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Delaware District Court Supports Secured Creditor Gift Plans

Michael Friedman and Aaron M. Krieger*

The U.S. District Court for the District of Delaware has provided further support within the Third Circuit for so-called "gift" plans (i.e., plans in which a secured creditor class "gifts" a portion of its plan distribution to a junior class). In this article the authors discuss the decision and its implications.

A recent decision of the U.S. District Court for the District of Delaware in *In re Nuverra Environmental Solutions Inc.* ("*Nuverra*") has provided further support within the Third Circuit (which includes the influential Delaware bankruptcy courts) for so-called "gift" plans (i.e., plans in which a secured creditor class "gifts" a portion of its plan distribution to a junior class).

BACKGROUND

The district court in *Nuverra* declined to issue a stay pending appeal of the Delaware bankruptcy court's confirmation of a gift plan notwithstanding the then-recent U.S. Supreme Court decision in *Czyzewski v. Jevic Holding Corp.* ("*Jevic*") that had cast doubt on the viability of such plans.[1] In connection with its ruling, the district court determined that the appellant was unlikely to succeed on the merits of its appeal and had failed to establish irreparable harm absent a stay.[2] Since entry of the Stay Order, the parties fully briefed the merits of the appeal, the district court held oral arguments and issued a ruling holding: (i) that the appeal is equitably moot, and (ii) that, in the alternative, the gift plan was otherwise confirmable.[3]

In an effort to prevent a recalcitrant class of creditors from prolonging a bankruptcy case, secured creditors may seek to "gift" a portion of the proceeds

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[1] *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017).

[2] *In re Nuverra Envtl. Sols., Inc.*, No. 17-10949-KJC (D. Del. Aug. 3, 2017) (the "Stay Order").

[3] *In re Nuverra Envtl. Sols., Inc.*, No. 17-10949-KJC (D. Del. Aug. 21, 2018) (the "Appeal Order").

they would otherwise receive to one or more junior classes in order to obtain their support for a proposed plan of reorganization. Many bankruptcy practitioners consider the ability to propose a reorganization plan that includes such a gift (i.e., a "gift plan") a critical and necessary tool to obtain a consensual restructuring plan.

In recent years, the viability of gift plans has been in question. In 2011, the U.S. Court of Appeals for the Second Circuit in *Dish Network Corp. v. DBSD North America Inc.* ruled that a gift plan was invalid if it did not strictly comply with the Bankruptcy Code's absolute priority rule.[4] Courts in the Third Circuit have generally taken a different approach and have shown a willingness to approve gift plans.[5] Many believed that gift plans were in further danger even in the Third Circuit after the Supreme Court's decision in *Jevic*.[6] However, at least in the Third Circuit, with the district court's latest *Nuverra* decision, gift plans of the sort employed by Nuverra remain safe.

THE *NUVERRA* DELAWARE BANKRUPTCY COURT DECISION

In *Nuverra*, the bankruptcy court was presented with a plan of reorganization in which the debtors' secured creditors were owed $500 million and the debtors' agreed valuation was only $300 million.[7] Applying the absolute priority rule, unsecured creditors would not have been entitled to any distribution under the plan.[8] However, in order to promote the plan's confirmation, secured creditors made a gift under the plan to two classes of unsecured creditors: (a) holders of unsecured senior notes would receive a four-six percent recovery of their claims based on the gift and (b) trade and other creditors whose claims arose from day-to-day operations would receive a 100 percent recovery.[9] Trade creditors voted to accept the plan and holders of unsecured notes voted against.[10]

One of the noteholders objected to the plan, arguing that it was unfairly discriminatory.[11] The bankruptcy court held that, although the proposed plan was presumed to unfairly discriminate among creditors, such presumption had

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[4] *In re DBSD N. Am., Inc.*, 634 F.3d 79 (2d Cir. 2011).

[5] *See, e.g., In re Genesis Health Ventures Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001).

[6] For further coverage of potential implications of the *Jevic* decision, *see* https://www.chapman.com/insights-publications-First_Circuits_Old_Cold_Decision_Cools_Fears_Jevic_Reach.html.

[7] Stay Order, *supra* note 2.

[8] *Id.*

[9] *Id.*

[10] *Id.*

[11] *Id.*

been rebutted.[12] The bankruptcy court explained that, because the noteholder class was not entitled to any distributions at all under the absolute priority rule, (i.e., the class would have received nothing but for the gift), there was no discrimination—because both the noteholders and trade creditors were the beneficiaries of a gift.[13] In so ruling, the bankruptcy court also rejected arguments that the gift should be viewed as a distribution from the bankruptcy estate's property in violation of the absolute priority rule.[14] Rather, the bankruptcy court ruled that the plan was fair, and confirmed it over the rejection and objection of the rejecting class.[15]

THE *NUVERRA* DISTRICT COURT DECISION

After first denying the appellants' request for a stay pending appeal, the district court, on appeal, held that the appeal met the criteria for equitable mootness, which, the district court explained, requires a determination as to: "(1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation."[16] In this case, the district court noted, the appellants conceded that the plan had been substantially consummated, satisfying the first prong of the Third Circuit test.[17] As to the second prong of the test, the district court ruled that it could not legally grant appellants' proposed relief, which it characterized as an order directing the debtors to provide appellant with the same treatment as general unsecured creditors—payment of 100 cents on the dollar plus interest—as compared with the four to six percent recovery provided to other members of the class.[18] The district court further found that there was no other relief that it could legally grant that would not require undoing the plan and necessarily harming third parties.[19] As a result, the district court found that the appeal met the Third Circuit's criteria for equitable mootness.[20]

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[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] Appeal Order (citing *In re Tribune Media Co.*, 799 F.3d 272, 278 (3d Cir. 2015) (quoting *In re SemCrude*, 728 F.3d 314, 321 (3d Cir. 2013).

[17] Appeal Order, *supra* note 3.

[18] *Id.*

[19] *Id.*

[20] *Id.* (citing *In re Tribune Media Co.*, 799 F.3d 272, 278 (3d Cir. 2015)).

The district court did not stop there, however, noting that it could "readily resolve the merits of [the] appeal against the appealing party."[21] Citing applicable Third Circuit precedent, the district court affirmed the bankruptcy court's ruling, holding that the district court could "find no error in the Bankruptcy Court's conclusion that the Plan did not unfairly discriminate, which is based on uncontroverted, case-specific facts and consistent with applicable case law and legislative history concerning unfair discrimination."[22]

As was true of both the bankruptcy court and the district court's prior denial of the requested stay pending appeal, the district court's decision in the Appeal relied primarily on *In re Genesis Health Ventures Inc.*,[23] a case with, what the district court described as, "virtually identical facts."[24] The court in *Genesis* held that the presumption of unfair discrimination was rebutted where the distribution was based on the agreement of senior lenders to allocate a portion of the value to which they would have otherwise been entitled under the Bankruptcy Code.[25] *Genesis*, like *Nuverra*, involved a gift from senior secured creditors' recovery to certain, but not all, classes of general unsecured creditors.[26] As in *Nuverra*, while all of the unsecured creditors did not receive the same recovery, no creditor was skipped in favor of a more junior creditor.

The district court also rejected arguments made by appellants that relied on prior Third Circuit precedent opposing the practice of so-called "vertical" gifting (the gifting of a distribution from a senior class of creditors in a manner that skips over an intermediary junior class of dissenting creditors) as inapposite to the *Nuverra* case involving so-called "horizontal" gifting (the distribution of unequal gifts by a secured creditor to two classes of junior creditors).[27] Finally, the district court refused to find any error with the bankruptcy court's determination that a rational basis existed for the plan's separate classification of noteholder claims.[28]

In reaching its decision, the district court did not discuss the Supreme Court's then-recent decision in *Jevic* in its Stay Order and has not done so in the Appeal Order either. In *Jevic*, the Supreme Court addressed the question of

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[21] *Id.*

[22] *Id.*

[23] 266 B.R. 591 (Bankr. D. Del. 2001) ("Genesis").

[24] Appeal Order, *supra* note 3.

[25] *Id.*

[26] *Id.*

[27] *Id.*

[28] *Id.*

whether a proposed settlement that called for a structured dismissal contemplating distributions contrary to the absolute priority rule was permissible under the Bankruptcy Code. The Supreme Court replied in the negative, and said that even in "rare cases," priority under the Bankruptcy Code cannot simply be disregarded. Many believed that this case would be the death knell for gift plans such as the one confirmed in *Nuverra*, but the case was not addressed in either the Stay Order or the Appeal order. The Appeal Order has been further appealed to the Third Circuit Court of Appeals.

CONCLUSION

The fate of the bankruptcy gift plan is still not certain. As discussed, the Second Circuit (which includes the New York courts) has taken a critical view of gift plans even before the *Jevic* decision. While *Jevic* has not been as widely applied as some commentators feared, it remains to be seen whether any other courts will apply it beyond the narrow facts of the case and how other courts will approach the holdings in *Nuverra*. However, at least in Delaware and at least for the time being, the horizontal gift plan remains viable.