand to the cannabis industry (though the debtor's materials were used for other types of crops as well), and a secured creditor sought dismissal for violation of the CSA. The debtor, which merely sold equipment, could not persuade the court, which dismissed the bankruptcy case.[9]

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[6]Citing *Irving Tanning Co. v. Me. Superintendent of Ins. (In re Irving Tanning Co.)*, 496 B.R. 644, 660 (1st Cir. B.A.P. 2013).

[7]See *In re Claar Cellars LLC*, No. 20-00044-WLH11, 2021 WL 137732 (Bankr. E.D. Wash. Jan. 14, 2021) (citing *Garvin*); *In re Juarez*, No. 19-60051, 2020 WL 7398994, at *1 (9th Cir. Dec. 17, 2020) [same] [unpublished].

[8]*In re Cook Investments NW, SPNWY, LLC.*, No. 17-5516 BHS, 2017 WL 3641914, at *2 (W.D. Wash. Aug. 24, 2017).

[9]Relying heavily on a 10th Circuit BAP decision, *Arenas v. United States Trustee (In re Arenas)*, 535 B.R. 845 (10th Cir. BAP 2015). Though the bankruptcy court held the segregation of income derived from cannabis was not permissible in *In re Johnson*, 532 B.R. 53 (Bankr. W.D. Mich. 2015) (Chapter 13 debtor held a license as a marijuana grower under the Michigan Medical Marijuana Act (MMMA)), the court did not automatically dismiss the case.

Thus, while other courts have held that any tangential touching of the growing cannabis industry is *per se* "bad faith" because it is proposed in a means "forbidden by law," the Ninth Circuit has soundly reasoned that this goes beyond the requirements of the Bankruptcy Code, and a lessor who deals with a tenant who may be related to the cannabis industry is not automatically ineligible for bankruptcy relief.[10]

The Bankruptcy Appellate Panel has held in at least one instance that a bankruptcy court's *sua sponte* dismissal, without clear fact finding, of a case that may involve income from a dispensary, was inappropriate. Judge Tight writes in *Olson v. Van Meter (In re Olson)*, 2018 Bankr. LEXIS 480 (B.A.P. 9th Cir. Feb. 5, 2018): "When a court imposes the harsh penalty of dismissal in circumstances such as those presented here, it is imperative that it state with clarity and precision its factual and legal bases for doing so."

The Ninth Circuit decision makes good sense. Besides being the first major court to finally square the issue with the undeniable trends towards legitimacy (discussed above), it makes a crucial distinction in the oversight duties and capabilities of courts. The other hard line position, that some other courts have taken, holds that for instance a landlord cannot receive even a single penny for a cannabis-related tenant – even if that amount is segregated and not put toward creditor payments under a plan – such a result is ultra-harsh and ultimately will work a great burden to property owners. Bankruptcy judges are not landlords and their judgment was never meant to substitute for that of landlords or landowners.

As a side note, perversely the contrarian position would punish those landlords who do inquire as to the business of their tenants. Punishing the active and knowledgeable landlord surely is not the aim of the Bankruptcy Code? Must a plan include the business of every tenant of a multi-unit lessor?

After *Garvin* there is good precedent in this Circuit for the reorganization of debtors who are *ancillary* to the cannabis industry, as there very well should be.[11] And there may even "be cases where Chapter 11 relief is appropriate for an individual or a non-individual entity directly engaged in a marijuana-related business."[12] To hold otherwise would create untenable consequences.

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[10]A response to *Garvin* swiftly came out the Michigan bankruptcy court, *In re Basrah Custom Design, Inc.*, 600 B.R. 368 (Bankr. E.D. Mich. 2019), which held under similar facts that a commercial lease to a marijuana cultivator was a violation of the CSA and presented unclean hands, leading to an unconfirmable plan and dismissal of the case. The *Barash* court explicitly rejected *Garvin*. Other courts have accepted *Garvin*'s reasoning generally as it relates to 1129(a)(3). E.g. *In re Dernick*, No. 18-32417, 2020 WL 6833833, at *1 (Bankr. S.D. Tex. Nov. 20, 2020).

[11]Potentially even direct, if related to CBD products. *See In re Cwnevada LLC*, 2019 Bankr. LEXIS 1770 (Bankr. D. Nev. May 15, 2019).

[12]*In re CWNevada LLC*, 602 B.R. 717, 747 (Bankr. D. Nev. 2019) (debtor's case dismissed on abstention grounds given pending state proceedings at time of filing).

Supporting Cases:

Olson v. Van Meter (In re Olson), 2018 Bankr. LEXIS 480 (B.A.P. 9th Cir. Feb. 5, 2018)

Northbay Wellness Group, Inc. v. Beyries, 789 F.3d 956 (9th Cir. 2015)

Butner v.US., 440 U.S. 48 (1979)

Irving Tanning Co. v. Me. Superintendent of Ins. (In re Irving Tanning Co.), 496 B.R: 644, 660 (1st Cir. B.A.P. 2013)

Con – No (*Robbin Itkin*):

C. Should the court confirm a plan involving a marijuana-based business? No as required under Federal Law.

Bankruptcy courts should not permit restructurings or liquidations of marijuana related or marijuana adjacent businesses. Marijuana is a Schedule 1 controlled substance under the Controlled Substances Act, 21 U.S.C. § 801 *et seq.,* and, as such, no plan can be submitted in compliance with applicable law. Additionally, it would be impermissible to allow a trustee to administer marijuana related assets because doing so would violate other federal law. Given the supremacy of federal law, even where states authorize marijuana-related businesses, bankruptcy courts, as federal courts, cannot sanction violation of federal law. This issue must be resolved by the U.S. Congress-it is not appropriate for bankruptcy court resolution.

Despite the *Garvin* holding, courts still should not approve plans where the trustee could arguably need to distribute proceeds or other monies from a cannabis-based business, or otherwise involve itself in the affairs of such a business. In a recent case in the Chapter 13 context, *In re Burton*, 610 B.R. 633 (BAP 9th Cir. Jan. 14, 2020), Chapter 13 debtors sought confirmation of their Chapter 13 plan. The Debtors owned a 65% interest in a medical marijuana LLC, which, while no longer operational or income-generating, was party to a litigation in which it could have a recovery. The Bankruptcy Court dismissed the Chapter 13 case pursuant to §§ 105(a) and 1307(c), concluding that under these circumstances the court could find itself involved in distributing proceeds of the marijuana LLC's litigation. The BAP affirmed the ruling.

Supporting Cases:

In re Burton, 610 B.R. 633 (BAP 9th Cir., Jan. 14, 2020)

In re Basrah Custom Design, Inc., 600 B.R. 368 (Bankr. E.D. Mich. 2019)

In re CWNevada LLC, 2019 Bankr. LEXIS 1770 (Bankr. D. Nev. May 15, 2019)

In re Mother Earth's Alternative Healing Coop., Inc., Case No. 12-10223, Doc. No. 54 (Bankr. S.D. Cal. Oct. 23, 2012)

In Rent-Rite Super Kegs West Ltd., 484 B.R. 799 (Bankr. D. Colo. 2012)

In re Arenas, 514 B.R. 887 (Bankr. D. Colo. 2014)

D. Can the court confirm a plan involving a marijuana-based business in the 9th Circuit? No, and this answer is not changed due to the *Garvin* decision

Garvin is thoroughly distinguishable from cases involving marijuana-based businesses seeking chapter 11.

Garvin was decided based upon an improper objection to the Plan. The bankruptcy court denied the UST' s motion to dismiss filed at the beginning of the case, but with leave to renew the motion to dismiss at the plan confirmation hearing. The UST did not renew that motion, but instead filed the objection to the plan based on 1129(a)(3).

The Debtor unquestionably was in violation of the federal Controlled Substances Act, 21 U.S.C. Sections 801-971, which prohibits "knowingly ... leas[ing] ... any place ... for the purpose of manufacturing, distributing, or using any controlled substance .... " By perpetuating a violation of federal law, and basing plan payments to creditors on funds from such illegal activity, the plan and payments relied upon by creditors were at risk. Accordingly, rather than 1129(a)(3), the UST's objection should have been based upon 1129(a)(ll) - the Debtor could not meet the required element that "the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."

The law cannot possibly support violations of federal law just because creditors in a bankruptcy case do not object to the violations. Further, the violator of federal law comes to the Bankruptcy Court with "unclean hands."

Garvin was compellingly criticized by *Way to Grow* as improperly interpreting applicable case law under 1129(a)(3)-- by avoiding an interpretation of 1129(a)(3)'s "means forbidden by law" prong and instead grounding its holding on the plan being "proposed in good faith" prong.

Supporting Cases:

In re Way to Grow, Inc., No. 18-CV-3245-WJM, 2019 WL 6332541 (D. Colo. Sept. 18, 2019

Garvin v. Cook Invs. NW, No. 18-35119, 2019 WL 1945280 (9th Cir. May 2, 2019)

In re Basrah Custom Design, Inc., 600 B.R. 368 (Bankr. E.D. Mich. 2019)

In re CW Nevada LLC, 2019 Bankr. LEXIS 1770 (Bankr. D. Nev. May 15, 2019)

In re Mother Earth's Alternative Healing Coop., Inc., Case No. 12-10223, Doc. No. 54 (Bankr.

S.D. Cal. Oct. 23, 2012)

In Rent-Rite Super Kegs West Ltd., 484 B.R. 799 (Bankr. D. Colo. 2012)

In re Arenas, 514 B.R. 887 (Bankr. D. Colo. 2014)

III. SBRA…One Year Later

Is the Small Business Reorganization Act of 2019 a positive improvement in the law?

Pro – More than one year after its effective date, it is clear that the SBRA has served its purpose. The SBRA has made chapter 11 reorganization more accessible to small business debtors, as evidenced by the more than 80 Sub Chapter V cases that have been filed (or have elected Sub Chapter V retroactively) in the Central District of California alone. The streamlined legal process improves judicial economy and allows the debtor to focus its time and resources on reorganization rather than litigating in bankruptcy court. It is better for debtors and the economy to encourage reorganization. The trustee is an effective monitor of the case and is charged with protecting creditor interests. Because the debtor files the only plan of reorganization, with advice from the trustee, the bankruptcy case can proceed much more quickly and efficiently.

The due diligence requirement for preference actions bolsters the transferee's defenses to a clawback. Due diligence may have been an implicit requirement prior to SBRA in any event, so at worst the change to preferences codifies what is already the practice and therefore has no practical effect.

Con – The SBRA is a failure. The percentage of actual confirmed Subchapter V cases is relatively low, as the SBRA only requires the *filing* of a plan within 90 days. There is no deadline to confirm. Trustee appointments in every case also add a layer of unnecessary administrative expense. The new process gives failing businesses too much leeway, at their creditors' expense. The streamlined process and making § 1125 inapplicable unless ordered by the court may leave creditors less informed about the full picture of the debtor's finances . Creditors know their own interests and how to protect them better than a trustee would, and the SBRA takes away creditors' voices in the reorganization process, especially since creditors cannot file competing plans of reorganization. At the same time, owner/management retains equity without requiring the plan to satisfying the absolute priority rule. Thus, creditors do not have a choice notwithstanding that the owner's mismanagement may have cause the failure of the business.

The "preferences" changes mean that debtors are less likely to avoid preferences because of the costs of performing due diligence or filing in other jurisdictions. With fewer preferences clawbacks, bankruptcy estates will be smaller, reducing the debtor's ability to repay creditors. A debtor only has 90 days to file a plan which is significantly less than the time provided for a small business under § 1121. The time can only be extended "if the need for the extension is attributable to circumstances for which the debtor should not be held accountable." 11 U.S.C. § 1189. Lastly, administrative expenses can be paid over time as part of the plan which forces professionals to be invested along with their clients in the risk that the plan would not be successful.

Subtopics:

- Should the $7.5 CARES Act increase in debt limit for filing under Subchapter V be made permanent?

- Does debtor need to be operating to file under Subchapter V?

- Is Subchapter V just for operating plans or can it be used for liquidation?

Supporting Authority:

- The SBRA passed Congress with bipartisan support, including the unanimous approval of the House Judiciary Committee. *See* Cong. Rec. H7220 (daily ed. July 23, 2019) (statement of Rep. Cicilline). The bill was also supported by the National Bankruptcy Conference and the American Bankruptcy Institute. *See id.*

- The SBRA increases options available to small business debtors and allows the debtor the freedom to choose the best option for its business. *See* 11 U.S.C. § 103(B)(i) (recognizing that subchapter V of chapter 11 is an opt-in process).

- Taken together, the provisions of the SBRA are likely to allow more small businesses access to chapter 11 relief, which was previously only realistically available to large corporations that could afford the burdensome costs and fees. *See* Cong. Rec. H7219 (daily ed. July 23, 2019) (statement of Rep. Cicilline) (stating that the previous chapter 11 process "was designed with large, complex corporations in mind" and "[did] not include adequate protections or safeguards for small businesses").

- In many cases, reorganization is a more effective option to make creditors whole, and it allows the debtors to continue pursuing productive economic activity, with potentially wider benefits on the economy as a whole. *See, e.g.*, Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775, 787–88 (1987) (describing non-creditor parties like employees, suppliers, neighboring property owners, and taxing local governments that can benefit from a business's successful reorganization). Greater accessibility to reorganization can both provide a safety net to debtors and encourage creditors to lend. *See* Cong. Rec. H7220 (daily ed. July 23, 2019) (statement of Rep. Cline).

- Sub V issues are often analyzed or compared using Chapter 12 cases.

- The SBRA makes it simpler for debtors to create a plan of reorganization, which may be approved over creditor objections, so long as it does not "discriminate unfairly" and is "fair and equitable" to all creditors. *See* § 1191(b). Creditors may not file competing plans. § 1189 ("Only the debtor may file a plan under this subchapter.").

- The SBRA also introduces changes to preferences in section 547 by requiring the debtor/trustee to allege preferences "based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses." § 547(b). The statute also increases the jurisdictional threshold to sue for preferences in the district where the bankruptcy

case is pending to $25,000. 28 U.S.C. § 1409(b). Smaller amounts must be sought in the district where the defendant resides.

- A small revision to SBRA was made under The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") enacted and effective March 27, 2020, which increased the debt limit to $7.5 million.

- 11 U.S.C. § 1189(b)

Cases:

- Cases that have addressed extensions of the § 1189(b) deadline: *In re Trepetin*, 617 B.R. 841 (Bankr. D. Md. 2020); *In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020).

- Cases that have addressed whether a business must be operating: *In re Wright*, 2020 WL 2193240 (Bankr. D. S.C. April 27, 2020); *In re Kevin Lynn Thurmon and Susan Jane Thurmon*, 2020 WL 7249555 (Bankr. W.D. Mo. December 8, 2020).

IV. Should Plan Be Confirmed Even If All Administrative Claims Are Not Paid In Full?

As one condition of confirmation of a chapter 11 plan, the bankruptcy court must find that each holder of an administrative claim will be paid in full. 11 U.S.C. §1129(a)(9)(A) ("Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—with respect to a claim of a kind specified in section 507(a)(2) [administrative claims and fees and charges against the estate] or 507(a)(3) [administrative claims arising after the involuntary petition and the order for relief] of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such.").

In a skinny chapter 11 case, this creates a dynamic for negotiation with administrative creditors. As explained in *In re Molycorp, Inc.*, 562 B.R. 67, 77–78 (Bankr. D. Del. 2017) (footnotes omitted):

> The Bankruptcy Code requires that in order to confirm a reorganization plan the court must satisfy itself that the plan meets all the requirements of Chapter 11. For our purposes, section 1129(a)(9) of the Bankruptcy Code provides for the mandatory treatment of certain claims entitled to priority. Specifically, section 1129(a)(9)(A) of the Bankruptcy Code requires that, unless agreed otherwise, each holder of an administrative claim will receive cash equal to the allowed amount of such claim on the effective date of the plan; this is true regardless to the existence of unencumbered assets. Put differently, "[t]he Code's confirmation scheme elevates allowed administrative claims to a dominant priority such that unless the holders agree to a different treatment, a plan cannot be confirmed without full payment of those claims even if there are no estate assets to pay them." Moreover, "if the secured parties desire confirmation, the administration claims must be paid in full in cash at confirmation even it if means invading their collateral." The flip side of this requirement is that each administrative or priority creditor may hold the future of the case in its hands. "In bankruptcy, everyone's fate—the debtors, its employees and its creditors—is often intertwined and dependent on the success of the plan. While certain parties have the right to be paid in full, it is sometimes impossible to do so." Professor Douglas G. Baird well explains: "After the votes are received, the debtor can ask the court to approve the reorganization plan. The court must satisfy itself that the plan meets all the requirements of Chapter 11. Many are spelled [out] in §1129(a). The plan must, for example, pay off administrative expense claims in cash. §1129(a)(9)(A). This requirement may be burdensome for businesses that lack ready access to capital markets ... [However,] [p]ractices have emerged that make this requirement less rigid than it might first appear. Administrative creditors are free to scale back or modify their claims in a side deal. Their willingness to do so depends on their past and future relationship with the debtor.

> For example, among the largest administrative claims may be payments owed to the debtor's counsel, and these are often structured with a schedule over time."

On October 18, 2018, Sears Holding Corporation and sister corporations filed voluntary petitions in the in Southern District of New York. The cases were jointly administered (1823538) before the Hon. Robert D. Drain.

In the view of some creditors, the Sears legal team were sometimes non-responsive, played procedural games, and asserted broad objections to legitimate administrative claims. Sears may have been considering a confirmation fight where most administrative claims would be subject to pending objections at the time of confirmation. (Should objections to administrative claims be resolved before the confirmation hearing?)

Judge Drain confirmed Sears' plan even though it was acknowledged by most parties and the press that the Sears estates did not have enough money to fund it. As a workaround, Sears created a ballot and post-confirmation procedures to address the liquidation and discounted payment of administrative claims. Most administrative creditors (not the lawyers!) would be paid less than 75% and over time on their administrative claims. *See, e.g.*, https://restructuring.primeclerk.com/sears/Home-Index ("On October 15, 2019, the Bankruptcy Court entered an order confirming the Modified Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and Its Affiliated Debtors. The Confirmation Order approved, among other things, the Administrative Expense Claims Consent Program, the Opt-In/Opt-Out Procedures, and the form of Opt-In Ballot and Opt-Out Ballot [for administrative creditors].").

Holders of administrative expense claims (*i.e.,* non-professionals) were encouraged to voluntarily reduce their claims in exchange for expedited review of their claims and a promise of a greater certainty of recovery. An administrative claimant who opted out of the program retained its right to have its claim paid in full on the later of the plan's effective date or the date that the amount of the claim is agreed upon by the debtors and the creditor. But this would require expensive litigation and a long delay in a very contentious case.

Pro: What's the alternative? If the cases were converted to chapter 7, administrative claimants would receive even less than under the confirmed plan. The Sears plan allowed for administrative claimants to opt-in to a settlement, opt-out, or do nothing. Under the Bankruptcy Code, administrative claimants can agree to treatment of less than 100% payment. Congress has shown some flexibility here. *See, e.g.*, 11 U.S.C. § 1191 in the Small Business Debtor Reorganization amendments ("Notwithstanding section 1129(a)(9)(A) of this title, a plan that provides for the payment through the plan of a claim of a kind specified in paragraph (2) or (3) of section 507(a) of this title may be confirmed under subsection (b) of this section.").

Con: The Bankruptcy Code is clear. There should be no loophole that allows confirmation of a chapter 11 plan that does not provide for full payment to administrative claimants who do not agree to take less. If necessary, the professionals should be required to disgorge their fees in order to pay the other administrative claims in full.

Cases: Selected Sears case filings

V. Arbitration – Getting to the "Core" of the Issue

Should Bankruptcy Courts Enforce Arbitration Provisions in Adversary Proceedings/Objections to Claims?

Pro – Yes

A. Federal Arbitration Act/policy favoring arbitration

B. Freedom of contract

C. Less burden on the Bankruptcy Courts

D. Potentially faster resolution of disputes

E. Non-bankruptcy or non-core issues need not be determined by Bankruptcy Courts and Bankruptcy Courts may lack expertise to determine specialty issues

Supporting Cases:

- *In re Willis*, 944 F.3d 577 (5th Cir. 2019).
- *In re Scott*, 608 B.R. 774 (Bankr. S.D. Ga. 2019).
- *In re Williams*, 564 B.R. 770 (Bankr. S.D. Fl. 2017).

Con – No

A. Bankruptcy/Reorganization policy and the underlying purposes of the Bankruptcy Code

B. Protect debtors, especially individuals

C. Cost

D. Statutorily "core" claims defined in the Bankruptcy Code

E. Lack of leverage of parties required to sign pre-bankruptcy arbitration agreements

F. Claims may rightfully belong to creditors who are not parties to the arbitration agreements (e.g. fraudulent conveyances)

G. Claims may only arise upon the bankruptcy filing and not be pre-bankruptcy claims of the debtor (e.g., property of the estate issues)

H. Situations where there is a right to a jury trial on issues which fall outside the scope of the arbitration clause

Supporting Cases:

- *In re Cuker Interactive, LLC*, 2021 WL 196468 (S.D. Cal. 2021).
- *In re Henry*, 944 F.3d 587 (5th Cir. 2019).
- *In re EPD Investment Company, LLC*, 821 F.3d 1146 (9th Cir. 2016).
- *In re Eber*, 687 F.3d 1123 (9th Cir. 2012).
- *In re Thorpe Insulation Co.*, 671 F.3d 1011 (9th Cir. 2012).

Cases For
I. The Importance of "Chutzpah" in the PG&E Case

KeyCite Yellow Flag - Negative Treatment
Declined to Follow by In re Fast, Bankr.D.Colo., December 21, 2004

285 F.3d 1231
United States Court of Appeals,
Ninth Circuit.

In re Samuel Duke CARDELUCCI, Debtor.
Willem Onink, Marsha Onink, Appellants,
v.
Samuel Duke Cardelucci, Appellee.

No. 00–56541.
|
Argued and Submitted Jan. 16, 2002.
|
Filed April 12, 2002.

Synopsis

Unsecured creditor objected to confirmation of solvent Chapter 11 debtor's proposed plan, as failing to provide for payment of postpetition interest at appropriate rate. The United States Bankruptcy Court for the Central District of California ruled that creditor was entitled to postpetition interest only at federal judgment rate, and creditor appealed. The District Court, Dean D. Pregerson, J., affirmed. On further appeal, the Court of Appeals, Zilly, United States District Judge for the Western District of Washington, sitting by designation, held that "legal rate" of interest to which unsecured creditor was entitled on its claim, from date that petition was filed, in Chapter 11 case of solvent debtor, was federal judgment, rather than state statutory, rate.

Affirmed.

Procedural Posture(s): On Appeal.

West Headnotes (9)

[1] **Bankruptcy**
Conclusions of law; de novo review

Court of Appeals reviews de novo the district court's decision on appeal from bankruptcy court, and applies same standard of review as standard applied by district court.

16 Cases that cite this headnote

[2] **Bankruptcy**
Conclusions of law; de novo review

Bankruptcy court's conclusions on questions of statutory interpretation are conclusions of law subject to de novo review.

16 Cases that cite this headnote

[3] **Interest**
What law governs

Interest
Computation of rate in general

"Legal rate" of interest to which unsecured creditor was entitled on its claim, from date that petition was filed, in Chapter 11 case of solvent debtor, was federal judgment, rather than state statutory, rate. Bankr.Code, 11 U.S.C.A. § 726(a)(5); 28 U.S.C.A. § 1961(a).

22 Cases that cite this headnote

[4] **Statutes**
Language

When interpreting statute, court assumes that Congress carefully selected and intentionally adopted the language used.

2 Cases that cite this headnote

[5] **Interest**
Computation of rate in general

In using definite article "the," instead of indefinite "a" or "an," to specify that unsecured creditors are entitled to postpetition interest "at the legal rate" when debtor is solvent, Congress indicated its intent that single source be used to calculate postpetition interest. Bankr.Code, 11 U.S.C.A. § 726(a)(5).

12 Cases that cite this headnote

[6] **Interest**
Computation of rate in general

In using terms "legal rate," in requiring solvent debtors to pay postpetition interest "at the legal rate" to their unsecured creditors, Congress

manifested its intent that the one source used to calculate appropriate rate of interest should be statutory; commonly understood meaning of "at the legal rate" at time Bankruptcy Code was enacted was rate fixed by statute. Bankr.Code, 11 U.S.C.A. § 726(a)(5).

15 Cases that cite this headnote

[7] **Federal Courts**
Interest

In diversity actions brought in federal court, prevailing plaintiff is entitled to prejudgment interest at state law rates, while postjudgment interest is determined by federal law.

31 Cases that cite this headnote

[8] **Bankruptcy**
Interest

Overriding policy consideration in an award of interest to creditor in bankruptcy case is the balancing of equities among creditors.

[9] **Constitutional Law**
Bankruptcy
Interest
Constitutional and statutory provisions

Award of postpetition interest on unsecured claims, in Chapter 11 case of solvent debtor, not at contractual or at state statutory rates, but only at lower federal judgment rate, did not violate unsecured creditor's substantive due process rights; utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. U.S.C.A. Const.Amends. 5, 14; Bankr.Code, 11 U.S.C.A. § 726(a)(5).

24 Cases that cite this headnote

Attorneys and Law Firms

***1232** Fred K. Knez, John A. Boyd, Thompson & Colgate, Riverside, CA, for the plaintiffs-appellants.

***1233** William M. Burd, Karen Sue Naylor, Burd & Naylor, Santa Ana, CA, for the defendant-appellee.

Appeal from the United States District Court for the Central District of California; Dean D. Pregerson, District Judge, Presiding. D.C. No. CV–00–01990DDP.

Before: SCHROEDER, Chief Judge,McKEOWN, Circuit Judge, and ZILLY, District Judge. *

OPINION

ZILLY, District Judge.

Appellants Willem and Marsha Onink appeal the district court's application of the federal interest rate as defined by 28 U.S.C. § 1961(a) to an award of post-petition interest pursuant to 11 U.S.C. § 726(a)(5). This appeal presents the narrow but important issue of whether such post-petition interest is to be calculated using the federal judgment interest rate or is determined by the parties' contract or state law. We conclude that 11 U.S.C. § 726(a)(5) mandates application of the federal interest rate. Accordingly, we AFFIRM.

Appellee Samuel Duke Cardelucci owns and operates several rubbish companies in Southern California. On January 15, 1993, a California state court jury found that Cardelucci had engaged in predatory pricing and was jointly and severally liable to the Oninks for unfair trade practices. The state court subsequently entered judgment in the amount of $5,423,825.50 plus interest calculated at the rate of 10% per annum in favor of the Oninks. The state court judgment was ultimately affirmed on appeal with the amount of damages modified to $5,273,147.50 plus interest at the applicable legal rate.

After judgment was entered in the state court action, Cardelucci filed a voluntary petition for relief under Chapter 11 in the United States Bankruptcy Court for the Central District of California. Cardelucci's Modification of Fourth Amended Plan of Reorganization provided for payment in full of the Oninks' claim with post-confirmation interest at the rate of 5% and post-petition interest at a rate to be determined under the provisions of the Bankruptcy Code.

During subsequent proceedings before the bankruptcy court regarding the Plan, the parties agreed that the Oninks were entitled to post-petition interest but disputed whether the applicable interest rate was California's state statutory interest rate of 10% or the federal interest rate. The bankruptcy court held that the federal interest rate of approximately 3.5%, calculated pursuant to 28 U.S.C. § 1961(a), rather than the judgment rate provided for by state law, applied. Thereafter, the Oninks withdrew their objections to the Plan without prejudice to their right to appeal the interest rate determination and the bankruptcy court ordered the Plan confirmed. The Oninks appealed the bankruptcy court's determination to the district court which affirmed the bankruptcy court's ruling. This appeal followed.

[1] [2] This Court reviews de novo the district court's decision on an appeal from a bankruptcy court. *In re Gruntz,* 202 F.3d 1074, 1084 n. 9 (9th Cir.2000) (en banc). This Court applies the same standard of review applied by the district court. *In re Chang,* 163 F.3d 1138, 1140 (9th Cir.1998). Statutory interpretation is a question of law subject to de novo review. *In re Celebrity Home Entertainment, Inc.,* 210 F.3d 995, 997 (9th Cir.2000).

***1234 [3]** Where a debtor in bankruptcy is solvent, an unsecured creditor is entitled to "payment of interest at the legal rate from the date of the filing of the petition" prior to any distribution of remaining assets to the debtor. 11 U.S.C. § 726(a)(5). The question presented by this appeal is whether "interest at the legal rate" means a rate fixed by federal statute or a rate determined either by the parties' contract or state law. The Bankruptcy Code does not define the term "interest at the legal rate" and there is a paucity of legislative history regarding this statutory provision.

Although no Court of Appeals has addressed this issue, bankruptcy courts have split over the correct interpretation of this phrase, finding that it either means one single rate as determined by 28 U.S.C. § 1961(a)(the "federal judgment rate approach") or is based on a contract rate or applicable state law (the "state law approach"). *Compare In re Dow Corning Corp.,* 237 B.R. 380, 394 (Bankr.E.D.Mich.1999) (applying the federal judgment rate), *with In re Carter* 220 B.R. 411, 416–17 (Bankr.D.N.M.1998) (using the state law approach to determine the appropriate interest rate).

In *In re Beguelin,* 220 B.R. 94, 99(9th Cir.BAP1998), the Bankruptcy Appellate Panel of the Ninth Circuit squarely addressed the issue presented in this appeal. The BAP held that the federal judgment rate applied to post-petition interest. *Beguelin,* 220 B.R. at 100. Contrasting the state law and federal judgment rate approaches, the BAP concluded that the interests of "fairness, equality, and predictability in the distribution of interest on creditors' claims" as well as the interest in applying federal law to federal bankruptcy cases, required application of the federal judgment rate approach. *Id.* at 100–101 (citing *In re Melenyzer,* 143 B.R. 829 (Bankr.W.D.Tex.1992), and *In re Godsey,* 134 B.R. 865 (Bankr.M.D.Tenn.1991)). While this Court is not bound by a B.A.P. decision, we find the reasoning of *Beguelin* to be persuasive and adopt it. *See Bank of Maui v. Estate Analysis, Inc.,* 904 F.2d 470, 471 (9th Cir.1990).

[4] The principles of statutory interpretation lend strong support to the conclusion that Congress intended "interest at the legal rate" in 11 U.S.C. § 726(a)(5) to mean interest at the federal statutory rate pursuant to 28 U.S.C. § 1961(a). Congress specifically chose the language "interest at the legal rate," replacing the originally proposed language "interest on claims allowed." *Report of the Commission on the Bankruptcy Laws of the United States,* H.R. Doc. No. 93–137, § 4–405(a)(8), (1st Sess.1973), *reprinted in* Collier App. Pt. 4(c), at 4–679. This Court "assume[s] that Congress carefully select[s] and intentionally adopt[s] the language" used in a statute. *Ebben v. Comm'r,* 783 F.2d 906, 916 (9th Cir.1986) (Beezer, J., concurring in part and dissenting in part). Thus, instead of a general statement allowing for awards of interest, Congress modified what type and amount of interest could be awarded with the specific phrasing "at the legal rate."

[5] **[6]** The definite article "the" instead of the indefinite "a" or "an" indicates that Congress meant for a single source to be used to calculate post-petition interest. *See, e.g., American Bus Ass'n v. Slater,* 231 F.3d 1, 4–5 (D.C.Cir.2000); *United States v. Kanasco, Ltd.,* 123 F.3d 209, 211 (4th Cir.1997); *In re Dow Corning Corp.,* 237 B.R. at 404; *Black's Law Dictionary* 1477 (6th ed. 1990) ("In construing statute, definite article 'the' particularizes the subject which it precedes and is word of limitation as opposed to indefinite or generalizing force 'a' or 'an' "). The use of "legal rate" indicates that Congress intended the single source to be statutory because the commonly

understood meaning ***1235** of "at the legal rate" at the time the Bankruptcy Code was enacted was a rate fixed by statute. *See, e.g.,* *Inv. Serv. Co. v. Allied Equities Corp.,* 519 F.2d 508, 511 (9th Cir.1975) (distinguishing "interest at the legal rate" as a rate defined by statute from a rate determined pursuant to the parties' contract); *In re Dow Corning Corp.,* 237 B.R. at 402 (citing cases). Congress' choice of the phrase "interest at the legal rate" suggests that it intended for bankruptcy courts to apply one uniform rate defined by federal statute. *See* 3 *Norton Bankruptcy Law & Practice* 2d § 73:7 n. 55 (1997 & Supp.2000) (stating "[i]nterest is set at the federal judgment rate as of the petition date"); 6 *Collier on Bankruptcy* ¶ 726.02(5) (15th ed. rev.1997) ("The reference in the statute to the 'legal rate' suggests that Congress envisioned a single rate, probably the federal statutory rate for interest on judgments.").

Additionally, using the federal rate promotes uniformity within federal law. Upon the filing of the bankruptcy petition, creditors with a claim against the estate must pursue their rights to the claim in federal court and entitlement to a claim is a matter of federal law. *See* *Bursch v. Beardsley & Piper,* 971 F.2d 108, 114 (8th Cir.1992) ("[O]nce a bankruptcy petition is filed, federal law, not state law, determines a creditor's rights."). Absent a timely objection, all claims filed against the bankrupt estate are "deemed allowed" as of the date of filing. 11 U.S.C. § 502(a). This allowed claim, like a judgment, gives the creditor a legal "right to payment" of a specific sum of money against the debtor. 11 U.S.C. § 101(5); 11 U.S.C. § 502(b). As of the date of the filing of the petition, creditors hold a claim, similar to a federal judgment, against the estate, the payment of which is only dependent upon completion of the bankruptcy process. In this respect, the purpose of post-petition interest makes the award analogous to an award of post-judgment interest. *See* *Kaiser Aluminum and Chem. Corp. v. Bonjorno,* 494 U.S. 827, 835–36, 110 S.Ct. 1570, 108 L.Ed.2d 842 (1990) (stating that the purpose of post-judgment interest is "to compensate the successful plaintiff for being deprived of compensation for the loss from the time between the ascertainment of the damages and the payment by the defendant") (citation omitted).

[7] It has long been the rule that an award of post-judgment interest is procedural in nature and thereby dictated by federal law. *Hanna v. Plumer,* 380 U.S. 460, 473–74, 85 S.Ct. 1136, 14 L.Ed.2d 8 (1965) (stating that procedural matters arising in federal court are decided by federal law). This rule is best illustrated by the difference in treatment of pre-judgment and post-judgment interest in diversity actions. In diversity actions brought in federal court a prevailing plaintiff is entitled to pre-judgment interest at state law rates while post-judgment interest is determined by federal law. *See* *Northrop Corp. v. Triad Int'l Mktg., S.A.,* 842 F.2d 1154, 1155 (9th Cir.1988). In bankruptcy, an allowed claim becomes a federal judgment and therefore entitles the holder of the judgment to an award of interest pursuant to federal statute. *See* *In re Chiapetta,* 159 B.R. 152, 160–61 (Bankr.E.D.Penn.1993); *In re Melenyzer,* 143 B.R. at 833.

[8] Lastly, applying a single, easily determined interest rate to all claims for post-petition interest ensures equitable treatment of creditors. An overriding policy consideration in an award of interest to a creditor is the balancing of equities among the creditors. *See* *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 165, 67 S.Ct. 237, 91 L.Ed. 162 (1946) ("It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities ***1236** between creditor and creditor or between creditors and the debtor."). By using a uniform interest rate, no single creditor will be eligible for a disproportionate share of any remaining assets to the detriment of other unsecured creditors. *See* *Beguelin,* 220 B.R. at 100(citing *In re Melenyzer,* 143 B.R. at 832).

In addition to promoting fairness among creditors, application of the federal rate is the most judicially efficient and practical manner of allocating remaining assets. Calculating the appropriate rate and amount of interest to be paid to a myriad of investors has the potential to overwhelm what could otherwise be a relatively simple process pursuant to 11 U.S.C. § 726(a)(5). *See* *Beguelin,* 220 B.R. at 101 ("It is not hard to imagine the administrative nightmare that bankruptcy trustees would otherwise face if they were required to calculate a different interest rate, based on a different source of interest rate, for each creditor."); *see also,* *Katchen v. Landy,* 382 U.S. 323, 328, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966) (stating "a chief purpose of the bankruptcy laws is to secure a prompt and effectual administration ... of the [bankruptcy] estate ...") (citation omitted).

The Court recognizes that these two interests, fairness among creditors and administrative efficiency, may be of limited relevance in certain bankruptcy proceedings. Where there are only a few unsecured creditors seeking post-petition interest and there are sufficient assets to pay all claims for all interest, there will be no concerns regarding equity among creditors or practicality. In those instances, a debtor may receive a windfall from the application of a lower federal interest rate to an award of post-petition interest. Nonetheless "interest at the legal rate" is a statutory term with a definitive meaning that cannot shift depending on the interests invoked by the specific factual circumstances before the court. *See* *In re Thompson,* 16 F.3d 576, 581 (4th Cir.1994).

[9] Appellants make a final argument that under the circumstances of this case, an award of interest pursuant to a federal statute violates substantive due process. Assuming, *arguendo,* that there is a substantive right to post-petition interest, Appellants' substantive due process claim fails because the application of the federal interest rate to all claims is rationally related to the legitimate interests in efficiency, fairness, predictability, and uniformity within the bankruptcy system. While the instant case might lend itself to easy application of an alternate interest rate, "a classification does not fail rational-basis review because it 'is not made with mathematical nicety or because in practice it results in some inequality.' " *Heller v. Doe,* 509 U.S. 312, 321, 113 S.Ct. 2637, 125 L.Ed.2d 257 (1993) (quoting *Dandridge v. Williams,* 397 U.S. 471, 485, 90 S.Ct. 1153, 25 L.Ed.2d 491 (1970)).

AFFIRMED.

All Citations

285 F.3d 1231, 39 Bankr.Ct.Dec. 110, Bankr. L. Rep. P 78,658, 02 Cal. Daily Op. Serv. 3146, 2002 Daily Journal D.A.R. 3877

Footnotes

* Honorable Thomas S. Zilly, United States District Judge for the Western District of Washington, sitting by designation.

End of Document

Entered on Docket
December 30, 2019
EDWARD J. EMMONS, CLERK
U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re:	Bankruptcy Case
	No. 19-30088-DM
PG&E CORPORATION,	
	Chapter 11
- and -	
	Jointly Administered
PACIFIC GAS AND ELECTRIC COMPANY,	
Debtors.	Date: December 11, 2019 Time: 10:00 AM
☐ Affects PG&E Corporation	Place: Courtroom 17
☐ Affects Pacific Gas and Electric Company	450 Golden Gate Ave. 16th Floor
☒ Affects both Debtors	San Francisco, CA
* *All papers shall be filed in the Lead Case, No. 19-30088 (DM).*	

MEMORANDUM DECISION REGARDING POSTPETITION INTEREST

I. INTRODUCTION

On December 11, 2019, the court heard oral argument on the discrete legal issue of the applicable postpetition interest to be paid to four classes of allowed unsecured and unimpaired claims, under any chapter 11 reorganization plan for solvent debtors PG&E Corporation and Pacific Gas and Electric Company ("Debtors"). The Debtors, joined by certain Shareholders, argue that creditors in all four classes should receive interest

calculated pursuant to 28 U.S.C. § 1961(a) (the "Federal Interest Rate") in effect as of the petition date (January 29, 2019) these chapter 11 cases. That rate for these jointly administered cases is 2.59 percent. Debtors contend that use of the Federal Interest Rate is consistent with *In re Cardelucci*, 285 F.3d 1231 (9th Cir. 2002) ("*Cardelucci*"), which holds that unsecured creditors in a solvent case should receive postpetition interest calculated at the Federal Interest Rate.

Several parties, including the Official Committee of Unsecured Creditors, the Ad Hoc Committee of Senior Unsecured Noteholders, the Ad Hoc Committee of Holders of Trade Claims and others (collectively "Unsecured Creditors") oppose the motion. They urge application of various rates, generally determined by applicable contracts between the Debtors and the respective claimants, judgment rates or some other rate.

For the following reasons, the court concludes that the Debtors are correct, that *Cardelucci* controls and that the Federal Interest Rate applies to any Plan.

II. APPLICABLE LAW

Statutory construction of the Bankruptcy Code[1] is "a holistic endeavor" requiring consideration of the entire statutory scheme. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), cited by *In re BCE West, L.P.*, 319 F.3d 1166, 1171 (9th Cir. 2003).

[1] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

In *Timbers*, the Supreme Court utilized this holistic approach to analyze five seemingly unconnected provisions of Title 11 in determining that oversecured creditors are entitled to receive postpetition interest. Applying a similar holistic approach, this court has looked to the structure of the Bankruptcy Code and the purposes behind its many parts to conclude while unsecured creditors are entitled to postpetition interest in a solvent estate, the Bankruptcy Code requires application of the Federal Interest Rate to those claims and that such an application does not impair these claims. Even if *Cardelucci* were not binding, the court would reach the same conclusion.

Chapter 5, subchapter I ("Creditors and Claims") of the Bankruptcy Code sets forth the guiding principles for filing and allowance of claims or interests, administrative expenses, determination of secured status and other provisions not important to the current analysis. In contrast, the court must apply the critical provisions of chapter 11, subchapter II ("The Plan"). Section 1123(a) states what a plan "shall" do or include. Section 1123(b) states what a plan "may" do or include. As a definitional matter, section 1124 explains that a class of claims or interest is impaired unless the plan leaves certain legal, equitable and contractual rights unaltered (§ 1124(1)), or cures, restates, or compensates the rights of class or interest members (§ 1124(2)(A)-(E)).

The structure of the Bankruptcy Code and the applicability of these definitional and empowering sections, therefore, dictate rights that are fixed as of the petition date and what

rules apply after that. Nothing suggests that, absent specific rules, provisions dealing with prepetition entitlements carry over postpetition. For example, section 502(b)(2) clearly provides that a claim for "unmatured interest"[2] may not be allowed. An exception to the rule is found in section 506(b) that permits accrued interest to be allowed as long as the security is "greater than the amount of such claim."

The Unsecured Creditors' argument that somehow the definitions and remedies found in section 1124 override the plain impact of section 502(b)(2) is simply not persuasive and would require the court to ignore not only the plain words of the statute but also the holistic notion of treating them as part of a combined comprehensive instrument of definitions, applicability and implementation. Section 1124(1) describes what claims are unimpaired and section 1124(2) describes what is necessary for a plan to "unimpair" impaired claims. In contrast, chapter 5 ("Creditors and Claims") dictates how claims and interests are dealt with in the substantive chapters: 7, 11, 12 and 13. The subparts of section 502(b) list nine specific rules for affecting allowed claims.

An example not directly related to this case proves the point. Section 502(b)(4) disallows the claim of an insider or an attorney to the extent it exceeds the reasonable value of the services. Unsecured Creditors could not persuade the court or even make a convincing argument that somehow an insider or an attorney whose asserted claim exceeds a reasonable value could

[2] No one has suggested that "unmatured interest" means anything other than "postpetition interest."

take refuge in section 1124((1)'s definitional provision and escape the clear intention of Congress to limit unreasonable claims for services in the same manner it has limited postpetition unsecured claims for unmatured interest. For the same reason, underlying non-bankruptcy law must give way to contrary provisions of the Bankruptcy Code. *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 444 (2007) (quoting *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 20 (2000).

With that background, the court turns to the applicability of *Cardelucci* and its clear message.

III. THIS COURT'S RESPONSIBILITY UNDER *STARE DECISIS*

This court is bound by the Ninth Circuit's *Cardelucci* decision unless it can be distinguished or overruled:

> Courts are bound by the decisions of higher courts under the principle of *stare decisis*. The doctrine derives from the maxim of the common law, "Stare decisis et non quieta movere," which literally means, "Let stand what is decided, and do not disturb what is settled." See 1B Jeremy C. Moore et al., Moore's Federal Practice ¶ 0.402[1] (2d ed. 1992). Moore's treatise describes the rule as follows:
>
> > The rule, as developed in the English law, is that a decision on an issue of law embodied in a final judgment is binding on the court that decided it and such other courts as owe obedience to its decisions, in all future cases. *Id.*
>
> Under this principle a decision of a circuit court of appeal is binding on all lower courts in the circuit, including district courts and bankruptcy courts (absent a contrary United States Supreme Court decision). *Zuniga v. United Can Co.*, 812 F.2d 443, 450 (9th Cir. 1987).

> This is true even if there is a split of opinion between the controlling circuit and another circuit court of appeals, and the lower court believes that the controlling circuit court is in error. *Zuniga*, 812 F.2d at 450; *Hasbrouck v. Texaco, Inc.*, 663 F.2d 930, 933 (9th Cir. 1981)[.]

In re Globe Illumination Co., 149 B.R. 614, 617 (Bankr. C.D. Cal. 1993) (multiple internal citations omitted).

Cardelucci is a published panel opinion by the Court of Appeals for the Ninth Circuit. It is binding on this court. *State Farm Fire & Cas. Ins. Co. v. GP West, Inc.*, 2016 WL 3189187, 90 F. Supp.3d 1003, 1018 (D. Haw. 2016) (citation and internal quotation marks omitted). *See Lair v. Bullock*, 798 F.3d 736, 747 (9th Cir. 2015) ("[W]e are bound by a prior three-judge panel's published opinions, ...") (citing *Miller v. Gammie*, 335 F.3d 889, 892–93 (9th Cir. 2003) (en banc)).

IV. THE HOLDING OF *CARDELUCCI*

In *Cardelucci*, the Ninth Circuit framed the issue before it as follows:

> This appeal presents the narrow but important issue of whether such post-petition interest is to be calculated using the (federal judgment rate) or is determined by the parties' contract or state law.

Cardelucci, 285 F.3d at 1231.

The Ninth Circuit held that in chapter 11 cases involving solvent debtors, unsecured creditors are entitled to postpetition interest at the federal judgment rate, not at not

at contractual or state statutory rates. *Id.* at 1234. In so holding, the Ninth Circuit observed that application of the lower federal judgment rate did not violate an unsecured creditor's substantive due process rights (*id.* at 1236) and that utilization of federal judgment rate for all claims was rationally related to legitimate interests in efficiency, fairness, predictability, and uniformity within bankruptcy system. *Id.*

While the court pinpointed a "narrow but important issue," it did not narrow the application of its holding, which must be applied broadly given the structure of the Bankruptcy Code and the clear and plain meaning of its applicable provisions, as noted above.

In *Cardelucci*, the debtor and his opponents, holders of a state court judgment, set aside various differences and thereby permitted confirmation to proceed subject to a reservation of rights concerning the applicable postpetition interest rate.[3] The Ninth Circuit concluded that the reference by Congress to "the legal rate" in section 726(a)(5) was intentional, in that

[3] While the opinion is silent on the specifics of that debtor's plan, the opponents' claim was impaired for reasons not relevant to this analysis. In the present case the Unsecured Creditors' claims are unimpaired. The Unsecured Creditors put the cart before the horse when they contend that the application of the "fair and equitable" test of section 1129(b) determines that their claims are impaired under section 1124.

Congress had rejected proposed language of "interest on claims allowed." *Cardelucci*, 285 F.3d at 1234. The court also emphasized that a single, easily determined rate for all postpetition interest ensures equitable treatment of creditors.[4] Although *Cardelucci* was a chapter 11 case, the reference to section 726(a)(5) was critical. Without that reference, the court would be compelled by section 502(b)(2) to allow claims "except to the extent that . . . (2) such claim is for unmatured interest."[5] There is no specific provision in chapter 11 that allows any interest on unsecured claims.[6] Without that reference, Unsecured Creditors would be left with no allowed postpetition interest.

The rule in the seventeen years since *Cardelucci* is clear: unsecured creditors of a solvent debtor will be paid the Federal Interest Rate whether their prepetition contracts call for higher or lower rates, or applicable state law judgment rates

[4] In this case, given the vast array of creditors' claims, the equal application of such uniform policy is all the more compelling.

[5] The exception found in section 506(b) for secured claims has no bearing here.

[6] The court rejects the argument by the Ad Hoc Committee of Holders of Trade Claims that section 103(b) precludes consideration of section 726(a)(5). *Cardelucci* merely compared the chapter 7 outcome (apply the Federal Interest Rate) as part of the "best interest" test of Section 1129(a)(9) to compare whether creditors do better in chapter 7 or chapter 11.

are higher, or there are no other applicable rates to consider. Nor is that rule limited to impaired claims. *Cardelucci* is unequivocal and articulates several reasons for broad application of its holding despite the recognition of the narrow issue presented:

> 1. The use of the term "legal rate" indicates the Congress intended the single source to be statutory because of the common use of the term when the Bankruptcy Code was enacted.
>
> 2. Using the federal rate promotes uniformity within federal law.
>
> 3. The analogous post-judgment interest entitlement compensates for being deprived of compensation for the loss of time between ascertainment of damages and payment.
>
> 4. Application of a single, easily determined rate ensures equitable treatment of creditors.
>
> 5. With a uniform rate, no single creditor will be eligible for a disproportionate share of the remaining assets.

Cardelucci, 285 F.3d at 1235-1236.

The Unsecured Creditors refer to the opinion's "parting note" to support their cause. The actual conclusion rejects a substantive due process argument that has not been developed here for good reasons. To this court, the "parting note" that dooms their cause is in the penultimate paragraph, and bears repeating:

> The Court recognizes that these two interests, fairness among creditors and administrative efficiency, may be of limited relevance in certain bankruptcy proceedings. Where there are only a few unsecured creditors seeking post-petition interest and there are sufficient assets to pay all claims for all

> interest (sic), there will be no concerns regarding equity among creditors or practicality. In those instances, a debtor may receive a windfall from the application of a lower federal interest rate to an award of post-petition interest. Nonetheless 'interest at the legal rate' is a statutory term with a definitive meaning that cannot shift depending on the interests invoked by the specific factual circumstances before the court. *See In re Thompson*, 16 F.3d 576, 581 (4th Cir. 1994).

Cardelucci, 285 F.3d at 1236.

Unsecured Creditors' reliance on older cases invoking the "absolute priority" rule in defense of postpetition interest at the contract rate are unavailing. *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510 (1941), was decided under the former Bankruptcy Act and is of questionable viability now that the Bankruptcy Code includes sections 726(a)(5) and 502(b)(2). Similarly, *Debentureholders Protective Committee of Continential Inv. Corp. v. Continental Inv. Corp.*, 679 F.2d 264 (1st Cir. 1982), was decided under Chapter X of the former Bankruptcy Act and thus offers no guidance here.

The Ninth Circuit's decision in *L&J Anaheim Associates v. Kawasaki Leasing International, Inc.* (*In re L&J Anaheim Associates*), 995 F.2d 940 (9th Cir. 1993) does not change the outcome. *L&J Anaheim* was decided only a few months after *Cardelucci* and did not cite it, as it addressed an altogether different issue.

In *L&J Anaheim*, a secured creditor filed a chapter 11 plan that was opposed by the debtor. In order to achieve the statutory requirement for at least one impaired class, the creditor, Kawasaki, proposed changing its own state law remedies

following debtor's breach. It eliminated its right to exercise various remedies under the California Uniform Commercial Code, replacing those entitlements under its proposed plan with a requirement that its collateral and a related lawsuit be sold at public auction under procedures mandated by the Bankruptcy Code.

In determining that Kawasaki's rights were altered, and thus its claim was impaired, the court stated:

> At first blush the idea that an improvement in ones' position as a creditor might constitute 'impairment' seems nonsensical."

L & J Anaheim, 995 F.2d at 942.

The court examined the term of art adopted by Congress to replace language in the prior Bankruptcy Act and concluded that section 1124 created certainty in determining whether or not a creditor was impaired. Once again, section 1124 is definitional, describing improvement in the context of the plan presented as impairment. The court had no occasion to address whether, for an impaired class, postpetition interest was even relevant.

Of importance here is that the plan's own language altered Kawasaki's rights; in the present case, the Bankruptcy Code, and not the Plan, is what causes Unsecured Creditors to have their postpetition interest limited to the Federal Judgment Rate. The Plan is not the culprit.

A few months after *Cardelucci*, the Ninth Circuit *decided Platinum Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.*, 314 F.3d 1070 (9th Cir. 2002). There, the court addressed whether or not a plan proponent had proposed the plan

in good faith under section 1129(a)(3) when its sole purpose was to enable the debtors to cure and reinstate an obligation. At that time, *Great W. Bank & Trust v. Entz-White Lumber and Supply, Inc. (In re Entz-White Lumber and Supply, Inc.)*, 850 F.2d 1338 (9th Cir. 1988), was good law. Under *Entz-White*, plan proponents were permitted to cure defaults under former section 1124(3), leaving the objecting creditor not impaired under section 1124. Perhaps predicting the crucial distinction between what a plan does and what the Bankruptcy Code does, the *Sylmar Plaza* court rejected the argument that a plan lacks good faith when it permits owners of a solvent debtor to avoid paying postpetition interest at the default interest rate. The fact that a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding. Quoting the bankruptcy court in *In re PPI Enters. (US), Inc.*, 228 B.R. 339 (Bankr. D. Del. 1998), the court stated:

> In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely altered creditors' contractual and non bankruptcy rights . . . .
>
> The fact that a debtor proposes a plan which it avails itself of an applicable Code provision does not constitute evidence of bad faith.

Sylmar Plaza, 314 F.3d at 1075 (citations omitted).

Cases cited by the *Sylmar Plaza* creditor to support a per se rule were distinguishable in that neither adopted or approved such a rule and, moreover, ". . . because none involved an objection to a plan by an unimpaired creditor." *Id.*

At oral argument counsel for one of the Unsecured Creditors argued that *Cardelucci* has been superseded by *In re New Investments, Inc.*, 840 F.3d 1137 (9th Cir. 2016). That argument is unavailing. The *New Investments* decision concludes that the 1994 amendments to section 1124 abrogated the holding of *Entz-White* that default interest rates could be eliminated by curing defaults under a plan. The decision does not even mention postpetition interest or *Cardelucci* and does not deal with unimpaired claims under section 1124(1) and thus is of no bearing on the issue presented or the outcome here.

V. IMPAIRED OR UNIMPAIRED CLAIMS ARE TREATED ALIKE

Unsecured Creditors attempt in vain to escape *Cardelucci's* impact by arguing that, unlike the impaired claim there, their claims will be unimpaired under a plan. The court rejects Unsecured Creditors' argument.

First, *Cardelucci*, in answering the narrow question, drew no distinction as to whether the rule it announced was confined only to impaired claims. The clear and unequivocal analysis based on section 726(b)(5) is obvious: it applies to all unsecured and undersecured claims in a surplus estate.

Second, no plan compels the payment of the Federal Interest Rate. Rather, the Bankruptcy Code does. A similar analysis was applied very recently by the Fifth Circuit in *In re Ultra Petroleum Corporation*, ___ F.3d____, 2019 WL 6318074 (November 26, 2019). There, the court contrasted the treatment of creditors' claims outside of bankruptcy and whether the plan itself was a source of limitation on their legal, equitable and contractual rights, or rather the Bankruptcy Code. The court

looked to the language of section 1124(1), defining not impaired when the plan ". . . leaves unaltered [the claimant's] legal, equitable and contractual rights." The court ruled that a claim is impaired only if the plan itself does the altering, not what the Bankruptcy Code does.

Ultra Petroleum agreed with the only other court of appeals decision to draw the distinction between what a plan might do and what the Bankruptcy Code does do. *In Solow v. PPI Enterprises (U.S.) Inc. (In re PPI Enterprises (U.S.) Inc.)*, 324 F.3d.197 (3d Cir. 2003) the court upheld confirmation of a plan notwithstanding a limitation on an objecting landlord's statutorily capped damages under section 502(b)(6). It held that where section 502(b)(6) alters a creditor's non-bankruptcy claim, there is no alteration of the claimant's "legal, equitable and contractual rights" for purposes of impairment under section 1124(1). *Id.* at 203.

The *PPI Enterprises* court agreed with the bankruptcy court's analysis in *In re American Solar King Corp.*, 90 B.R. 808 (Bankr. W.D. Tex. 1988) where the bankruptcy court made the following very thoughtful observation:

> A closer inspection of the language employed in [s]ection 1124(1) reveals 'impairment by statute to be an oxymoron.' Impairment results from what the plan does, not what the statute does. A plan which 'leaves unaltered' the legal rights of a claimant is one which by definition, does not impair the creditor. A plan which leaves a claimant subject to other applicable provisions of Bankruptcy Code does no more to alter a claimant's legal rights than does a plan which leaves a claimant vulnerable to a given state's usury laws or to federal environmental laws. The Bankruptcy Code itself is a statute which, like other statutes, helps

> to define the legal rights of person's, just as surely as it limits contractual rights. Any alteration of legal rights is a consequence not of the plan but of the bankruptcy filing itself.

American Solar, 90 B.R. at 819-20.

The *Ultra Petroleum* court noted that decisions from bankruptcy courts across the country have reached the same conclusion, agreeing that impairment results from what a plan does, not from what a statute does. Its conclusion reinforces the point:

> We agree with *PPI*, every reported decision identified by either party, and Collier's treatise. Where a plan refuses to pay funds disallowed by the Code, the Code - not the Plan – is doing the impairing.

Ultra Petroleum, 2019 WL 6318074 at *5.

Like the creditors in *Ultra* Petroleum, the Unsecured Creditors' complaint is with Congress and the Bankruptcy Code, not the drafters of a Plan. The Bankruptcy Code, not the Plan, limits them to the Federal Interest Rate.[7] The cases cited by Unsecured Creditors do not apply here, as the rights in those cases were impaired by the plan and not by operation of law. *See Acequia, Inc. v. Clinton (In re Acequia*), 787 F.2d 1352, 1363 (9th Cir. 1986) (shareholder voting rights altered by plan); *In re Rexford Properties, LLC*, 558 B.R. 352, 368 (Bankr. C.D. Cal 2016) (creditor's rights regarding ongoing business altered by plan).

There is no point in discussing section 1124(2), as that subsection is not relevant to the treatment of the four not

[7] For the same reason, creditors who hold contractual claims calling for interest lower than 2.59% will fare better under the Plan.

impaired classes. Were Debtors to have proposed a treatment of the Unsecured Creditors' claims that cured, reinstated, or reversed any acceleration, then the analysis might be helpful. But because section 1124(1) is the operative section here, that ends the discussion.

Because the Plan leaves the Unsecured Creditors' claims not impaired, there is also no need to dwell on whether or not "fair and equitable" principles apply. They do not. Unimpaired Creditors, when treated as dictated by the Bankruptcy Code, are not impaired by the Plan. They are conclusively presumed to have accepted the Plan. Section 1126(f). Section 1129(b) is not available to them.[8]

VI. CONCLUSION

As a trial court in the Ninth Circuit, this court is bound to follow *Cardelucci* unless, as a matter of principled reasoning, it can be distinguished. No such grounds exist. The 1994 amendments to section 1124 predated *Cardelucci*. Thus, whether or not *Cardelucci* addressed the issue is not the point. Its rule is the law of this circuit until altered either by an *en banc* panel, the United States Supreme Court, legislation or some other controlling change in the law.

Even were *Cardelucci* not controlling, this court would follow the lead of *PPI* and *Ultra Petroleum* (and the lower court decisions cited by *Ultra Petroleum)*, and reject the contention

[8] For this reason, the court rejects as incorrect the bankruptcy court's reliance *In re Energy Future Holdings*, 540 ~~B.R. 109 (Bankr. D.~~ Del. 2015) on "equitable principles" to permit unsecured creditors in a solvent case to recover a contract rate or such other rate as it deemed appropriate.

of Objecting Creditors that imposition of the Federal Interest Rate impairs them. It is the Bankruptcy Code itself, not any plan provision, that imposes that rate.[9]

The court is not concurrently entering an order consistent with this Memorandum Decision as was the case with its recent decision in the Inverse Condemnation action (Dkt. No. 4895). Because of the close relationship between the postpetition interest question and the issues presented in the forthcoming Make-Whole dispute, orders disposing of them both at the same time seems appropriate and efficient. Whether either or both questions should be certified for direct appeal or to treated as final for purposes of Fed. R. Bankr. P. 7054, can be visited later.

END OF MEMORANDUM DECISION

[9] *Ultra Petroleum* remanded the case to the bankruptcy court to decide the appropriate Make-Whole amounts, the appropriate postpetition interest rate, and the applicability of the solvent-debtor exception. If the three judges on the Fifth Circuit panel had been members of the Ninth Circuit, there is no doubt they would have been bound by *Cardelucci*, thus limiting the remand to the Make-Whole issue.

Selected Filings from the Sears Case For IV. Administrative Claims Shall Be Paid In Full… Except When They Aren't

UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK		Hearing Date: August 16, 2019 Hearing Time: 10:00 a.m.
In re	:	Chapter 11
SEARS HOLDINGS CORPORATION, *et al.*,	:	Case No. 18-23578 (RDD)
Debtors.	:	Jointly Administered

OBJECTION OF THE UNITED STATES TRUSTEE TO MODIFIED SECOND AMENDED JOINT CHAPTER 11 PLAN OF SEARS HOLDING CORPORATION AND ITS AFFILIATED DEBTORS

TO: THE HONORABLE ROBERT D. DRAIN,
UNITED STATES BANKRUPTCY JUDGE

William K. Harrington, the United States Trustee for Region 2 (the "United States Trustee"), hereby submits this objection to the Modified Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and its Affiliated Debtors (the "Plan"). ECF Doc No. 4476. In support thereof, the United States Trustee respectfully states:

I. PRELIMINARY STATEMENT

The United States Trustee objects to confirmation of the Plan because the Debtor has failed to meet its burden of proof to show that the Plan meets the statutory requirements of section 1129 of the Bankruptcy Code. First, the Plan impermissibly seeks non-debtor third-party releases that do not comport with Second Circuit law and the Bankruptcy Code. As set forth in greater detail below, the United States Trustee respectfully requests that the Court require the Debtors to eliminate the non-debtor third party releases. Second, the Plan both releases claims against the Debtors as well as enjoins post-petition actions against the Debtors. This is the equivalent of providing the Debtor a discharge. Section 1141(d)(3) of the Bankruptcy Code,

however, prohibits liquidating debtors from receiving a discharge. Therefore, because in these cases the Debtors are liquidating, the Debtors must remove the provisions which provide the Debtor the functional equivalent of a discharge. Finally, as set forth in the Disclosure Statement, the Debtors estimate a razor thin margin to pay administrative claims in full. In order for the Plan to be confirmed, all administrative expense claims must be paid in full unless the holder of an administrative claim agrees to a different treatment. Accordingly, at confirmation the Debtors must demonstrate that the Plan complies with Bankruptcy Code section 1129(a)(9).

II. BACKGROUND

A. General Background

1. Sears Holdings Corporation and its debtor affiliates ("Sears" or "Debtors") commenced voluntary cases under chapter 11 of the Bankruptcy Code on October 15, 2018 (the "Petition Date").

2. The Debtors are authorized to continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

3. The Debtors' chapter 11 cases are being jointly administered for procedural purposes only pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure. ECF Doc. No. 118.

4. On October 24, 2018, the United States Trustee appointed the Official Committee of Unsecured Creditors. ECF No. 276.

5. On the Petition Date Sears operated 687 retail stores in forty-nine states, Guam, Puerto Rico, and the U.S. Virgin Islands. See Declaration of Robert A. Riecker, ECF Doc. No. 3, ¶ 25.

6. On February 8, 2019, the Bankruptcy Court entered the Order (I) Approving the Asset Purchase Agreement Among Sellers and Buyers, (II) Authorizing the Sale of Certain of the Debtors' Assets Free and Clear of Liens, Claims, Interests and Encumbrances, (III) Authorizing the Assumption and Assignment of Certain Executory Contracts and Leases in Connection Therewith and (IV) Granting Related Relief (the "Sale Order"). ECF No. 2507. The Sale Order approved a transaction by which the Debtors sold substantially all of their assets.

B. The Plan and Disclosure Statement

7. On April 17, 2018, the Debtors filed their initial Joint Chapter 11 Plan of Sears Holding Corporation and its Affiliated Debtors and accompanying disclosure statement. ECF Nos. 3275 and 3276, respectively.

8. On June 28, 2019, the Court entered an Order approving the Debtors' Disclosure Statement for the Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and its affiliated Debtors. ECF No. 4392. On July 9, 2019, the Debtors filed their Disclosure Statement (the "Disclosure Statement") for Modified Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and its affiliated Debtors. ECF No. 4478.

9. On the effective date of the Plan, all of the Debtors' assets will be transferred to a liquidating trust. Disclosure Statement at 2. A liquidating trustee and liquidating trust board of directors will be appointed to carry out the terms of the Plan. Id.

10. According to the Disclosure Statement, the Debtors' estimate that administrative claims, excluding claims pursuant to section 507(b) of the Bankruptcy Code, will be approximately $468 million. Disclosure Statement at 57- 58. The Debtors further estimate, not including litigation recoveries, that they will have approximately $487 million to satisfy administrative claims. Id. at 58. To the extent the Debtors determine there will be an administrative shortfall, the Debtors state that they may solicit administrative claimants to receive less than a 100% recovery before or after the confirmation hearing. Id.

11. The Plan provides non-consensual third-party releases for the benefit of certain Released Parties.

12. Specifically, under the Plan each Released Party shall be deemed released and discharged by Releasing Parties

> from any and all Causes of Action that such Entity would have been legally entitled to assert in its own right (whether individually or collectively) based on or relating to, or in any manner arising from, in whole or in part, the Debtors, the Debtors' Estates, the Plan, the filing and administration of the Chapter 11 Cases, including the Asset Purchase Agreement, the Sale Transaction, the purchase, sale or rescission of the purchase or sale of any security of the Debtors, the subject matter of, or the transactions or events giving rise to, any Claim or Interest that is treated in the Plan, the business or contractual arrangements between any Debtor and any Released Party (other than assumed contracts or leases), the restructuring of Claims and Interests before or during the Chapter 11 Cases, the negotiation, formulation, preparation or consummation of the Plan (including the Plan Supplement), the Definitive Documents, or any related agreements, instruments or other documents, or the solicitation of votes with respect to the Plan, in all cases based upon any other act or omission, transaction, agreement, event or other occurrence taking place on or before the Effective Date; provided, that, nothing in Section 15.9(b) of the Plan shall be construed to release the Released Parties from gross negligence, willful misconduct, criminal misconduct or intentional fraud as determined by a Final Order by a court of competent jurisdiction; provided, further, that, nothing in Section 15.9(b) of the Plan shall be construed to release any Claim or Cause of Action relating to or arising from the Sale Transaction following entry of the Sale Order by the Bankruptcy Court; provided further, that nothing shall be construed to release the Released Parties

> from any Canadian Causes of Action. The Releasing Parties shall be permanently enjoined from prosecuting any of the foregoing Claims or Causes of Action released under Section 15.9(b) of the Plan against each of the Released Parties. For the avoidance of doubt, notwithstanding anything to the contrary herein, the releases set forth in section 15.9(b) of the Plan shall not apply to any investor that does not qualify as an "Accredited Investor" (within the meaning of rule 501(a) of Regulation D of the Securities Act of 1933).

Plan at Section 15.9(b).

13. Released Parties are defined under the Plan to include

> (a) the Debtors; (b) the Creditors' Committee and each of its members; (c) the Liquidating Trustee; (d) the Liquidating Trust Board; and (e) with respect to each of the foregoing entities in clauses (a) through (b), all Related Parties; provided, that, with respect to each of the foregoing entities in clauses (c) and (d), each shall not be "Released Parties" under the Plan:(i) the ESL Parties; (ii) any person or Entity against which any action has been commenced on behalf of the Debtors or their Estates, in this Bankruptcy Court or any court of competent jurisdiction prior to the Confirmation Hearing; (iii) any Entity identified as a defendant or a potential defendant of an Estate Cause of Action in the Plan Supplement; and (iv) any subsequent transferee of any of the foregoing with respect to any Assets of the Debtors; provided, further, that recovery on account of any Causes of Action against the Specified Directors and Officers, solely with respect to D&O Claims, shall be subject to the limitations set forth in Section 15.11.

Plan at Section 1.135.

14. Related Parties are defined under the Plan to include

> such Party's successors and assigns, managed accounts or funds, and all of their respective postpetition officers, postpetition directors, postpetition principals, postpetition employees, postpetition agents, postpetition trustees, postpetition advisory board members, financial advisors, attorneys, accountants, actuaries, investment bankers, consultants, representatives, management companies, fund advisors and other professionals, and persons' respective heirs, executors, estates, servants, and nominees, including the Restructuring Committee, Restructuring Subcommittee, and each of its respective members; provided, that, any ESL Party shall not be a Related Party.

Plan at 1.134.

15. Releasing Parties include holders of claims who (1) vote to accept the Plan, (2) reject the Plan or abstain from voting on the Plan but do not opt-out of the releases on their ballots. Plan at Section 15.9(b).

16. In addition to the releases, the Plan permanently enjoins holders of claims and interests from pursuing claims against, among others, the Debtors. Plan at 15.8 (b). Specifically, section 15.8(b) of the Plan provides as follows:

> Except as expressly provided in the Plan, the Confirmation Order, or a separate order of the Bankruptcy Court, all Entities who have held, hold, or may hold Claims against or Interests in any or all of the Debtors (whether proof of such Claims or Interests has been filed or not and whether or not such Entities vote in favor of, against or abstain from voting on the Plan or are presumed to have accepted or deemed to have rejected the Plan) and other parties in interest, along with their respective present or former employees, agents, officers, directors, principals, and affiliates are permanently enjoined, on and after the Effective Date, with respect to such Claims and Interests, from (i) commencing, conducting, or continuing in any manner, directly or indirectly, any suit, action, or other proceeding of any kind (including any proceeding in a judicial, arbitral, administrative or other forum) against or affecting the Debtors or the Liquidating Trust or the property of any of the Debtors or the Liquidating Trust, (ii) enforcing, levying, attaching (including any prejudgment attachment), collecting, or otherwise recovering by any manner or means, whether directly or indirectly, any judgment, award, decree, or order against the Debtors or the Liquidating Trust or the property of any of the Debtors or the Liquidating Trust, (iii) creating, perfecting, or otherwise enforcing in any manner, directly or indirectly, any encumbrance of any kind against the Debtors or the Liquidating Trust or the property of any of the Debtors or the Liquidating Trust, (iv) asserting any right of setoff, directly or indirectly, against any obligation due from the Debtors or the Liquidating Trust or against property or interests in property of any of the Debtors or the Liquidating Trust; and (v) acting or proceeding in any manner, in any place whatsoever, that does not conform to or comply with the provisions of the Plan.

Id.

III. OBJECTION

A. Confirmation Standards and Statutory Framework

There are two relevant statutes pertinent to the issues herein governing chapter 11 plan provisions and confirmation. Section 1123(b)(6) allows plan proponents to include terms that are "not inconsistent with the applicable provisions" of the Code. 11 U.S.C. § 1123(b)(6). Section 1129 of the Bankruptcy Code authorizes the bankruptcy court to confirm a plan only when it "complies with the applicable provisions of the Code." 11 U.S.C. 1129. The plan proponent bears the burden of establishing compliance with section 1129. In re Charter Commc'ns, 419 B.R. 221, 243-44 (Bankr. S.D.N.Y. 2009) (citing Heartland Fed. Savs. & Loan, Ass'n v. Briscoe Enters. (In re Briscoe Enters.), 994 F.2d 1160, 1165 (5th Cir. 2993) (stating that "[t]he combination of legislative silence, Supreme Court holdings, and the structure of the Code leads this Court to conclude that preponderance of the evidence is the debtor's appropriate standard of proof both under §1129(a) and in a cramdown")); In re Worldcom, Inc., No. 02-13533 (AJG), 2003 WL 23861928, at *46 (Bankr. S.D.N.Y. Oct. 31, 2003) (citing In re Briscoe Enters.).

B. The Plan Improperly Deems Consent to Third-Party Releases[1]

The Plan improperly deems that the Released Parties are released by creditors that vote to reject the Plan or abstain from voting on the Plan but do not opt-out of the releases on their ballots. Plan at Section 15(9)(b).

1 The United States Trustee acknowledges that in several other cases the Court has overruled the United States Trustee's objection to plan confirmation regarding the need for an opt-in requirement for third-party releases. Nonetheless, particularly under the facts of these cases, including the potential for a small distribution to unsecured creditors in these liquidating cases, the United States Trustee reiterates his prior position herein.

The Court in In re SunEdison, Inc., 576 B.R. 45, 13-14 (Bankr. S.D.N.Y. 2017) ruled that creditors who did not affirmatively vote could not be deemed to consent to the releases in the plan. The Court in SunEdison cited to the following language in In re Chassix Holdings, 533 B.R. 54, 81 (Bankr. S.D.N.Y. 2015) ("Chassix"):

> Charging all inactive creditors with full knowledge of the scope and implications of the Proposed third party *releases*, and implying a "consent" to the third party *releases* based on the creditors' inaction, is simply not realistic or fair, and would stretch the meaning of "consent" beyond the breaking point.

Emphasis in original.

Further, the SunEdison Court held that the debtors have failed to sustain their burden of proving that the Court had subject matter jurisdiction to approve the third party releases. In re SunEdison, Inc., 576 B.R. 453 (Bankr. S.D.N.Y. 2017). In that case, the non-voting releasors did not consent to the release, the creditors were not being paid in full, and the third party claims would have been extinguished rather than channeled to a fund for payment. Id. Further, the debtors did not identify which third party claims would directly impact their reorganization and given the scope of the release, the Court determined that it is likely that many of the claims would not impact the reorganization. Id. Thus, the Court granted the debtors leave to propose a modified form of release under the condition that they must specify the release by name or readily identifiable group and the claims to be released, demonstrate how the outcome of the claims to be released might have a conceivable effect on the debtors' estates and show that this is one of the rare cases involving unique circumstances in which the release of the claims is appropriate under Metromedia. Id.

The Chassix Court also made clear its opposition to requiring creditors to opt out of the releases. The Court required the debtors to revise the definition of "Consenting Creditors" in the

plan and did not permit an opt-out procedure for creditors who abstained from voting, voted to reject the plan, or were deemed to accept or reject the plan. Chassix, 533 B.R. at 80-82. Accordingly, creditors who reject the Plan or abstain from voting on the Plan but do not opt- out of the releases on their ballots should not be deemed to have consented to the third-party releases in the Plan.

Additionally, the Plan, if confirmed, will provide releases to a wide range of third parties. Specifically, third-party releases include the Released Parties' successors and assigns, managed accounts or funds, and all of their respective postpetition officers, postpetition directors, postpetition principals, postpetition employees, postpetition agents, postpetition trustees, postpetition advisory board members, financial advisors, attorneys, accountants, actuaries, investment bankers, consultants, representatives, management companies, fund advisors and other professionals, and persons' respective heirs, executors, estates, servants, and nominees, including the Restructuring Committee, Restructuring Subcommittee, and each of its respective members. Plan at Sections 1.134 and 1.135. The Debtors have not met their burden to prove that the Court has subject matter jurisdiction to release this multitude of persons who qualify as Released Parties from claims of the creditors who do not opt out of the third-party releases. See In re SunEdison, Inc., 576 B.R. at 463.

C. The Debtor Release and Injunction are Akin to a Discharge and Should Not be Permitted Under Section 1141(d)(3)

The Debtors are defined as a Released Party under the Plan. Plan at 1.135. Section 15.8 of the Plan enjoins holders of claims and interests from pursuing claims against the Debtors. Plan at Section 15.8(b). Section 1141(d)(3) of the Bankruptcy Code provides that the confirmation of a plan does not discharge a debtor if (i) the plan provides for the liquidation of

all or substantially all of the property of the estate, (ii) the debtor does not engage in business after consummation of the plan, and (iii) the debtor would be denied a discharge under section 727(a) of the Bankruptcy Code if the case were a Chapter 7 liquidation case. 11 U.S.C. §1141(d)(3); see also In re Wood Family Interests, Ltd., 135 B.R. 407, 410 (Bankr. D. Colo. 1989)(holding that a discharge is not available to corporate or partnership debtors who propose a liquidating plan of reorganization). Because (i) the Plan provides for the liquidation of the Debtors' assets, (ii) the Debtors will not retain any significant assets to operate after the consummation of the Plan, and (iii) the Debtor, as a corporation, would not be entitled to a discharge in a Chapter 7 case, the Court should direct the Debtors to remove those portions of the Plan that provide for releases and injunctions to be provided the Debtors. See In re Bigler, LP, 442 B.R. 537, 544-56 (Bankr. S.D. Tex. 2010 (where liquidating debtor is not permitted a discharge due to section 1141(d)(3), a plan injunction preventing post-confirmation prosecution of claims that would operate as a discharge is also impermissible).

D. The Debtors Must Meet Their Burden and Demonstrate That They Comply with Section 11 U.S.C. 1129(a)(9)

For the Plan to be confirmed administrative expense claims must be paid in full, unless the holder of an administrative claim agrees to a different treatment. 11 U.S.C. § 1129(a)(9). As set forth in the Disclosure Statement, the Debtors' estimate a razor thin margin to pay administrative claims in full. Disclosure Statement at 58. Accordingly, at confirmation the Debtors must demonstrate that the Plan complies with Bankruptcy Code section 1129(a)(9).

IV. CONCLUSION

WHEREFORE, the United States Trustee respectfully submits that the Court sustain the Objection of the United States Trustee and grant such other relief as is just.

Dated: New York, New York
August 1, 2019

Respectfully Submitted,

WILLIAM K. HARRINGTON
UNITED STATES TRUSTEE

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Hearing Date and Time:
August 16, 2019 at 10:00 am (EST)

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
SEARS HOLDING CORPORATION, *et al.*,	Case No. 18-23538 (RDD)
Debtors.[1]	(Jointly Administered)

OBJECTION BY PEARL GLOBAL INDUSTRIES LTD. TO CONFIRMATION OF MODIFIED SECOND AMENDED JOINT CHAPTER 11 PLAN OF SEARS HOLDINGS CORPORATION AND ITS AFFILIATED DEBTORS

[1]The Debtors in these Chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc. (4861); Sears Roebuck Acceptance Corp. (0535); Sears, Roebuck de Puerto Rico, Inc. (3626); SYW Relay LLC (1870); Wally Labs LLC (None); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); SHC Licensed Business LLC (3718); SHC Promotions LLC (9626); Sears Brands Management Corporation (5365); and SRe Holding Corporation (4816). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

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TO THE HONORABLE ROBERT D. DRAIN,
UNITED STATES BANKRUPTCY JUDGE:

Pearl Global Industries, Ltd. ("Pearl Global"), an administrative expense claimant under §§503(b)(1) and (b)(9)[2] of the Bankruptcy Code,[3] by its attorneys, Davidoff Hutcher & Citron LLP, submits the following objection to the Modified Second Amended Joint Chapter 11 Plan of Sears Holdings Corporation and its Affiliated Debtors ("Plan"), and represents and says:

PRELIMINARY STATEMENT

1. The Plan may not be confirmed because it violates §§1129(a) (7) and (9) of the Bankruptcy Code. The Debtors' estates are administratively insolvent and the Plan is not feasible.

2. The critical issue relating to §503(b)(9) claims remains unresolved and the amount of these claims is too large for the Debtors to satisfy the feasibility requirement for confirmation. The Debtors kicked the can down the road, so as to avoid the gatekeeping issue for allowance or disallowance of §503(b)(9) claims (e.g whether vendor claims should be evaluated under the Third Circuit's *World Imports* analysis or that of the lower courts in that case). Accordingly, the Debtors will need to adequately reserve for these claims.

3. In addition to the unresolved §503(b)(9) claims, there are unresolved administrative claims under §503(b)(1), including Pearl Global's "inducement" claim totaling $961,625.92 relating to goods ordered pre-petition but received by the Debtors post-petition. According to the Debtors, there are $63 million of claims relating to goods ordered pre-petition but provided to the Debtors post-petition. Because the Debtors have refused, to date, to engage

[2] Pearl Global filed two §503(b)(9) claims totaling $630,897: (i) a claim against Sears for $134,673 and (ii) a claim against Kmart for $496,224.

[3] Pearl Global was the Debtors' largest vendor in India and its third largest supplier of women's apparel in the world.

in discovery on this issue, it is presently unknown how many of these claimants also have valid inducement claims under §503(b)(1). Accordingly, the Debtors will need to adequately reserve for these claims.

4. Therefore, it appears impossible for the Debtors to present a sufficient record for the Court to find, by a preponderance of the evidence, that the Plan is feasible.

BACKGROUND

A. The Chapter 11 Filing

5. On October 15, 2018, Sears filed for chapter 11 protection. Notably, this bankruptcy was not an emergency filing but, rather, a slow slide into bankruptcy over many years during which time Sears' demise was widely reported in the financial news. In fact, Sears has been liquidating outside of a formal bankruptcy proceeding for many years prior to the commencement of this case. Accordingly, Sears' had plenty of time to plan for this bankruptcy.

B. October 15, 2018 Letter to Vendors by Sears CFO

6. A significant amount of goods sold by Sears was manufactured by foreign vendors who usually shipped their goods by boat. The amount of time to deliver these goods, from loading the goods overseas to unloading them in the United States, usually took more than twenty (20) days. This worldwide supply chain was critical to Sears' business and its ability to continue in chapter 11, whether to reorganize or sell its assets as a going concern.

7. Thus, when this case was filed, Sears was very concerned that foreign vendors might stop their goods in transit,[4] or refuse to provide goods post-petition, if they did not receive assurances that payment would be made for goods delivered after the bankruptcy filing.

[4] On the Petition Date, $961,625.92 worth of Pearl Global's goods were in transit under various prepetition orders from the Debtors.

8. To induce its vendors not to stop goods in transit, Sears sent a "Letter to Vendors" dated October 15, 2019, by Robert Riecker, its Chief Financial Officer, to various vendors[5] stating:

> **We do not anticipate any impact to vendor payments:** We intend to pay vendors in the ordinary course for all goods and services provided on or after the filing date. Invoices for these goods and services should be submitted through the ordinary channels, and payments will be processed in accordance with the terms of our purchase order or contract. Claims for amounts owed, for goods delivered, and services rendered prior to the filing date will be determined by the Court.

Exhibit A (emphasis in the original).

9. Also, Sunaina Kapoor, the Debtors' employee responsible for direct communications with Pearl Global, sent an email to Pearl Global, on October 18, 2018, quoting, almost entirely, Mr. Riecker's statement about payment for all goods and services "provided" on or after the filing date":

> The company intends to pay our vendors in the ordinary course for all goods and services provided on or after the filing date. Invoices for these goods and services should be submitted through the ordinary channels, and payments will be processed in accordance with the terms of our purchase order or contract. Claims for amounts owed, for goods delivered, and services rendered prior to the filing date will be determined by the Court.

Exhibit B.

C. Debtors' Initial List of Allowed §503(b)(9) Claims and "Guaranty of Payment" to Foreign Vendors

10. Apparently, in preparation for its bankruptcy filing, Sears prepared a list of vendors entitled to §503(b)(9) claims. On October 18, 2019, Michael Mcelwee, Director of Sourcing-Sears and Kmart Women's Apparel, told Mr. Kapoor, among others, that he could sort

[5] Counsel for Pearl Global has requested the Debtors to provide a list of all vendors to whom the Letter to Vendors was sent but, to date, the Debtors have refused to provide this list.

this information for women's apparel vendors so as to show each vendor their allowed §503(b)(9) shipments:

> Hi All,
>
> This is an update on the pre-petition payments. Would like you to know that all goods received up to **20 days prior** to the 10/15 filing are guaranteed to pay 100% by the court.
> Attached you will find the vendor receipts list that shows which vendors orders are guaranteed. You can sort to show your vendors. *This is good news!*

Exhibit C (emphasis in original). Mr. Kapoor then repeated this "pre-petition guarantee" (see the subject line of the email) to at least one foreign vendor, Eskay International PVT LTD, stating:

> Sharing payment update for your reference:
>
> Quote……
> This is an update on the pre-petition payments. Would like you to know that all goods received up to **20 days prior** to the 10/15 filing are guaranteed to pay 100% by the court.
> Attached you will find the vendor receipts list that shows which vendors orders are guaranteed. You can sort to show your vendors. *This is good news!*
> Unquote……..

Exhibit D (emphasis in original).

D. <u>The Vendor Comfort Order</u>

11. On November 20, 2018, upon motion by the Debtors,[6] the Court entered an order to give comfort to vendors about payment for their goods: the *Final Order Authorizing Debtors*

[6] Paragraph "19" of the Debtors' motion (Doc 14) stated:

> Prior to the Commencement Date, and in the ordinary course of business, the Debtors ordered approximately $162 million in Merchandise from suppliers and vendors that will not be delivered until on or after the Commencement Date (the "Prepetition Orders"). These suppliers and vendors may be concerned that, because the Debtors' obligations under the Prepetition Orders arose prior to the Commencement Date, such obligations will be treated as general unsecured claims in these Chapter 11 Cases. <u>Accordingly, certain vendors may refuse to provide goods to the Debtors (or may recall shipments thereof) purchased pursuant to the Prepetition Orders unless the Debtors issue substitute purchase orders postpetition or obtain an order of the Court providing that all undisputed obligations of the Debtors arising from the postpetition delivery of goods subject to</u>

to (I) Pay Prepetition Claims of (A) Shippers, Warehousemen, and Other Non-Merchandise Lien Claimants, and (B) Holders of PACA/PASA Claims, and (II) Confirm Administrative Expense Priority for Prepetition Orders Delivered to the Debtors Postpetition, And Satisfy Such Obligations in the Ordinary Course of Business (the "Vendor Comfort Order") [Doc. No. 843]. Paragraph "8" of the Vendor Comfort Order provided that:

> All undisputed obligations of the Debtors arising from the postpetition delivery or shipment [] of goods under the Prepetition Orders are granted administrative expense priority status pursuant to section 503(b)(1)(A) of the Bankruptcy Code, and the Debtors are authorized, but not directed, to pay such obligations in the ordinary course of business consistent with the parties' customary practices in effect prior to the Commencement Date.

E. The Asset Purchase Agreement and §503(b)(9) Claims

12. On February 11, 2019, after Court approval, the Debtors sold substantially all of their assets to Transform Holdco LLC ("Transform"), pursuant to an Asset Purchase Agreement dated January 17, 2019 ("APA"). Pursuant to the APA, Transform agreed to assume up to $139 million of §503(b)(9) claims.[7] However, the APA failed to explain how Transform would or could know which §503(b)(9) claims to pay. Also, the Disclosure Statement does not explain which §503(b)(9) claims Transform should pay or, otherwise, how Transform should know or decide which §503(b)(9) claims it should pay.

F. Procedures Order for §503(b)(9) Claims Kicked the Can Down the Road

13. According to the Debtors, $1.36 billion in §503(b)(9) claims have been filed. However, according to the Debtors, there are many duplicate claims and other reasons why most of these claims should not be allowed. Further, according to the Debtors, allowed §503(b)(9)

Prepetition Orders are afforded administrative expense priority status under section 503(b) of the Bankruptcy Code. (emphasis added).

[7] This $139 million payment obligation was subject to potential offsets that could significantly reduce the amount of this payment.

claims should total only $181 million. However, the Debtors have not provided their analysis of these claims.

14. Furthermore, the Debtor's obtained an order from the Court barring any §503(b)(9) claimant from filing a motion to allow their claim. *See* Doc 2673, ¶20. Instead, the Debtors sought to address these claims through a claims resolution process. *See id*., ¶19(a)-(c). The Debtors were required to provide monthly reports, beginning April 1, 2019, showing their progress in resolving these claims.[8] The Disclosure Statement does not provide any information about these reports.

G. Section 503(b)(1) "Inducement" Claims

15. Pearl Global filed a motion for allowance of an administrative expense claim in the amount of $961,625.93, pursuant to §503(b)(1), relating to goods ordered by Sears pre-petition but delivered post-petition. Several other vendors filed similar motions and the Debtors opposed all of them. On May 21, 2019, the Court denied these motions, to the extent they were based upon the argument that the enactment of §503(b)(9) in 2005 with BAPCPA, should change the legal analysis the courts have used to resolve §503(b)(1) claims based upon goods ordered pre-petition but received by debtors in possession post-petition.

16. However, Pearl Global's §503(b)(1) motion included an additional argument based upon an "inducement" theory and the Court ruled that the record on this issue needed to be developed. Because the Debtors have, to date, refused to engage in discovery on this issue, they will need to reserve, in full, for this claim. Also, it is presently unknown how much of the $63 million in goods ordered pre-petition but delivered to the Debtors post-petition may be subject to similar inducement claims under §503(b)(1).

[8] Counsel for Pearl Global has requested copies of these monthly reports but the Debtors have refused to provide them.

H. The Plan and Payment of Administrative Expenses Including §503(b)9) Claims

17. Section 2.1 of the Plan provides that, except to the extent that a holder of an Allowed Administrative Expense Claim agrees otherwise, each holder of an Allowed Administrative Expense Claim (other than a Fee Claim) shall receive cash in an amount equal to such Allowed Administrative Expense Claim. *See* Plan, § 2.1(a). Specifically, holders of Administrative Expense Claims will be paid:

> (x) first out of the Wind Down Account; and (y) *if the amount available for Distribution pursuant to the foregoing clause (x) is insufficient* to remit all Distributions required to be made to such holders pursuant to this sentence, *subject to* the payment in full of any Allowed ESL 507(b) Priority Claims and Other 507(b) Priority Claims in accordance with Sections 2.4 and 2.5 of the Plan, respectively, from the Net Proceeds of Total Assets; provided, that, for the avoidance of doubt Administrative Expense Claims shall be paid on the latest of (i) the Effective Date, (ii) the first Business Day after the date that is thirty (30) calendar days after the date such Administrative Expense Claim becomes an Allowed Administrative Expense Claim, and (iii) the next Distribution Date after such Administrative Expense Claim becomes an Allowed Administrative Expense Claim. For the avoidance of doubt, this Section 2.1 shall not govern Distributions on Allowed ESL 507(b) Claims and Other 507(b) Priority Claims and Distributions on such Claims shall be governed by Sections 2.4 and 2.5 of the Plan, respectively. [Plan, § 2.1(a)]

18. In accordance with the APA, holders of Allowed Administrative Expense Claims arising under §503(b)(9) shall be paid:

> (x) first by or on behalf of the Debtors on or after the date that Transform or any of its subsidiaries satisfies any amounts that may be owed pursuant to section 2.3(k)(iv) of the Asset Purchase Agreement up to $139 million in the aggregate, *as may be reduced*, dollar-for-dollar by, as applicable, the Aggregate DIP Shortfall Amount, Specified Receivables Shortfall Amount, Warranty Receivables Shortfall Amount and Prepaid Inventory Shortfall Amount (as those terms are defined in the Asset Purchase Agreement) and less any amounts previously satisfied by the Transform or any of its subsidiaries, and (y) if the amount available for Distribution

> pursuant to the foregoing clause (x) is insufficient to remit all Distributions required to be made to such holders pursuant to this sentence, in accordance with Section 2.1(a). [Plan, § 2.1(b)].

19. Pursuant to the Plan, Allowed Fee Claims shall be satisfied in full from (a) the proceeds of the Carve Out Account (as defined in the DIP Order), and (b) net proceeds of the Total Assets. As set forth in the Plan, such Fee Claims will be paid:

> in full, in Cash, by the Debtors or Liquidating Trust, as applicable, in such amounts as are Allowed by the Bankruptcy Court (i) on the date upon which an order relating to any such Allowed Fee Claim is entered or as soon as reasonably practicable thereafter; or (ii) upon such other terms as may be mutually agreed upon between the holder of such an Allowed Fee Claim, the Debtors (subject to the consent of the Creditors' Committee, not to be unreasonably withheld), or the Liquidating Trustee, as applicable, (x) first out of the Carve Out Account; and (y) if the amount available for Distribution pursuant to the foregoing clause (x) is insufficient to remit all Distributions required to be made to such holders pursuant to this sentence, from the Net Proceeds of Total Assets. Notwithstanding the foregoing, any Fee Claims that are authorized to be paid pursuant to any administrative orders entered by the Bankruptcy Court may be paid at the times and in the amounts authorized pursuant to such orders. [Plan, § 2.2(b).]

20. As of June 22, 2019, the Debtors estimated that the Administrative Expense Claims, excluding any claim entitled to administrative priority under §507(b) of the Bankruptcy Code, total approximately $468 million for all of the Debtors. *See* Disclosure Statement, § IV.T.

21. However, this estimate included only $181 million in §503(b)(9) claims and, presumably, it did not include Pearl Global's §503(b)(1) inducement claim nor any of the other potential inducement claims from the $63 million pool of claimants.

22. When the Disclosure Statement was filed, the Debtors estimated that the assets available to satisfy Administrative Expense Claims would total approximately $487 million.

However, this includes Transform's agreement to assume up to $263 million of liabilities (subject to reduction in accordance with the APA), $69 million in various operating accounts, $69 million in the professional fee Carve Out Account, and $39 million in cash and inventory being withheld by Transform. Transform has disputed the amounts the Debtors claim are owed under the APA and these issues are the subject of ongoing litigation before the Court, as well as litigation relating to §507(b) claims, the results of which are still pending.

ARGUMENT

POINT I

THE PLAN VIOLATES § 1129(a)(9)

23. The Plan violates §1129(a)(9) because holders of allowed administrative expenses will not be paid in full, on the effective date, nor will there be sufficient funds in reserve to pay any such claims that are disputed if and when such claims are allowed.[9] *See Midway Airline Parts, LLC v. Midway Airlines Corp. (In re Midway),* 406 F.3d 229, 242 (4th Cir. 2005) (noting that "an administrative expense claim under §503(b) must be paid in cash on the effective date of the plan in a chapter 11 proceeding"); *Pan Am Corp. v. Delta Air Lines*, 175 B.R. 438, 483 (Bankr. S.D.N.Y. 1994) (referring to Bankruptcy Code section 1129(a)(9) as the "administrative solvency" requirement and stating that "[b]y itself, administrative insolvency would have prevented confirmation of the Joint Plan."); *see also In re Teligent, Inc.*, 282 B.R. 765, 722 (Bankr. S.D.N.Y. 2002) (noting, when a debtor tried to pay administrative claimants less than full payment, that any administrative creditors solicited by the debtors could prevent confirmation by refusing the different treatment and demanding payment in full); *In re Scott*

[9] The timing and payment of administrative claims is governed by §1129(a)(9)(A) of the Bankruptcy Code, which requires that, with respect to administrative expense claims, "on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim," unless the "holder of a particular claim has agreed to a different treatment of such claim. 11 U.S.C. § 1129(a)(9).

Cable Commc'ns, Inc., 227 B.R. 596, 600 (Bankr. D. Conn. 1998) ("The code's confirmation scheme elevates allowed administrative claims to a dominant priority such that unless the holders agree to a different treatment, a plan cannot be confirmed without full payment of those claims even if there are no estate assets to pay them.").

24. No matter how much they try to manipulate the numbers, the Debtors will be unable to establish administrative solvency under the record that will be before the Court.[10] The Debtors made a conscious decision to avoid any resolution of issues underlying hundreds of millions of dollars of administrative claims and, by kicking the can down the road, they will be unable to satisfy §1129(a)(9).

25. It is undisputed that filed §503(b)(9) claims total *in excess of $1.3 billion dollars* and, while the Debtors may argue that allowed §503(b)(9) claims will total only $181 million, *see* Disclosure State, § IV.T., there is no support for this billion dollar plus reduction in §503(b)(9) claims.[11]

26. In addition to the huge amount of unresolved §503(b)(9) claims, the Debtors have ignored the §503(b)(1) inducement claims which could total in excess of $50 million.[12]

27. In addition to the unresolved issues relating to the §503(b)(9) claims and

[10] Any reliance upon prospective outcomes and recoveries from avoidance claims and the Lampert/ESL Lawsuit is insufficient for the Debtors to meet their burden of satisfying §1129(a)(9). *See e.g.*, *In re Am. Capital Equip., LLC*, 688 F.3d 145, 156 (3d Cir. 2012) ("A plan will not be feasible if its success hinges on future litigation that is uncertain and speculative, because success in such cases is only possible, not reasonably likely.") (quoting *Sherman v. Harbin (In re Harbin)*, 486 F.3d 510, 519 (9th Cir. 2007)); *Quarles v. U.S. Trustee*, 194 B.R. 94, 97 (W.D. Va. 1996) (stating that a debtor's premise "that outcomes in pending litigation favorable to him will cure his financial ills is pure speculation" and concluding that the debtor did not have a reasonable likelihood of effectuating a reorganization).

[11] The Debtors should be required to produce all of the monthly reports showing what progress has been made to reduce the pool of §503(b)(9) claims. Also, it should be relatively easy for the Debtors to identify all of the duplicate claims and tabulate the total amount. Whatever information supports the Debtor's purported reduction in §503(b)(9) claims by over one billion dollars also be disclosed.

[12] This could be a very significant number, since there are up to $63 million in claims that could fall within this category. The Debtors should know how many vendors received the Letter to Vendors or the fee guarantee.

§503(b)(1) inducement claims, the Debtors numbers simply will not withstand scrutiny at the confirmation hearing. Even the Creditors' Committee recently observed that "there remains a significant possibility that any plan confirmed in these cases will require concessions by the Debtors' administrative creditors." ECF No. 4239, ¶ 2; *see also* ECF No. 4636, ¶ 17 (Declaration in Support of Motion of Debtors for Modification of Retiree Benefits). [13]

28. Simply put, the Debtors cannot demonstrate by a preponderance of the evidence their ability to pay, or reserve for, the §503(b)(9) Claims. *See, e.g., JP Morgan Chase Bank, N.A. v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns, Inc.),* 419 B.R. 221, 244 (Bankr. S.D.N.Y. 2009) (observing that plan proponent bears the burden of establishing by a preponderance of the evidence that a plan meets the requirements of section 1129 of the Bankruptcy Code).

29. The Wind Down account balance, as of the confirmation hearing, is likely to be short, by a large amount, of the cash needed for confirmation. Among other deficiencies, it appears that the Debtors have not included costs associated with litigating disputes with Administrative Expense Claims, which apparently will involve both the attorneys for the Debtors as well as the attorneys for the Creditors Committee, and these undisclosed costs will add to the risk of administrative insolvency.

30. In sum, the Debtor have not demonstrated that the proposed treatment of administrative claims under the Plan satisfies the requirements of §1129(a)(9) of the Bankruptcy Code and this failure renders the Plan unconfirmable as a matter of law. *See, e.g.*, *In re Teligent,*

[13] While the Creditors Committee may have recognized that the only way a Plan can be confirmed in this case will be for the Debtors to negotiate with the administrative creditor body, so that they accept different treatment than that required under §1129(a)(9)(A), the Debtors have chosen a different strategy based upon their misguided view that the Court is, somehow, so invested in having a Plan confirmed that it will run roughshod over the foreign vendors' rights. Then, after confirmation, the Debtors will pick off the foreign vendors one at a time. Since hope springs eternal, Pearl Global is cautiously optimistic that the Debtors will soon realize that a different path should be taken, one that results in a plan the administrative vendor group can support.

Inc., 282 B.R. at 722.

POINT II

THE PLAN IS NOT FEASIBLE PURSUANT TO SECTION 1129(A)(11)

31. Section 1129(a)(11) of the Bankruptcy Code contains the "feasibility requirement" for conformation of a plan and it requires that:

> [c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

11 U.S.C. § 1129(a)(11); *In re Adelphia Business Solutions,* 341 B.R. 415, 421 (Bankr. S.D.N.Y. 2003). The purpose of the feasibility require "is to protect creditors against unrealistic plans that have little or no chance of success. *In re Adelphia Business Solutions,* 341 B.R. at 421. "[A] plan based on impractical or visionary expectations cannot be confirmed." *Id.* (quoting *In re Prudential Energy Co.,* 58 B.R. 857, 862 (Bankr. S.D.N.Y. 1986)).

32. By a preponderance of the evidence, the Debtors must demonstrate that the Plan's provision for the payment of all allowed administrative expense claims is feasible. This requires cash payments upon the effective date or appropriate cash reserves. However, the Debtors have not demonstrated, by a preponderance of the evidence, their ability to pay or reserve for Pearl Global's administrative claims, along with the other administrative claims that that must be paid or protected by an adequate reserve.

33. Notably, no objections to §503(b)(9) claims have been filed. Even more importantly, no estimation motions have been filed. Thus, it will be procedurally impossible for the Debtors to develop a sufficient record for the Court to even rule on feasibility. On what basis

will the Court be able to estimate $1.36 billion of filed §503(b)(9) claims at $181 million?[14]

34. It appears that the Debtors must win every dispute with Transform and the second lien lenders, and every other contingency and uncertainty, as of the transmittal of the Disclosure Statement, must fall in the Debtors favor for any possible feasibility of the Plan and, even then, most of the Debtors' estates will still be insolvent. And if the Debtors' have understated the projected expenses of the wind down, which we believe they have, then establishing the requisite proof of administrative solvency seems all but impossible.

35. Accordingly, the Plan cannot be confirmed because it is not feasible as required by §1129(a)(11).

CONCLUSIONS

Denying confirmation of the Plan does not mean that this case must be converted to a chapter 7 liquidation. The Debtors should negotiate with the administrative creditor body in an effort to reach a consensual Plan.

Dated: New York, New York
August 2, 2019

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[14] While the Court may have wide latitude in the manner in which it conducts the claim estimation process under Section 502, *see Adelphia*, 341 B.R. at 422-23, there still must be some modicum of due process. In *Adelphia*, Judge Gerber conducted a two-day evidentiary hearing on the feasibility of a large administrative claim that was critical to the issue of feasibility.

EXHIBIT A

Letter to Vendors

Date: October 15, 2018
To: Vendors
From: Robert Riecker
Re: An Important Update from Sears Holdings

To our valued vendors:

I am writing to give you an important update about Sears Holdings.

We have announced a series of actions to position us to establish a sustainable capital structure, continue streamlining our operations, and grow profitably for the long term. While we have sought to avoid a Chapter 11 process, we have ultimately determined that this is the most effective and orderly way to achieve a debt solution as efficiently as possible and be better positioned for the future. We began this process on October 15. Our goal is to emerge as a member-centric company, reorganized around a smaller platform of profitable stores, with the capital needed to allow us to prosper in the future.

We appreciate your ongoing support and are committed to being a great partner to you through this period and beyond. As a first step, we filed a number of customary motions with the Bankruptcy Court to ensure a smooth transition into the restructuring process without disruption to our day-to-day operations.

I would like to highlight some key points from our announcement:

- **We're open for business:** Our Sears and Kmart stores, and online and mobile platforms, are open and continue to serve our members and customers. Further, Sears Holdings' services and brand businesses will also operate as usual. We continue to rely on you to provide the goods and services necessary for us to continue providing our customers and members with trusted service.

- **We do not anticipate any impact to vendor payments:** We intend to pay vendors in the ordinary course for all goods and services provided on or after the filing date. Invoices for these goods and services should be submitted through the ordinary channels, and payments will be processed in accordance with the terms of our purchase order or contract. Claims for amounts owed, for goods delivered, and services rendered prior to the filing date will be determined by the Court.

- **We have sufficient funding for ongoing operations:** We have received commitments for $300 million in new debtor-in-possession (DIP) financing and are negotiating a $300 million subordinated DIP financing. Subject to court approval, this financing is expected to support our operations - and meet our obligations to vendors - during this process.

LEADERSHIP CHANGES

In conjunction with this news, Eddie Lampert has stepped down as CEO. To manage the day-to-day operations of the Company, our Board of Directors has created an Office of the CEO, which will be composed of Robert A. Riecker, Chief Financial Officer; Leena Munjal, Chief Digital Officer; and Gregory Ladley, President of Apparel and Footwear. This strong group will be supported by our new Chief

Restructuring Officer, Mohsin Meghji of M-111 Partners, as well as the rest of our Senior Leadership Team. They will be very focused on our vendor partners, and look forward to working with you through our restructuring process.

KEEPING YOU INFORMED

As part of our commitment to you, we will update you throughout the process. You can expect that your points-of-contact at the company will remain the same - and you will be hearing from this person shortly.

In the meantime, to help answer questions you may have about our restructuring, we have posted information for our vendors, including FAQs, on the following website: restructuring.searsholdings.com. You can also contact Sears Holdings' claims agent, Prime Clerk, at (844) 384-4460 (for toll-free domestic calls) and +1 (929) 955-2419 (for tolled international calls), or email searsinfo@primeclerk.com. While we anticipate today will be a very busy day, we will make every effort to return your call or email and connect with you on any questions you may have.

Thanks to your continued support and the proactive steps we're taking, we look forward to Sears Holdings emerging stronger than before. We look forward to continuing our work together.

Sincerely,

Robert Riecker
Chief Financial Officer

###

Vendor Talking Points

Introduction

- As one of our valued vendors, we want to give you an important update about Sears Holdings.
- As you know, over the last several years, we have worked hard to transform our business.

Our Chapter 11 Filing

- We have announced a series of actions to position us to estabiish a sustainabie capital structure, continue streamlining our operations, and grow profitably for the long term.
- Our goal is to emerge as a member-centric company, reorganized around a smaller platform of profitable stores, with the capital needed to allow us to prosper in the future.

Business as Usual

- We are open for business and the restructuring will have little impact on our day-to-day operations.
- As a first step, we filed a number of customary motions with the Bankruptcy Court to ensure just that.
- Importantly, we have sufficient funding for ongoing operations.
- We have received commitments for $300 million in new debtor-in-possession {DIP) financing and are negotiating a $300 million subordinated DIP financing.
- Subject to court approval, this financing is expected to support our operations - and meet our obligations to vendors - during this process.

Impact on Vendor Claims

- We intend to pay vendors and partners in the ordinary course for all goods and services provided on or after the filing date.
    - o Invoices for these goods and services should be submitted through the typical channels, and payments will be processed in accordance with the terms of your purchase order or contract.
- Claims for amounts owed, for goods delivered, and services rendered prior to the filing date will be determined by the Court.

Leadership Change

- To manage the day-t o-day operations of the Company, our Board of Directors has created an Office of the CEO, which will be composed of Robert A. Riecker, Chief Financial Officer; Leena Munjal, Chief Digital Officer; and Gregory Ladley, President of Apparel and Footwear.

- The Office of the CEO will be supported by our newly appointed Chief Restructuring Officer, Mohsin Meghji of M-111 Partners, as well as our Senior Leadership Team.

- They will be very focused on our vendor partners, and look forward to working with you through our restructuring process.

- Eddie Lampert has stepped down as CEO . He will remain Chairman of the Board.

Ongoing Partnership with Our Vendors

- We are committed to being a great partner to you through this period and beyond.

- We are committed to paying you on a timely basis for the goods and services you provide to us on a going-forward basis.

- During this process, we continue to rely on you to provide the goods and services necessary for us to continue providing our customers and members with trusted serv ice.

Commitment to Communication

- We will provide updates throughout the process as events warrant .

- You can expect that your point s-of - cont act at the company will remain the same.

- I'm happy to answer any questions you may have to the best of my abilities.

- To help answer some of the most common vendor questions about our restructuring, we have posted information for our vendors, includ ing FAQs, on the following website: restructuring.searsholdings.com.

Conclusion

- Thank you for your continued support.

- We believe the pro act ive steps we're taking will help Sears Holdings emerge stronger than before.

###

EXHIBIT B

From: Sunaina Kapoor (India) <Sunaina.Kapoor@searshc.com>
Sent: Tuesday, 16 October 2018 12:22 **PM**
To: Sanjay Sarkar <sarkar@norpknit.com>
Cc: Pankaj Aggarwal <panka j.aggarwal(fv.pearlglobal.com>; ashish.garg@pearlgloba l.com; **pulkit** seth <pulkit.seth@pearlglobal.com>; Md, Safeyee (Bangladesh) <Safeyee.Md@searshc.com>; 'Abhinaov **Dhain'** <abhinaov.dhain@pearlglobal.com>; manu gautam <manu.gautam@pearlglobal.com>
Subject: FW: Vendor payments/Letter to Vendors

Hi Mr Sarkar,

Yesterday Sears Holdings announced a series of actFt1%}ti sition us to establish a sustainable capital structure, continue streamlining our operations and grow profitably for the long term.

While we sought to avoid a Chapter 11 process, we have ultimately determined this is the most effective and orderly way to undertake these actions. Our goal is to emerge as a member-centric company, reorganized around a smaller platform of profitable stores, with the capital needed to allow us to prosper in the future.

We would like to share below email from SIIC regarding filing of pending payment details on the given link.

Please do the needful on priority.

Quote .....

If goods were delivered or rendered prior to the filing date they should:

Visit the website managed by our Claims Agent at https://restructuring.primeclerk.com/sears/ to download the claims request form.

Please have our suppliers complete the form and email it to shcvendors@primeclerk.com

This site will also help with any questions regarding our restructuring. There is an international number provided to our Prime Clerk at **1 (929) 955-2419** and an email searsinfo@primeclerk.com that they can use for any further questions.

The company intends to pay our vendors in the ordinary course for all goods and services provided on or after the filing date. Invoices for these goods and services should be submitted through the ordinary channels, and payments will be processed in accordance with the terms of our purchase order or contract. Claims for amounts owed, for goods delivered, and services rendered prior to the filing date will be determined by the Court.

For all future business we need to move any current suppliers who are TT site or CIA to terms.

Attached is the letter our vendors should have received from our CFO, Robert Riecker.

Please advise with any additional questions or concerns.

Thank you,

Unquote.....

Thanks

Best Regards

Sunaina

Merchandising Manager

Kids & Women- Knits/Woven

Mahesh Seth
212-840-3183 ext 101
269-277-0724 cell

EXHIBIT C

From: Mcelwee, Michael
Subject: pre-petition guarantee
Importance: High
Sensitivity: Private

Hi All,

This is an update on the pre-petition payments. Would like you to know that a ll goods received up to **20 days prior** to the 10/15 filing are guaranteed to pay 100% by the court.
Attached you will find the vendor receipts list that shows which vendors orders are guaranteed . You can sort to show your vendors. *This is good news!*

Rgds,
Michael McElwee
Director of Sourcing - Sears and Kma,t Women's Apparel
201 Spear Street. 5n, floor
San Francisco, CA 94105

EXHIBIT D

From: Sunil Jhangiani <sunilj@esjayintl.com>
Date: 30 January 2019 2:24:49 PM GMT+05:30
To: "Sunaina Kapoor (India)" <Sunaina.Kapoor@searshc.com>
Cc: Kavitas Email <kavitas@esjayintl.com>, "Balakrishna (balakrishna@esjayintl.com)" <balakrishna@esjayintl.com>
Subject: Fwd: pre-petition guarantee

Hi Sunaina,

This is mail i was referring to yesterday.
Please check as your figure did not tally.

1

Thanks

Regards

Sunil

Begin forwarded message:

From: "Sunaina Kapoor (India)" <Sunaina.Kapoor@searshc.com>
Date: 18 October 2018 10:53:10 AM GMT+05:30
To: Sunil Jhangiani <sunilj@esjayintl.com>
Cc: Kavitas <Kavitas@esjayintl.com>
Subject: RE: pre-petition guarantee

Hi Sunil,

Sharing payment update for your reference:

Quote.....
This is an update on the pre-petition payments. Would like you to know that all goods received up to **20 days prior** to the l0/15 filing are guaranteed to pay 100% by the court.
Attached you will find the vendor receipts list that shows which vendors orders are guaranteed. You can sort to show your vendors. *This is good news!*
Unquote.....

ES.JAY INTERNATIONAL PVT LTD	VENDOR	201833	9/2(
ESJAY INTERNATIONAL PVT LTD	VENDOR	201834	9/2,
ESJAY INTERNATIONAL PVT LTD	VENDOR	201834	9/2't
E.SJAY INTERNATIONAL PVT LTD	VENDOR	201835	10/'t.
ES.JAY INTERNATIONAL PVT LTD	VENDOR	2.01834	9/24
ESJAY INTERNATIONAL PVT LTD	VENDOR	201834	9/2::.
ES.JAY INTERNATIONAL PVT LTD	VENDOR	2.01834	9/25
ES.:IAY INTERNATION.AL PVT LTD	VENDOR	201835	10/1

Faculty

Hon. Martin R. Barash is a U.S. Bankruptcy Judge for the Central District of California in Woodland Hills and Santa Barbara, sworn in on March 26, 2015. He brings more than 20 years of legal experience to the bench. Prior to his appointment, Judge Barash had been a partner at Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles since 2001, where he counseled parties in chapter 11 cases and litigated chapter 7 and chapter 11 bankruptcy cases. He first joined the firm as an associate in 1999. Earlier in his career, Judge Barash worked as an associate of Stutman, Treister & Glatt P.C. in Los Angeles. He also has served as an adjunct professor of law at California State University, Northridge. Following law school, Judge Barash clerked for Hon. Procter R. Hug, Jr. of the U.S. Court of Appeals for the Ninth Circuit from 1992-93. He is a former ABI Board member, for which he served on its Education Committee, and he is a former member of the Board of Governors of the Financial Lawyers Conference. In addition, he is a judicial director of the Los Angeles Bankruptcy Forum and a frequent panelist and lecturer on bankruptcy law. Judge Barash received his A.B. *magna cum laude* in 1989 from Princeton University and his J.D. in 1992 from the UCLA School of Law, where he served as member, editor, business manager and symposium editor of the *UCLA Law Review*.

Hon. Neil W. Bason is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles, appointed in 2011. While in private practice at Howard Rice Nemerovski Canady Falk & Rabkin, P.C. and Duane Morris LLP, he represented a wide variety of interests in commercial bankruptcy and insolvency matters, including secured and unsecured creditors, trustees, receivers, debtors/borrowers, guarantors, prospective asset-purchasers, and other parties in interest. Before that, he clerked for Hon. Dennis Montali, U.S. Bankruptcy Judge for the Northern District of California and Chief Judge of the Bankruptcy Appellate Panel of the Ninth Circuit. Judge Bason received his J.D. *magna cum laude* from Boston University School of Law in 1988, where he was a note editor on its law review.

Hon. Sheri Bluebond is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles, appointed Feb. 1, 2001. She served as Chief Bankruptcy Judge for the district from Jan. 1, 2015, through Dec. 31, 2018. Previously, Judge Bluebond was a partner with Irell & Manella LLP in Los Angeles from 1995-2001, where she co-chaired its Creditors' Rights and Insolvency Group, and specialized in bankruptcy, debtor/creditor relations and business litigation, representing debtors in possession and trustees as well as secured and unsecured creditors. From 1991-95, she was a shareholder with Murphy, Weir & Butler, and she was also an associate for Gendel, Raskoff, Shapiro & Quittner from 1983-91. Judge Bluebond is a Fellow of the American Bankruptcy College and a member of the Los Angeles County Bar Association, the American Bar Association and ABI. She currently serves on the Executive Committee and the Bankruptcy Committee of the Commercial Law and Bankruptcy Section of the Los Angeles County Bar Association and the Board of Governors of the Los Angeles Bankruptcy Forum, and has at various times served on the Board of Trustees of Jewish Big Brothers Big Sisters of Los Angeles/Camp Max Straus, the Board of Governors of the Financial Lawyers Conference, the Board of Directors of the Turnaround Management Association and the Board of Trustees for the Los Angeles County Bar Association. Judge Bluebond received her undergraduate degree from the University of California at Los Angeles in 1982 and her J.D. from the University of California at Los Angeles School of Law in 1985.

J. Scott Bovitz is a senior partner with Bovitz & Spitzer in Los Angeles, where he practices both consumer and business bankruptcy law and represents debtors and creditors. He is Board Certified in Business Bankruptcy Law by the American Board of Certification, which he chaired, and he is a Certified Specialist in Bankruptcy Law for the State Bar of California Board of Legal Specialization, which he also chaired. Mr. Bovitz is rated AV-Preeminent by Martindale-Hubbell and has been selected as *Southern California Super Lawyer* in bankruptcy and creditor/debtor rights. In addition, he is a lawyer representative for the Ninth Circuit Judicial Conference, a coordinating editor of the *ABI Journal*, a former member of the California Committee of Bar Examiners, a former adjunct professor of law at Loyola Law School in Los Angeles, a former executive editor and author of *Personal and Small Business Bankruptcy Practice in California*, a former president of the Los Angeles Bankruptcy Forum and a former education and conference co-chair of the California Bankruptcy Forum. Mr. Bovitz received his J.D. in 1980 from Loyola Law School in Los Angeles.

Hon. Julia W. Brand is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles, appointed on Oct. 24, 2011. On Dec. 1, 2016, she was appointed to the Ninth Circuit Bankruptcy Appellate Panel. Before taking the bench, Judge Brand practiced primarily with Katten Muchin Rosenman, LLP, Brownstein, Hyatt, Farber & Schreck, LLP, and Danning Gill, Diamond & Kollitz, LLP, where she represented debtors, creditors and unsecured creditors' committees in chapter 11 cases. She was a charter member of the Southern California Network of the International Women's Insolvency and Restructuring Confederation, and she served as Network co-chair from 2007 through 2010 and as Communications chair in 2011. Judge Brand received her B.A. from the University of California in 1981 and her J.D. from the University of Southern California School of Law in 1985.

Paul D. Buie is a managing director with Onyx Asset Advisors in Los Angeles, where he focuses on originations and investments for the firm. He works closely with restructuring professionals, secured lenders, corporate executives, venture capitalists and private-equity groups to help them understand and monetize the underlying value of all types of assets, including inventory, machinery and equipment, intellectual property and real estate. Mr. Buie has more than 20 years of expertise in the advisory, monetization, valuation, treasury and lending industries. He received his B.A. in political science from the University of California, Irvine and his graduate degree from the Institut d'Etudes politiques de Paris.

Leslie A. Cohen is an attorney and owner of Leslie Cohen Law, PC in Santa Monica, Calif., where she represents businesses and individuals in bankruptcy and insolvency matters, financial disputes, structuring, restructuring, reorganization, adversary proceedings and appeals. She has represented numerous asset-purchasers and sellers in negotiating and litigating bankruptcy acquisitions and contract assumptions and rejections. She also advises companies on the structuring and funding of special-purpose entities, distressed acquisitions and workouts. Ms. Cohen is a member of the Bankruptcy Mediation Panel for the Central District of California and has been an editor of the *California Bankruptcy Journal* since 2007. She is an active lecturer and author, and lectures regularly at the UCLA Anderson School of Business. She has also spoken for the International Conference of Shopping Centers, ABI, the American Bar Association, the National Conference of Bankruptcy Judges, the Financial Lawyers Conference, the Los Angeles Bankruptcy Forum, the California Bankruptcy Forum and the Century City Bar Association, as well as private firms. Ms. Cohen is admitted to the State Bar of California and regularly lectures at the UCLA undergraduate business law program and the

UCLA Anderson School of Business graduate program. Ms. Cohen received her B.A. in 1977 from the University of California at San Diego and her J.D. in 1980 from UCLA School of Law, where she was an associate editor of the *UCLA Law Review*.

Caroline R. Djang is a partner in Best Best & Krieger LLP's Business practice group in Irvine, Calif. She is the chief bankruptcy counsel and leads the firm's Bankruptcy practice. Ms. Djang practices in the areas of insolvency, bankruptcy and litigation. She counsels her creditor clients on the best strategies for pursuing and collecting debts within the bounds of bankruptcy law and advises them on their prospects for recovery. She also helps her clients in financial distress to understand their options. Ms. Djang is an at-large member of the Ninth Circuit Conference Executive Committee and the secretary/treasurer of the Orange County Bar Association's Commercial Law and Bankruptcy Section. She also is a subchapter V chapter 11 trustee. Prior to joining BB&K, Ms. Djang was a partner at Rutan & Tucker, LLP, and before entering private practice, she clerked for U.S. Bankruptcy Judges Ellen Carroll, Vincent P. Zurzolo, Sheri Bluebond and Richard M. Neiter. She received her B.A. in English and history from the University of Pennsylvania and her J.D. from Loyola Law School.

Robbin L. Itkin is a partner with Sklar Kirsh, LLP in Los Angeles, and is also a mediator, trustee and advisor. Among her high-profile clients are entertainers, producers, directors, writers and athletes, company CEOs and board members, as well as private and public companies in the entertainment, sports, real estate, hospitality, manufacturing, energy, retail, transportation and other industries. Ms. Itkin has successfully restructured billions of dollars of debt in out-of-court restructurings and in chapter 11 bankruptcy cases. She frequently speaks at educational conferences regarding commercial, bankruptcy and other matters including women's issues, and has provided legal commentary for television and radio shows. She appeared on NBC's Los Angeles affiliate, where she discussed her representation of season ticket-holders in the Los Angeles Dodgers bankruptcy case. She has also offered commentary on other television news outlets, including "NBC Nightly News with Brian Williams," the "Today Show," where she spoke on women in the workplace, and C-SPAN, where she interviewed U.S. Supreme Court Justice Anthony Kennedy. The Century City Bar Association named Ms. Itkin "Bankruptcy Lawyer of the Year" for 2013, and she has been named among the Top 100 *Southern California Super Lawyers* as well as among the Top 50 Women *Southern California Super Lawyers*. She also is listed as a "Top 100" in *Who's Who in LA Law* and is recognized in *The Best Lawyers in America*. Ms. Itkin currently serves as a Board Member Emeritus for the City of Hope National Medical Center and Beckman Cancer Research Institute, as a board member for the Los Angeles Women's Leadership Council, and as a board member for the Los Angeles Chapter of Credit Abuse Resistance Education (CARE). She received her B.A. in 1981 from the University of California, Los Angeles and her J.D. in 1984 from the University of Southern California.

Lei Lei Wang Ekvall is a partner with Smiley Wang-Ekvall, LLP in Costa Mesa, Calif., and concentrates her practice on insolvency and bankruptcy-related matters, including workouts, business reorganizations, creditors' rights, and trustee, committee and receiver representation in diverse industries such as hospitality, medical, real estate, technology, entertainment, manufacturing and retail. Ms. Wang Ekvall served a judicial clerkship to Hon. Alan M. Ahart, William J. Lasarow, Kathleen T. Lax, Kathleen P. March, and Vincent P. Zurzolo, all U.S. Bankruptcy Judges, from October 1992 to September 1993. From September 1993 to September 1994, she clerked for Bankruptcy Court Judge Hon. Kathleen P. March. Ms. Wang Ekvall is is vice chair of the Central District of California's At-

torney Discipline Committee, secretary of the Masters Division of the Orange County Bar Association, and a board member of the Los Angeles Bankruptcy Forum. She also serves on the board of the Orange County Bar Association's Charitable Fund and served as its president in 2011. In addition, she has chaired various committees and sections of the Orange County Bar Association, including its Pro Bono Committee, Resolutions Committee, and Commercial Law and Bankruptcy Section. Among other recognitions, in 2019 Ms. Wang Ekvall was selected as Attorney of the Year by the Orange County Women Lawyers Association. She rated AV-Preeminent by Martindale-Hubbell, and since 2008 has been named a *Southern California Super Lawyer*. In 2011 and 2014, she was named a Top Bankruptcy Attorney by *O.C. Metro* magazine. Ms. Wang Ekvall is a frequent speaker on the topic of bankruptcy law and receiverships and co-authored *Bankruptcy for Businesses*, published in April 2007 by Entrepreneur Media, Inc., and distributed by McGraw-Hill. She received her undergraduate degree in information and computer science in 1988 from the University of California, Irvine and her J.D. in 1992 from the University of Southern California.

Corey R. Weber is a litigator with Brutzkus Gubner in Woodland Hills, Calif., where he focuses his practice on bankruptcy and business and commercial litigation. He represents bankruptcy trustees, receivers, creditors and municipalities in bankruptcy proceedings, and in federal and state court litigation. He also frequently litigates fraudulent-transfer actions, including in Ponzi scheme cases. During law school, Mr. Weber served as a judicial extern for Hon. Alex Kozinski of the U.S. Court of Appeals for the Ninth Circuit, and he worked for IBM's international financial consolidation group while working toward his M.B.A. He serves as a board member and secretary of the Ninth Judicial Circuit Historical Society, and he is the immediate past chair and member of the Executive Committee of the California Lawyers Association (CLA) Business Law Section. He was previously appointed by the State Bar of California's Board of Trustees as a member of the State Bar of California Business Law Section Executive Committee, and he previously co-chaired the Insolvency Law Committee. Mr. Weber was appointed by the U.S. District Court for the Central District of California as a Central District of California Lawyer Representative to the Ninth Circuit Judicial Conference for a three-year term (2016-19), and now serves as an *ex officio* Lawyer Representative (2019-21). He received his B.A. from the University of California, Irvine, his M.B.A. from the University of Notre Dame and his J.D. from the University of Southern California Law School.

Hon. Scott H. Yun is a U.S. Bankruptcy Judge for the Central District of California in Riverside, sworn in on June 23, 2014. Prior to his appointment to the bench, he was a shareholder of Stutman, Treister & Glatt in Los Angeles, where he specialized in representing debtors, committees and other constituents in chapter 11 bankruptcy cases. Before entering private practice, he clerked for Hon. Ernest M. Robles, U.S. Bankruptcy Judge for the Central District of California. Judge Yun received his B.A. *cum laude* from University of California, Los Angeles in 1993 and his J.D. from the University of Southern California in 1996, during which time he was an extern for Hon. Barry Russell, U.S. Bankruptcy Judge for the Central District of California.

Hon. Vincent P. Zurzolo is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles. He was initially appointed on April 18, 1988, and is currently serving his third term. He served as Chief Judge from 2007-10. Judge Zurzolo received his bachelor's degree from the University of California, San Diego in 1978 and his J.D. from the University of California, Davis School of Law in 1982.