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In Delaware, the Gift Plan Is Not Dead Yet

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On August 3, 2017, the Delaware district court in In re Nuverra Environmental Solutions Inc. upheld the Delaware bankruptcy court's confirmation of a so-called "gift" plan (i.e., a plan in which a secured creditor class "gifts" a portion of its plan distribution to a junior class), notwithstanding the recent U.S. Supreme Court decision in Czyzewski v. Jevic Holding Corp. that had cast doubt on the viability of such plans.[1]

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 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. 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.[2] Courts in the Third Circuit (which includes the influential Delaware bankruptcy courts) have taken a different approach and have approved gift plans.[3] Many believed that gift plans were in further danger of extinction after the Supreme Court's decision in Jevic. However, at least in the Third Circuit, that does not appear to be the case.

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The Nuverra Delaware Bankruptcy Court Decision

In Nuverra, the Delaware 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 $300 million. Applying the absolute priority rule, unsecured creditors would not have been entitled to any distribution under the plan. 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 4-6 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. Not surprisingly, the trade creditors voted to accept the plan and the holders of unsecured notes voted against the plan.[4]

One of the noteholders objected to the plan, arguing that it was unfairly discriminatory.[5] The bankruptcy court held that, although the proposed plan was presumed to unfairly discriminate among creditors, such presumption had been rebutted.[6] The bankruptcy court explained that, because the noteholder class was not entitled to any distributions at all under the absolute priority rule, (i.e., it would have received nothing but for the gift), there was no discrimination — both the noteholders and trade creditors were the beneficiaries of a gift.[7] In so ruling, the bankruptcy court also rejected arguments that the gift should be viewed as a distribution from the bankruptcy estate's property that violated the absolute priority rule.[8] Rather, the bankruptcy court ruled that the plan was fair, and confirmed it over the rejection and objection of the rejecting class.[9]

The Nuverra District Court Decision

On appeal, the district court, citing Third Circuit precedent, affirmed the bankruptcy court's ruling, explaining that "the presumption of unfair discrimination is rebutted where the distribution is 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."[10]

Notably, both the bankruptcy court and the district court in Nuverra relied on In re Genesis Health Ventures Inc., 266 B.R. 591 (Bankr. D. Del. 2001). 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.[11] Genesis, like Nuverra, involved a gift from senior secured creditors' recovery to certain, but not all, classes of general unsecured creditors.[12] 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.

Interestingly, in reaching its decision, the district court did not discuss the Supreme Court's recent decision in Jevic.[13] In that March 2017 decision, the Supreme Court addressed the question of whether a proposed settlement that called for a structured dismissal contemplating distributions contrary to the absolute priority rule was permissible under the Bankruptcy Code.[14] The Supreme Court replied in the negative, and said that even in "rare cases," priority under the Bankruptcy Code cannot simply be disregarded.15

Many believed that this case would be the death knell for gift plans such as the one confirmed in Nuverra, but neither the parties nor the court in Nuverra addressed the Jevic decision. Perhaps because Jevic involved gifting in the context of a structured dismissal of a bankruptcy case, the Nuverra court considered it sufficiently unrelated.

Other possibilities for distinguishing Jevic are: (1) the objecting noteholder in Nuverra, as a beneficiary of a proposed gift (albeit an unsatisfactory one) itself, could not use the Jevic decision as a basis to attack the proposed distribution to trade creditors without also invalidating the proposed distribution to noteholders and (2) Jevic involved vertical class-skipping, where a proposed distribution skips a class entirely in favor of more junior parties, whereas Nuverra involved horizontal class-skipping, (i.e., both classes of unsecured creditors in that case held the same priority). Thus, notwithstanding the Nuverra decision, it remains an open question as to whether, post-Jevic, gift plans may skip a class of more senior creditors in favor of a more junior class.

The fate of the bankruptcy gift plan is still not certain. As discussed, the Second Circuit took a critical view of gift plans even before the Jevic decision. It remains to be seen how other circuits will interpret Jevic, and how other courts will approach the holdings in Nuverra and Genesis. However, at least in Delaware and at least for the time being, the concept of the gift plan is not dead yet.

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1. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 981, 197 L. Ed. 2d 398 (2017)
2. Dish Network Corp. v. DBSD North America Inc. (In re DBSD North America Inc.), —F.3d—, 2011 WL 350480 (2d Cir. 2011)
3. See, e.g., In re Genesis Health Ventures Inc., 266 B.R. 591 (Bankr. D. Del. 2001).
4. Id.
5. Id. at *2.
6. Id.
7. Id.
8. Id.
9. Id.
10. Id. at *3.
11. In re Genesis Health Ventures Inc., 266 B.R. 591, 612 (Bankr. D. Del. 2001).
12. Id. at 598.
13. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017).
14. Id. at 980.
15. Id. at 986.

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