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Topic: Fighting Plan Exclusivity

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U.S. Bankruptcy Court (D. Ariz.) | Phoenix

Topic: Plan Gatekeeper Provisions

Jordan A. Kroop
Pachulski Stang Ziehl & Jones | New York

American Bankruptcy Institute
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ABI Talk
"Fighting Plan Exclusivity"

Topic Description

Chapter 11 debtors' right to exclusively propose a reorganization plan is a powerful tool. Termination of exclusivity is an under-utilized measure for resolution of chapter 11 cases without debtor cooperation.

Learning Objectives: Those attending:

- Will be briefly reminded about differing periods of plan exclusivity
- Will appreciate the legal and evidentiary burdens concerning extension and reduction of plan exclusivity
- Will consider creative alternatives for case resolution available via creditor proposed plans

Discussion

The rights and powers of the debtor in possession or trustee may not be exercised by creditors, with limited exceptions. However, the powers and options available to the proponent of a chapter 11 plan under § 1123 are extensive. The Bankruptcy Code allows a plan to be filed by someone other than the debtor in possession in certain circumstances. In those circumstances, a plan filed by a non-debtor can either cause a dramatically different negotiating environment, or result in a confirmation order that definitively, expeditiously and perhaps economically resolves disputes.

Step 1 – Exclusivity

In ordinary chapter 11, only the debtor may propose a plan for the first 120 days of the case,[1] unless a trustee is appointed,[2] or the court terminates the debtor's exclusivity for cause.[3] The exclusivity period is 180 days in a small business case.[4] The debtor may seek an extension of the exclusivity period for cause.[5] Denial of an extension request meets the same creditor objective.[6] After exclusivity expires, any party in interest may file a plan.[7] In Subchapter V, only the debtor may file a plan.[8]

A party seeking termination of exclusivity must demonstrate cause. Like seemingly every other decision entrusted to the bankruptcy court, the court must consider factors.[9] A debtor that proposes a new value cram down plan in a single asset context might well expect termination of exclusivity.[10] "The ability to file a competing plan, thereby allowing creditors to cast ballots for multiple plans, also encourages a chapter 11 policy of 'creditor democracy'."[11]

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[1] 11 U.S.C. § 1121(b), (c)(2), (3).

[2] § 1121(c)(1).

[3] § 1121(d).

[4] § 1121(e)(1).

[5] § 1121(d)(1), (e)(3).

[6] E.g. *In re Sharon Steel Corp.*, 78 B.R. 762 (Bankr. W.D. Pa. 1987); *In re Sw. Oil Co. of Jourdanton, Inc.*, 84 B.R. 448 (Bankr. W.D. Tex. 1987).

[7] *In re River Vill. Assocs.*, 181 B.R. 795, 803 (E.D. Pa. 1995).

[8] § 1189(a).

[9] *In re Henry Mayo Newhall Mem'l Hosp.*, 282 B.R. 444, 452 (B.A.P. 9th Cir. 2002), citing *In re Dow Corning Corp.*, 208 B.R. 661, 664–65 (Bankr. E.D. Mich. 1997); and *In re Express One Int'l, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996); *see In re GMG Cap. Partners III, L.P.*, 503 B.R. 596, 601 (Bankr. S.D.N.Y. 2014) (listing factors, citations omitted).

[10] *In re Situation Mgmt. Sys., Inc.*, 252 B.R. 859 (Bankr. D. Mass. 2000); *cf. Bank of America Nat'l Trust and Savings Assoc. v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 441–443, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999).

[11] *Matter of Mother Hubbard, Inc.*, 152 B.R. 189, 195 (Bankr. W.D. Mich. 1993).

The decision to limit or extend exclusivity under § 1121(d) should be reviewed for abuse of discretion,[12] except in the Ninth Circuit.[13]

Please note that soliciting acceptances or rejections of a debtor plan, or a competing plan, where the court has not approved a disclosure statement and terminated exclusivity, may lead to consequences under § 1126(e) and possibly contempt.[14]

Step 2 – Crafting The Plan

Section 1123 requires that a plan of reorganization must contain certain provisions in § 1123(a) and permits a plan to contain other provisions in § 1123(b), including "any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]."[15] Among other things, the plan must classify[16] and specify the treatment of classes of claims and interests,[17] must specify the same treatment for claims or interests in a class unless a disfavored claim or interest agrees otherwise,[18] and provide adequate means for implementation of the plan.[19] The plan must "contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee."[20]

The options available to a plan proponent under § 1123(b) are expansive. Examples are discussed below.

Step 3 – Examples

There are a number of reasons why a creditor or other interested party might want to prepare a plan without the debtor's cooperation.

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[12] E.g., *In re Adelphia Commc'ns Corp.*, 342 B.R. 122, 131 (S.D.N.Y. 2006).

[13] *In re Henry Mayo Newhall Mem'l Hosp.*, 282 B.R. 444, 448 (B.A.P. 9th Cir. 2002) ("the question of § 1121(d) "cause" to adjust exclusivity is a mixed question of law and fact that is reviewed de novo."), citing *Groner v. Miller (In re Miller)*, 262 B.R. 499, 503 (9th Cir. BAP 2001).

[14] *In re Aspen Limousine Serv., Inc.*, 198 B.R. 341 (D. Colo. 1996).

[15] § 1123(b)(6).

[16] § 1123(a)(1).

[17] §§ 1123(a)(2), (3).

[18] § 1123(a)(4).

[19] § 1123(a)(5).

[20] § 1123(a)(7).

Changing The Negotiation Range

A plan offered by a debtor can be evaluated within certain parameters – the best interests test, the absolute priority rule and so on. Where a creditor is allowed to propose a plausible competing plan, the debtor may be forced to improve the treatment of perhaps unsecured creditors in order to incentivize them to favor the debtor's plan, which is relevant under § 1129(c). For example, if the best interests test might require only a 10% dividend to unsecured creditors, but a competing plan offers 25%, it is hard for the debtor to stand on a 10% offer.

Settlements

Section 1123(b)(3) provides that a plan may settle or adjust claims or interests of the debtor or the estate, and retention and enforcement or estate claims or interests by the debtor, the trustee, "or by a representative of the estate appointed for such purpose."

In *Matter of Texas Extrusion Corp.*, four debtors were in litigious disputes with a secured creditor. The creditor and the creditors committee proposed a plan that provided for sale of estate property, payment to the creditor, release of litigation with the debtors/estates, payment to other creditors and administrative expenses, over the debtors' vehement objection. The Fifth Circuit approved the confirmation order on appeal.[21] In particular, the court of appeals approved the settlement of debtors' lawsuits via the plan, including the amount of consideration paid by the creditor, applying the abuse of discretion standard of review.[22] The court rejected the debtors' good faith objection under § 1129(a)(3) finding no clear error considering the plan and the totality of the circumstances.[23]

In *Skyline Ridge* the debtor owned a large, disputed claim, secured by a lien on real estate, and the real estate owner asserted disputed defenses and claims.[24] The parties' disputes would take years of state court litigation to resolve. After termination of exclusivity, the disputed creditor proposed a plan to settle the disputed claim of the estate for an immediate cash payment. Upon plan confirmation by Judge Whinery after lengthy evidentiary hearings, affirmed by the Ninth Circuit BAP, and payment of the settlement, the creditor obtained its land free and clear of the disputed note and lien, the debtor paid its creditors in full, and the debtor's equity owner retained millions of dollars of value via unencumbered assets in the reorganized debtor.

Sale

Section 1123(a)(5)(D) and (b)(4) authorize a plan to provide for sale of assets and distribution of proceeds. A creditor's plan may provide for sale of estate property over the debtor's objection in

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[21] *Matter of Texas Extrusion Corp.*, 844 F.2d 1142 (5th Cir. 1988).

[22] *Matter of Texas Extrusion Corp.*, 844 F.2d at 1158.

[23] *Matter of Texas Extrusion Corp.*, 844 F.2d at 1160.

[24] *In re Skyline Ridge, LLC*, No. 4:18-BK-01908-BMW, 2020 WL 3089257 (Bankr. D. Ariz. June 10, 2020); *In re Skyline Ridge, LLC*, No. 4:18-BK-01908-BMW, 2020 WL 6821717 (Bankr. D. Ariz. Nov. 16, 2020), *aff'd*, No. 4:18-BK-01908-BWM, 2021 WL 3829311 (B.A.P. 9th Cir. Aug. 25, 2021).

order to fund creditor payments.[25] Notably, § 1123 does not require compliance with § 363 in a plan sale, while § 1123(b)(2) requires compliance with section 365 as to assumption, rejection or assignment of executory contracts and unexpired leases.

In *TCI2 Holdings*, funds affiliated with Carl Icahn purchased certain debt at a discount and thereafter jointly proposed a plan with Beal Bank seeking control over Atlantic City properties associated with Donald Trump. Ultimately the Debtor's plan was confirmed but the series of plan amendments improved treatment of the competing creditors' claims.[26]

In *Internet Navigator*, a creditor's plan provided for the creditor to takeover the debtor via confirmation of its competing plan.[27]

In *Great Bay Hotel*, control over a chapter 11 Atlantic City hotel and casino was obtained as a result of confirmation of one of two separate plans proposed by parties in interest after debtor's exclusivity expired, and debtor abandoned its plan.[28]

In *111-121 E. Congress, L.L.C.*, Judge Gan confirmed the judgment lien creditor's plan for sale of debtor's single asset, via a proposed auction backed by a credit bid.[29] Debtor eventually withdrew its competing plan that, with modifications, provided for full payment of creditor claims, relying on its appeal to the district court.

Forced Liquidation

In *Farwest Pump Company* the creditors committee successfully proposed a liquidating plan over the debtor's objection.[30] Such a plan is by definition feasible if there are funds to satisfy claims entitled to immediate payment under § 1129(a)(7), (9).

Single Asset Real Estate

In a real estate case with a large deficiency claim, the respective moves of the debtor and the undersecured creditors are predictable. The debtor proposes a cram down plan, seeks to have the secured creditor make the § 1111(b) election and waive its unsecured claim, and the secured creditor objects to the plan. However, if in addition the secured creditor is granted leave to propose its own plan, and is willing to fund payment to unsecured creditors, even to treat their unsecured claims as unimpaired, the ground for a successful debtor's plan shrinks dramatically.[31]

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[25] See *Matter of Texas Extrusion Corp.*, 844 F.2d at 1165.

[26] *In re TCI 2 Holdings, LLC*, 428 B.R. 117 (Bankr. D.N.J. 2010).

[27] *In re Internet Navigator Inc.*, 289 B.R. 128 (Bankr. N.D. Iowa 2003).

[28] *In re Greate Bay Hotel & Casino, Inc.*, 251 B.R. 213, 220 (Bankr. D.N.J. 2000).

[29] Confirmation Order, *In re 111-121 E. Congress, L.L.C.*, No. 4:23-bk-02230-SHG, Order filed April 4, 2024 at DE 187.

[30] *In re Farwest Pump Co.*, 621 B.R. 871 (Bankr. D. Ariz. 2019).

[31] *See In re River Vill. Assocs.*, 181 B.R. 795 (E.D. Pa. 1995) (affirming confirmation of secured creditor's plan); *In re Coltex Loop Cent. Three Partners, L.P.*, 138 F.3d 39, 40 (2d Cir. 1998)

The ground shrinks further as the secured creditor buys unsecured debt. The creditor's plan can either adopt and take over the debtor's plan or simply provide for liquidation in lieu of foreclosure.

Blocking Liquidation

A debtor unhappy with confirmation of a creditor's plan may seek to convert the case from chapter 11 to chapter 7. In the context of a confirmed creditor's plan, courts will deny conversion or reconvert the case to chapter 11.[32]

Control

In *Asarco*, the debtor's parent proposed a plan, as did the debtor. Both plans were confirmable. The bankruptcy court found that the debtor's parent's plan was preferable under § 1129(c) and the order confirming the parent's plan was affirmed by the district court over numerous objections.[33]

In *Sound Radio*, the bankruptcy court authorized warring shareholders to propose competing plans for the debtor.[34]

In *Meruelo Maddux Properties*, the Ninth Circuit affirmed confirmation of a plan proposed by a shareholder over the plan proposed by the debtor's officers and directors.[35]

Bankruptcy Judge Power

A debtor unhappy with a looming confirmation of a creditor's plan may object that the bankruptcy judge lacks the power to confirm a plan that provides for settlement of lawsuits. The Fifth Circuit rejected that effort in *Texas Extrusion*.[36] Consent is also a problem for the debtor, which presumably chose the bankruptcy forum and may be pursuing its own chapter 11 plan.

(reversing confirmation of debtor's new value plan); *In re Three Flint Hill Ltd. P'ship*, 213 B.R. 292, 297 (D. Md. 1997) (affirming confirmation of lender's plan).

[32] *Matter of Texas Extrusion Corp.*, 844 F.2d at 1161; *In re Kearney*, 619 B.R. 487 (Bankr. D.N.M. 2020), *aff'd*, 625 B.R. 83 (B.A.P. 10th Cir. 2021).

[33] *In re ASARCO LLC*, 420 B.R. 314 (S.D. Tex. 2009).

[34] *Matter of Sound Radio, Inc.*, 93 B.R. 849, 850 (Bankr. D.N.J. 1988), *aff'd in part, remanded in part*, 103 B.R. 521 (D.N.J. 1989), *aff'd sub nom. In re Sound Radio Inc.*, 908 F.2d 964 (3d Cir. 1990), and *aff'd sub nom. Appeal of Robinson*, 908 F.2d 964 (3d Cir. 1990) (table).

[35] *In re Meruelo Maddux Properties, Inc.*, 637 F. App'x 1012 (9th Cir. 2016).

[36] *Matter of Texas Extrusion Corp.*, 844 F.2d at 1165.

Gatekeeper Provisions

Jordan Kroop

Pachulski Stang Ziehl & Jones

Imagine:

- Founder of Chapter 11 debtor, ousted prepetition
- Extremely vindictive, indignant, and litigious
  - Either prepetition or post-petition
  - Established record of vexatious litigiousness
  - Prepetition litigation against debtor's private equity sponsor and current management
- Evident or even stated desire to obstruct debtor's successful reorganization for non-economic, spiteful motives

Needs:

- Restrict, frustrate, or disincentivize unrestrained, harassing litigation
- Prevent interference with implementation of confirmed plan and post-effective date management
  - Liquidation trustee
  - Reorganized debtor
- Control legal expenses to protect creditor recoveries

Solution: Gatekeeper Provision

No Gated Party may commence or pursue any claim, including for negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence, against any Protected Party that arose or arises from or is related to the Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, or any transaction in furtherance of the foregoing unless the Bankruptcy Court determines, after notice and a hearing, that the claim is colorable, thereby authorizing the Gated Party to bring the claim. The Bankruptcy Court retains sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, only to the extent legally permissible, to adjudicate the underlying colorable claim. "Colorable" means a claim not without foundation, not without merit, and not being pursued for any improper purpose such as harassment, assessed by taking into consideration the Bankruptcy Court's knowledge of the Case, the parties, and any additional evidence presented at the hearing on the motion for leave.

Parties

+ **Gated Parties:** "Collectively: (a) any plaintiff in the Shareholder Litigation; (b) any direct or indirect parent of any such plaintiff; and (c) any Person partially or wholly owned or controlled by any such plaintiff."
+ **Protected Parties:** "Collectively: (a) the Debtor; (b) the Reorganized Debtor; (c) the Litigation Trustee; (d) the DIP Lender; (e) the defendants in the Shareholder Litigation; and (f) the current and future officers, directors, and Professionals of the parties listed in (a) through (e)."

What It Does

+ Requires a Gated Party to seek leave from the Bankruptcy Court to bring a new claim or lawsuit before doing so
+ Gated Party must demonstrate that the claim or cause of action is "colorable"
+ Claim is barred if Bankruptcy Court finds it isn't colorable—*but* Gated Party can appeal this ruling
+ If Bankruptcy Court finds the claim colorable, Gated Party may proceed in any court of competent jurisdiction

What It Doesn't Do

+ Doesn't restrict Gated Party from pursuing appeals—appealing a Bankruptcy Court order (*including* a colorability determination under the Gatekeeper) is not subject to Gatekeeper
+ Doesn't apply to anyone other than a Gated Party
+ Doesn't impose vexatious litigant status on Gated Party
+ Doesn't shift fees

What It Isn't

+ Not a **release**
+ Not an **injunction**
+ Not an expansion of Bankruptcy Court **jurisdiction**

Not a Release

- A release extinguishes a claim and shields a person from liability on that extinguished claim
- A gatekeeper provision isn't a release because it doesn't:
  - (a) extinguish any claims
  - (b) shield any parties from liability or
  - (c) prevent a Gated Party from asserting any claim it believes it has against a Protected Party
- Because it's not a release, it's not a *Purdue*-style

Third-Party Release

Not an Injunction

- A plan injunction is an equitable device used to enforcing the debtor's discharge and protect the property dealt with by the plan
- It's aimed at claimants, equity interest holders, parties who participated in the case and entities related to them
- It's a policing mechanism to deter actions that violate the discharge or are otherwise inconsistent with the plan
- A gatekeeper provision doesn't involve any of those things and doesn't do any of those things

Not an Expansion of Bankruptcy Court Jurisdiction

+ Gatekeeper provision clearly provides: "The Bankruptcy Court retains sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, **only to the extent legally permissible**, to adjudicate the underlying colorable claim."
+ SCOTUS and all Circuit Courts of Appeals have held that Bankruptcy Courts may perform a gatekeeping function under appropriate circumstances without implicating the limits on their jurisdiction

Extraordinary Provision for Extraordinary Circumstances

+ Gatekeeper provisions target only a specific and unusual type of bankruptcy litigant
+ Even the most highly-aggressive creditors won't warrant such a powerful tool
+ Reserved for the most extraordinary instances of an obstreperous, vengeful litigant determined to obstruct process and destroy value for reasons having nothing to do with litigant's pecuniary interests or economic outcome from the case

Keep Your Eyes Open for the Fifth Circuit Decision in *Highland Capital*

+ The applicability of a gatekeeper provision to protect non-debtor, non-estate-fiduciary parties – even a gatekeeper's permissibility – will be decided any day
+ Oral argument was heard in February 2024

Faculty

Louis M. Bubala, III is Of Counsel with the Kaempfer Crowell law firm in Nevada. He represents creditors in and out of bankruptcy in Las Vegas, Reno and across the state. Mr. Bubala's practice regularly deals with climate change issues in hospitality, agriculture and small businesses dealing with heat, drought, fire and smoke. He became sponsorship chair for ABI's Southwest Bankruptcy Conference in 2019 and a member of its advisory committee in 2016. He also co-chaired ABI's Consumer Conference in Las Vegas in 2013 and 2014. Previously, Mr. Bubala clerked for U.S. Magistrate Judge Valerie Cooke. Before law school, he was a reporter and editor in Indiana. While covering the courts, he got to know U.S. District Judge Gene Brooks, who was president of the National Conference of Bankruptcy Judges in 1978-79. He also interviewed Alan Dershowitz (who returned a call for a story about his client, Mike Tyson), Don King, Manute Bol and Dan Quayle. In his free time, Mr. Bubala is on the boards of Friends of Nevada Wilderness and the Nevada Outdoor Business Coalition. He received his B.A. in 2000 from Indiana University School of Journalism and his J.D. in 2004 from the University of Oregon School of Law.

Robert M. Charles, Jr. is a partner with Lewis Roca Rothgerber Christie LLP in Tucson, Ariz. The firm's bankruptcy working group leader, he practices primarily bankruptcy law in both Arizona and Nevada. Mr. Charles is a Fellow in the American College of Bankruptcy and a past chair of the State Bar of Arizona Committee on Rules of Professional Conduct, and he served as a member of the Arizona Bar's Ethics Committee for many years. He lectures and writes extensively on bankruptcy law and legal ethics and is professor of practice (adjunct faculty) at the James E. Rogers University of Arizona College of Law teaching introduction to business reorganization in bankruptcy and bankruptcy and related issues. Mr. Charles is a member of ABI, sits on the advisory board for ABI's Southwest Bankruptcy Conference, and was a member of ABI's National Ethics Task Force. He is also vice chair of the Mass Torts subcommittee of the Business Bankruptcy Committee of the American Bar Association's Business Law Section. Mr. Charles previously clerked for Hon. Earl H. Carroll of the U.S. District Court for the District of Arizona. He received his B.A. from the University of Arizona in 1979 and his J.D. with distinction from the University of Arizona James E. Rogers College of Law in 1982.

Hon. Daniel P. Collins is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, appointed on Jan. 18, 2013. He served as chief judge from 2014-18 and is presently a conflicts judge in the Districts of Guam, Hawaii and Southern California. Previously, Judge Collins was a shareholder with the Collins, May, Potenza, Baran & Gillespie, P.C. in Phoenix, practicing primarily in the areas of bankruptcy, commercial litigation and commercial transactions. He is president of the National Conference of Bankruptcy Judges, is a Fellow in the American College of Bankruptcy, served on ABI's Board of Directors, is on the board of the Phoenix Chapter of the Federal Bar Association and is a member of the University of Arizona Law School's Board of Visitors. He also is a founding member of the Arizona Bankruptcy American Inn of Court. Judge Collins received both his B.S. in finance and accounting in 1980 and his J.D. in 1983 from the University of Arizona.

Jordan A. Kroop is an attorney with Pachulski Stang Ziehl & Jones in its New York office, where he represents debtors, official committees, acquirers and significant creditors in chapter 11 matters involving publicly traded and privately held companies throughout the nation. He is a Fellow of the American College of Bankruptcy and enjoys a national reputation for representing clients in such diverse industries as manufacturing, real estate development, construction, hospitality, food and beverage, gaming, health care and technology. Among the many prominent chapter 11 matters he has handled, Mr. Kroop represented the Russian Tea Room and the NHL's Phoenix Coyotes in their chapter 11 cases. He also represented the Boston Celtics and the Milwaukee Bucks in reorganization matters. Mr. Kroop has represented debtor-sellers as well as strategic acquirers in chapter 11 asset sales throughout the country in transactions totaling more than $3 billion. In addition, he is an adjunct professor of law, teaching information privacy and advanced chapter 11 practice at Arizona State University's Sandra Day O'Connor College of Law. He also served as a lecturer on international commercial arbitration in Salzburg, Austria, for University of the Pacific's McGeorge School of Law in 2010 and 2011. Mr. Kroop was listed in *Lawdragon*'s 2023 and 2022 "500 Leading U.S. Bankruptcy and Restructuring Lawyers" and the 2020 "500 Leading Global Restructuring & Insolvency Lawyers," he was named in *The Best Lawyers in America* in Phoenix for "Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law Lawyer of the Year" in 2017, and he was named a *Southwest Super Lawyer* from 2007-21 (he also was ranked in its Top 50 from 2019-21). In addition, he was one of 12 "Outstanding Young Bankruptcy Lawyers" in the U.S. by *Turnarounds & Workouts* in 2000, and was ranked "Superb" (10 out of 10) by Avvo.com. In 2007, he won an *ABI Journal* Publication Award, and he co-authored *Bankruptcy Litigation & Practice: A Practitioner's Guide* (Wolters Kluwer, 4th ed.) and dozens of articles in national restructuring publications. Mr. Kroop is rated AV-Preeminent by Martindale-Hubbell. He received his A.B. *magna cum laude* from Brown University and his J.D. from the University of Virginia.