IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
ONE AVIATION CORPORATION, *et al.*,[1]	Case No. 18-12309(CSS)
Debtors.	(Jointly Administered)
	Hearing Date: October 9, 2020 **UST Objection Deadline: October 5, 2020** Re: 878, 900, 908 & 926

UNITED STATES TRUSTEE'S OBJECTION TO DEBTORS' MOTION FOR ENTRY OF: (A) ORDER (I) APPROVING FORM AND MANNER OF NOTICE IN CONNECTION WITH SALE OF ASSETS OF THE DEBTORS, (II) SCHEDULING SALE HEARING, (III) APPROVING BID PROTECTIONS, (IV) AUTHORIZING PROCEDURES GOVERNING ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES, AND (V) GRANTING RELATED RELIEF; AND (B) ORDER (I) APPROVING PURCHASE AGREEMENT, (II) AUTHORIZING SALE FREE AND CLEAR OF ALL LIENS, CLAIMS, ENCUMBRANCES, AND OTHER INTERESTS, AND (III) GRANTING RELATED RELIEF (D.I. 878)

Andrew R. Vara, United States Trustee for Regions 3 and 9 ("U.S. Trustee"), objects (the "Objection") to the Debtors' Motion for Entry Of: (A) Order (I) Approving Form and Manner of Notice in Connection with Sale of Assets of the Debtors, (II) Scheduling Sale Hearing, (III) Approving Bid Protections, (IV) Authorizing Procedures Governing Assumption and Assignment of Certain Executory Contracts and Unexpired Leases, and (V) Granting Related Relief; and (B) Order (I) Approving Purchase Agreement, (II) Authorizing Sale Free and Clear

[1] The debtors in these chapter 11 cases, along with the last four digits of each debtor's tax identification number, as applicable, are: ONE Aviation Corporation (9649); ACC Manufacturing, Inc. (1364); Aircraft Design Company (1364); Brigadoon Aircraft Maintenance, LLC (9000); DR Management, LLC (8703); Eclipse Aerospace, Inc. (9000); Innovatus Holding Company (9129); Kestrel Aircraft Company, Inc. (2053); Kestrel Brunswick Corporation (6741); Kestrel Manufacturing, LLC (1810); Kestrel Tooling Company (9439); and OAC Management, Inc. (9986). The Debtors' corporate headquarters is located at 3250 Spirit Drive SE, Albuquerque, NM 87106.

of all Liens, Claims, Encumbrances, and Other Interests, and (III) Granting Related Relief (D.I. 878; the "Sale Motion"). In support of the Objection, the U.S. Trustee states as follow:

Introduction

1. The Debtors, faced with a Plan Sponsor unwilling or unable to take a previously-confirmed plan effective (the confirmation order for which has been vacated), have negotiated a sale agreement that provides for the negotiated plan distributions that would have been provided to the Noteholders, General Unsecured Creditors and Kestrel Secured Claimholders, but does not provide for payment in full of all allowed administrative or priority claims. This violation of the Bankruptcy Code's priority scheme absent a consensual plan of reorganization is impermissible. The consideration provided by the Purchaser to the estates must be distributed in accordance with the Bankruptcy Code, and administrative and priority creditors must be paid in full prior to distribution to general unsecured creditors.

Jurisdiction and Standing

2. Pursuant to 28 U.S.C. § 586, the U.S. Trustee is charged with the administrative oversight of cases commenced pursuant to Title 11 of the United States Bankruptcy Code. Section 586(a)(3)(G) mandates that the U.S. Trustee monitor "…the progress of cases under title 11" and further requires that the U.S. Trustee take "such actions as the United States trustee deems to be appropriate to prevent undue delay in such progress."

3. Pursuant to 11 U.S.C. § 307, the U.S. Trustee has standing to be heard in this matter.

Statement of Facts

4. On October 9, 2018, the above-captioned Debtors commenced these cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code.

5. On October 22, 2018, the U.S. Trustee appointed an official committee of unsecured creditors (the "Committee").

6. On the Petition Date, the Debtors filed their Joint Prepackaged Chapter 11 Plan of Reorganization for ONE Aviation Corporation and its Debtor Affiliates, along with the related disclosure statement. (D.I. 13 & 14). Although styled as a "Prepackaged Plan," the Debtors were unable to confirm a plan for nearly one year after the Petition Date.

7. In mid-January 2019, the Debtors and Citiking International US LLC ("Citiking"), the Debtors' pre-petition secured lender, DIP Lender and Plan sponsor, reached a settlement with the Committee. *See* D.I. 831 at ¶¶ 6-7. The Committee Settlement was incorporated into the First Amended Joint Prepackaged Chapter 11 Plan of Reorganization for ONE Aviation Corporation and its Debtor Affiliates (D.I. 341). The Committee Settlement has not been approved.[2]

8. The Debtors were unable to reach any resolution with other parties, and issues arose regarding Citiking's failure to approve a DIP budget, resulting in the Committee filing an objection to the Debtors' Second Motion to Extend the Debtors Exclusive Periods to File and Solicit Votes on a Chapter 11 Plan in June 2019. *See* 544 at ¶¶ 12-14.

9. As a result, the U.S. Trustee filed his Motion for the Entry of an Order Dismissing the Chapter 11 Case, or Alternatively, Converting the Case to Chapter 7 Pursuant to 11 U.S.C. § 1112(b) on June 19, 2019. (D.I. 554; the "Motion to Convert"), and the Debtors pivoted to a sale process. *See* D.I. 561.

10. The U.S. Trustee objected to the proposed sale, in part, because it "include[d] provisions to honor the Debtors' settlement with the Committee . . . ." *See* D.I. 620 at ¶ 3. The

[2] The Committee Settlement was incorporated into a plan that was eventually confirmed. The confirmation order has been vacated, and as a result the approval of the Committee Settlement has been

Motion indicated that the consideration for the assets to be sold includes "funding the Committee Settlement."

11. On July 26, 2019, the Debtors withdrew the Original Sale Motion. (D.I. 663).

12. On August 30, 2019, the Debtors filed the Second Amended Joint Prepackaged Chapter 11 Plan of Reorganization for ONE Aviation Corporation and its Debtor Affiliates (D.I. 659). The Second Amended Plan incorporated the Noteholder Settlement (a settlement with the Allowed Senior Subordinated Secured Note Claims)[3], and a new proposed treatment of Kestrel Secured Claims. The Kestrel Secured Claims Class voted to accept the plan.

13. On September 17, the Debtors filed the Second Amended Joint Prepackaged Chapter 11 Plan of Reorganization (as Modified) for ONE Aviation Corporation and its Debtor Affiliates (the "Confirmed Plan," D.I. 703). The Confirmed Plan was confirmed on September 19, 2019. (D.I. 707).

14. One of the conditions to the effectiveness of the Plan was that it would become effective on or before December 1, 2019. D.I. 707 at Exh. A, 9.1.9. The Plan did not go effective by December 1, 2019.

15. On May 5, 2020, the Committee filed the Motion of the Official Committee of Unsecured Creditors to Convert Debtors' Case to Chapter 7 (the "Conversion Motion," D.I. 831). The Dismissal Motion alleged that Citiking was attempting to "negotiate concessions of fees requested by the Debtors' professionals . . . [and] has yet to finalize the New ABL/Term Loan Facility with DW Partners." *Id.* at ¶ 13,

16. At the hearing on the Conversion Motion, the Debtors sought additional time to

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vacated.

[3] The Noteholder Settlement was incorporated into a plan that was eventually confirmed. The confirmation order has been vacated, and as a result the approval of the Noteholder Settlement has been vacated.

bring the plan effective, relying on assurances from Citiking that it would finalize the outstanding documents, meet its funding obligations, and pay United States Trustee fees. Sale Motion at ¶ 11.

17. Nevertheless, according to the Debtors, Citiking failed to perform its obligations or finalize the Plan transaction documents. *Id*. at ¶ 12.

18. As a result, the Debtors pivoted again to a sale process, and filed the pending Sale Motion.

19. At the hearing on the bidding procedures, the Court ruled that the order confirming the Confirmed Plan was vacated. The Confirmed Plan provides, "If the Confirmation Order is vacated, which shall occur automatically upon failure of the Effective Date: . . . (b) any settlement of Claims or Interests provided for hereby shall be null and void without further order of the Bankruptcy Court." D.I. 707 at Exh. A, ¶ 9.3.

20. The proposed sale seeks to implement the various unapproved settlements that had been incorporated into the Confirmed Plan. In addition, the proposed sale does not provide for the full payment of all allowed administrative or priority claims.

21. The following chart details the treatment of claims in the Confirmed Plan and as provided by the Sale agreement:

	Treatment under Plan	**Treatment under Sale**
General Administrative Expense Claims	Paid in full	Some paid in full; some assumed by Purchaser; some subject to payment from proceeds of preference actions; limits on payment of all claims
Professional Fee Claims	Paid through the Professional Fees Escrow Account	Paid $1.5M, equal to all actual accrued, unpaid, and expected Professional Fees.

DIP Claims	Allowed DIP Claims shall be replaced with obligations in an amount equal to such Allowed DIP Claim under the New ABL/Term Loan Facility	Senior most priority DIP financing, paid up to $9.75M minus any Cure Amounts in excess of $1,000,000; Remaining DIP receives no distribution
Priority Tax Claims	Paid in full	Some subject to payment from proceeds of preference actions; limits on payment of all claims
Other Priority Claims	Paid in full	Some subject to payment from proceeds of preference actions; limits on payment of all claims
Other Secured Claims	Paid in full	No distribution
First Lien Credit Agreement Claims	100% New Common Stock	No distribution
Senior Subordinated Secured Notes Claims	Pro Rata Share of $700,000	Pro Rata Share of $700,000
Kestrel Secured Claims	Pro Rata share of $200,000, plus releases	Pro Rata share of $225,000, no releases
Unsecured Note Claims	No distribution	No distribution
ONE Aviation General Unsecured Claims	Pro Rata Share of $825,000 plus $50,000 to a Claims Reconciliation Expense Fund	Pro Rata Share of $825,000, but only to certain creditors set forth on unfiled Schedule 2.3(h), plus $50,000 to a Claims Reconciliation Expense Fund; if the distribution is not cashed within 4 months of distribution, the distribution shall be null and void and the applicable amount returned to Purchaser
Kestrel General Unsecured Claims	No distribution	No distribution
Intercompany Claims	Reinstated or released	n/a
Interests in ONE Aviation	No distribution	No distribution
Interests in Other ONE Aviation Debtors	Reinstated for administrative convenience	n/a; Sold to purchaser

Intercompany Interests in Kestrel	Reinstated for administrative convenience	n/a; Unsold debtors remain in bankruptcy
Non-Intercompany Interests in Kestrel	No distribution	n/a; Unsold debtors remain in bankruptcy
Section 510(b) Claims	No distribution	No distribution

22. The proposed asset purchase agreement sells certain Avoidance Actions to the Purchaser, but also includes a provision that Avoidance Actions "released or intended to be released under section 5.13.4 of the Plan shall not be pursued [by the Purchaser]." 2.1 (x).

23. The proposed asset purchase agreement also adds an additional basis for objecting to priority and administrative expenses that is not contained in the Bankruptcy Code. Section 9.18 requires priority, administrative expenses or other costs to be paid out of the Wind-Down Account to be submitted to both the Purchaser and the Debtors. The Sale Agreement permits the Purchaser and Debtors to object to such the claims on the basis that it is not consistent in kind or amount with the Wind-Down Budget.

ARGUMENT

I. The Sale Motion Should be Denied Because it Seeks to Distribute Estate Assets in Violation of the Bankruptcy Code's Distribution System

A. Under the reasoning of the Supreme Court's *Jevic* decision, the priority-skipping distribution proposed in the Sale Motion is impermissible.

24. The Sale Motion seeks approval of a sale that will distribute the proceeds of the sale of estate assets to certain subordinated secured lenders and certain general unsecured creditors, while not providing for the full payment of all priority and administrative claims, DIP claims, and senior secured claims, and potentially not excluding unsecured claims from distribution. In addition, the payments to the subordinated secured lenders and the payment to general unsecured creditors are pursuant to settlement agreements that have not been approved by this Court. The payment to Kestrel secured claimholders is based upon treatment provided in

the vacated Plan, which the Kestrel secured claimholders voted to accept, but does not include the mutual releases included within such plan.

25. In *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), the Supreme Court rejected a non-plan priority-skipping distribution of estate assets in a chapter 11 case that the three lower courts had approved. Although *Jevic* presented the Supreme Court with an end-of-case, "structured dismissal" scenario, the Supreme Court's reasoning is not limited to either structured dismissals or case-ending distributions. Rather, the *Jevic* reasoning applies whenever a bankruptcy court is presented with distributions of estate assets in a chapter 11 case "that would be flatly impermissible" even if they were proposed in a plan "because they violate priority without the impaired creditors' consent." *Id*. at 985.

26. The Supreme Court's *Jevic* decision was premised upon the bedrock principle that "[t]he Code's priority system constitutes a basic underpinning of business bankruptcy law," which is "fundamental to the Bankruptcy Code's operation." *Jevic*, 137 S. Ct. at 983, 984.

27. The statutory priorities are established by 11 U.S.C. § 507, which is made applicable to chapter 11 cases by 11 U.S.C. § 103(a).

28. Thus, when analyzing a request to make non-plan priority-skipping distributions in a chapter 11 case, this Court must examine the Bankruptcy Code for "some affirmative indication of intent [that] Congress actually meant to make [the proposed disbursement] a backdoor means to" circumvent the statutory priority system established by section 507. *Id*. at 984. "The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure." *Id.*

29. No Bankruptcy Code provision provides for the priority-skipping distribution proposed in the Sale Motion. As a result, it is not allowed.

30. Although the Supreme Court acknowledged in *Jevic* that some courts have approved interim, as opposed to final, distributions outside of the usual priority such as "first day" wage orders, "critical vendor" orders, and "roll-ups," it noted that "these courts have usually found that the distributions at issue would enable a successful reorganization and make even the disfavored creditors better off." *Id.* at 985. Such is not the case here – no "reorganization" will be possible once the Debtors' assets have been sold, and once the proceeds of the sale have been disbursed there will be little likelihood that the skipped creditors will later be made "better off."

31. In addition, the Supreme Court held in *Jevic* that even "critical vendor" orders and similar "violation[s] of ordinary priority rules" must have "a[ ] significant offsetting bankruptcy-related justification." *Id.* at 986. No significant offsetting bankruptcy-related justification is suggested by the Sale Motion.

32. Indeed, the distribution proposed by the Sale Motion is more comparable to the examples of "proposed transactions that lower courts have refused to allow on the grounds that they circumvent the Code's procedural safeguards" to which the Supreme Court referred to in *Jevic* with disfavor. *Id.* The Sale Motion must be similarly denied because it is nothing but an attempt to circumvent both the Bankruptcy Code's priority distribution system and its procedural safeguards, which protect creditors from exactly the kind of treatment the Sale Motion proposes for skipped creditors.

33. In reiterating the importance of complying with chapter 11's procedural safeguards, *Jevic* is entirely consistent with the Supreme Court's long history of protecting the substantive and procedural rights of creditors, not courts, to determine whether to accept a proposal that does not follow the priorities of distribution. *Cf. Norwest Bank Worthington v.*

Ahlers, 485 U.S. 197, 207 (1988) ("the Code provides that it is up to the creditors – and not the courts –to accept or reject a reorganization plan which fails to . . . honor the absolute priority rule"). Even if a "Court . . . believe[s] that petitioners or other unsecured creditors would be better off" with the proposed deal, that "determination is for the creditors to make in the manner specified by the Code." *Id.*

34. Further, 11 U.S.C. § 105(a) does not authorize the approval of a non-plan priority-skipping distribution, as this Court cannot "alter the balance struck by the statute." *Id.* at 987 (quoting *Law v. Siegel*, 134 S. Ct. 1188, 1198 (2014)).

35. The Supreme Court in *Jevic* also rejected the idea that bankruptcy courts can disregard the statutory priority system in "rare cases" in which they find "sufficient reasons." *Jevic*, 137 S. Ct. at 986. The Supreme Court determined that, because "it is difficult to give precise content to the concept 'sufficient reasons,'" the exception would likely swallow the rule, and every case would be presented to the bankruptcy court as the "rare case." *Id.* The Supreme Court further found the consequences of accepting a "rare case" exception to be "potentially serious," including: (i) "departure from the protections Congress granted particular classes of creditors"; (ii) "changes in bargaining power of different classes of creditors even in bankruptcies that do not end in structured dismissals"; and (iii) "risks of collusion, i.e., senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors." *Id.*

36. All of the evils identified by the Supreme Court are present here. The Sale Motion departs from the Bankruptcy Code's creditor protections, it changes the bargaining power of creditors left out of the money even if this case does not end in structured dismissal, and it evinces collusion between Debtors, the Noteholders, the Committee and the Purchaser to

"squeeze out priority unsecured creditors."

37. As the Supreme Court feared in *Jevic*, here a few powerful players – the Debtors, the Noteholders and the Committee – have colluded to divvy up estate assets at the expense of those with little to no leverage in the bankruptcy process. The Committee took their authority under 11 U.S.C. § 1103(c) to investigate and – where warranted – object to certain acts by the Debtors, and it monetized this power. The Code nowhere authorizes parties to take money in return for withdrawing objections about a motion's validity. Yet rather than let the bankruptcy court determine whether the Noteholders and the Committee have any valid objections to the sale or otherwise, the proposed asset purchase agreement simply honors unapproved settlements resulting in priority-skipping distributions.

38. At best, the Supreme Court perhaps left room for early-in-the-case distributions outside of priority under the "doctrine of necessity." But, the Debtors, the Noteholders and the Committee do not, and cannot, argue that the distributions proposed in the Sale Motion could satisfy such a test. The proposed payments are not to critical vendors, taxing authorities, or rank-and-file employees. In fact, taxing authorities are among the priority creditors being skipped by the proposed payments. There is no doctrine, or Code section, that permits advance payment of ordinary general unsecured creditors.

39. While this Court may find that a sale is a reorganization, the priority-skipping payments are not necessary to enable the sale. The proceeds of the sale should be distributed consisted with the Congressionally mandated distribution scheme. If the Noteholders or the Committee have any objections to the sale, such objections can be resolved by this Court. In light of the foregoing, even if the Sale Motion is not viewed as proposing an end-of-case distribution, under the *Jevic* reasoning the Sale Motion must be denied because it proposes a

non-plan priority-skipping distribution in circumvention of the Bankruptcy Code's priority system and procedural safeguards, without any offsetting bankruptcy-related justification.

B. The Sale Motion should be denied because it proposes a priority-skipping end-of-case distribution.

40. The proposed distribution of the proceeds of the sale of substantially all of the Debtors' assets to select general unsecured creditors and subordinated secured lenders is, for all intents and purposes, the end of these chapter 11 cases. Once the Debtors' assets have been sold and the proceeds disbursed, there will be little left for the Debtors to do but to dismiss their cases, convert them to chapter 7, or file a liquidating chapter 11 plan.

41. In *Jevic*, the Supreme Court ruled that a "distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies." *Jevic,* 137 S. Ct. at 978.

42. The Supreme Court also recognized in *Jevic* that nonconsensual deviation from the statutory priority scheme is prohibited under chapter 7 liquidations and the chapter 11 plan process. *Id*. at 979; *see also id*. at 983 (stating that estate assets are "normally" disbursed "through a Chapter 7 liquidation or a Chapter 11 plan," both of which "are governed by priority").

43. As a result, the Supreme Court held in *Jevic* that, under each of the three avenues for leaving chapter 11 – conversion, dismissal, and plan confirmation – bankruptcy courts cannot approve distributions that would violate the priority distribution system established by Congress without the consent of the affected parties. *Id*. at 979 ("It is important to keep in mind that Chapter 11 foresees three possible outcomes."). Nevertheless, the Debtors and the Committee

propose a chapter 11 regime in which, prior to the point of the case at which estate assets are "normally" disbursed, and seemingly before but obviously preparatory to one of these three case-exiting events, a bankruptcy court is somehow empowered to alter the statutory priorities. This argument flies directly in the face of the Supreme Court's reasoning in *Jevic*, and finds no support whatsoever in the Bankruptcy Code. As the Supreme Court held in *Jevic*, "more than simple statutory silence" is required before the distribution proposed in the Sale Motion can be approved. *Id.* at 984.

44. By moving the payment of creditors' claims, which usually occurs at the end of the case, up to the time when the sale is closed, and seeking approval of such distributions even before the sale occurs, the Sale Motion seeks to avoid very important protections built into the structure of a chapter 11 case. These proposed distributions: (i) do not provide for payment in full of all administrative and priority claims; (ii) may discriminate in payment on unsecured claims (which payment is based upon a schedule of claims not filed with the Court or served on creditors); (iii) provide payment to a secured class of claims based on a proposed plan distribution that was previously accepted, but without the mutual releases that the plan previously provided; and (iv) fail to follow the plan solicitation process.

45. Here, the proceeds of the sale of substantially all of the Debtors' assets will be disbursed to unsecured creditors on their prepetition claims. No matter what the Debtors and the Committee call them, these are final distributions that will not provide any benefit to the Debtors' estate. They will not promote the Debtors' on-going business, will not fund litigation, and will not assist the Debtors' reorganization efforts. Simply put, there is no doctrine or Code section that permits early payment of general unsecured creditors from the proceeds of the sale of substantially all of the Debtors' assets in violation of the priority system.

C. Even if *ICL Holding* remains good law after *Jevic*, it is not applicable here because the Sale Motion proposes a distribution of estate property.

46. The Debtors and the Committee appear to contend that the proposed sale does not run afoul of *Jevic* because the disbursements are being made by the Purchaser directly to the Committee. As a result, the Debtors and the Committee may argue that the Third Circuit's decision in *In re ICL Holding Co., Inc.*, 802 F.3d 547 (3d Cir. 2015) governs this situation and supports granting the Sale Motion.

47. That argument fails because, unlike the sale proceeds to be disbursed here, the secured creditor's contribution in *ICL Holding* was not the proceeds of the sale of its collateral. In *ICL Holding*, a secured creditor seeking to purchase the assets of a number of debtors (including LifeCare Holdings, Inc.) agreed to place cash in a trust for the benefit of general unsecured non-priority creditors. *ICL Holding*, 802 F.3d at 551. In exchange, the creditors' committee withdrew its objection to the sale. *Id*. The Third Circuit found that the settlement between the creditors' committee and secured creditor did not need to comply with the priority scheme, but it did so on a narrow, factual ground. As the court explained, it allowed the transaction because the funds contributed by the secured creditor were not estate property because they "were not proceeds from its liens, did not at any time belong to LifeCare's estate, and will not become part of its estate even as a pass-through." *Id.* at 555-56.

48. Indeed, the Third Circuit in *ICL Holding* stated that "[w]e are not dealing with collateral (if we were, this would suggest it was LifeCare's property)." *Id.* at 557. The Third Circuit expressly distinguished the facts before it from "an ordinary carve-out . . . under which secured creditors permit the use of a portion of their collateral [that is, *estate property*] to pay administrative costs." *Id*. (emphasis in original).

49. Here, unlike in *ICL Holding*, the disbursement will be made from money derived

from the sale of the Debtors' property. The proceeds of the sale of estate property are themselves estate property. *See* 11 U.S.C. § 541(a)(6) ("property of the estate" includes "[p]roceeds . . of or from property of the estate). And, as the Third Circuit recognized in *ICL Holding*, even proceeds of the sale of estate property that serves as collateral for a secured creditor's lien is nevertheless still estate property. *ICL Holding*, 802 F.3d at 557.

50. Under the original asset purchase agreement filed with this Court, the contribution to the General Unsecured Creditors was listed as "consideration" for the sale of assets. Subsequently, the asset purchase agreement was amended, in an attempt to establish that the payment to the General Unsecured Creditors was not being made out of proceeds of the sale. This attempt failed.

51. The revised asset purchase agreement provides that the obligation to pay General Unsecured Creditors in the aggregate amount of $825,000 is an "Assumed Liability." D.I. 900 at Exh. 1, Section 2.3(h). The assumption of the liabilities set forth in Section 2.3 is expressly included in the consideration being paid for the Debtors' assets. *Id.* at Section 3.1 ("The aggregate consideration for the Purchased Assets shall equal of the sum of . . . the assumption and, without duplication, payment of the Assumed Liabilities.").

52. The payment to the General Unsecured Creditors in this case also differs from that in *ICL Holding* in a critical way. The Debtors, and not the Committee, are parties to the Sale Agreement. Unlike *ICL Holding*, where the debtors were not parties to the settlement or the motion to approve it, the Debtors here have negotiated the sale of their assets to the Purchaser and expressly agreed that part of the consideration for their assets would be the assumption of the unapproved settlement obligation to pay the General Unsecured Creditors the aggregate amount of $825,000.

53. In any event, it is not clear that *ICL Holding* is still good law, because, after *Jevic*, there is no longer any reason to draw a distinction between estate and non-estate property with regard to non-plan priority-skipping distributions in chapter 11 cases.

54. To be sure, the Supreme Court in *Jevic* did not expressly consider whether the Code's priority rules apply to "gifts" of purportedly non-estate property. But, in rejecting the *Jevic* settlement, the Supreme Court demanded strict adherence to the rules established by Congress and laid bare the true harms of so-called "gifting."

55. As previously mentioned, courts cannot approve distributions that deviate from the statutory priority system simply because the Code does not contain an express prohibition. Because the Supreme Court in *Jevic* held that the priority system is fundamental to the Code's operation, any departure from the priority system (whether in a structured dismissal, sale, settlement, or other court-approved agreement) must come from Congress. No authorization exists for bankruptcy courts to approve priority-skipping gifts of non-estate property. The integrity of a comprehensive bankruptcy system, including the painstakingly detailed priority rules governing distributions to creditors, cannot be cast aside in favor of creditor side deals. *Cf. In re Lehman Bros. Holdings, Inc.*, 508 B.R. 283, 294 (S.D.N.Y. 2014) ("The Bankruptcy Code is meant to be a comprehensive federal scheme . . . to govern the bankruptcy process.") (internal quotation marks omitted). "Although flexibility is necessary, the federal scheme cannot remain comprehensive if interested parties and bankruptcy courts in each case are free to tweak the law to fit their preferences." *Id*. (internal quotations and citations omitted). Simply put, parties should not reap the benefits from the comprehensive bankruptcy process without also accepting its obligations, including the obligation to follow statutory priorities.

56. In addition, the Third Circuit in *ICL Holding* failed to consider the full

consequences of priority-skipping distributions. By contrast, the Supreme Court in *Jevic* exposed the harms that priority-skipping settlements inflict upon disfavored creditors and observed that departures from the Code's priority rules – even in supposedly "rare" cases – run counter to the protections Congress granted particular classes of creditors. *Jevic*, 137 S. Ct. at 986. Those statutory protections take precedence over even well-intentioned payments to junior creditors, and departing from them invites "collusion, i.e., senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors." *Id.* at 986-87 (*citing Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 444 (1999) (discussing how the absolute priority rule was developed in response to "concern with 'the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage'" (quoting H.R. Doc. No. 93–137, pt. I, at 255 (1973))).

57. The failure to follow the statutory priorities increases uncertainty in the bankruptcy process and so makes settlements more, not less, difficult to achieve. *Jevic*, 137 S. Ct. at 987. The Supreme Court recognized that priority-circumventing theories such as "gifting" undermine the rights of creditors by, among other harms, depriving them of the prospect of a settlement that respects their priority.

58. Here, accepting the argument that the disbursements will be funded by money "gifted" by the Purchaser, rather than from estate funds created by the sale of substantially all of the estate's assets, would unleash the very harms that the Supreme Court in *Jevic* sought to avoid, namely the increased difficulty of reaching global settlements and the seeming collusion between debtors and favored creditors to squeeze out disfavored creditors.

59. For all of these reasons, even if *ICL Holding* remains good law after *Jevic*, it does

not apply here. As a result, it provides no support for the Sale Motion, which must be denied.

II. The Sale Motion is a *Sub Rosa* Plan That Could not be Approved Outside of a Chapter 11 Plan

60. The Sale Motion seeks authorization for a chapter 11 distribution of the sort that one would find in an impermissible *sub rosa* plan. The Third Circuit requires that settlements not "short circuit the requirements of Chapter 11 . . . by establishing the terms of the plan *sub rosa* in connection with the sale of assets." *In re Energy Future Holdings Corp*., 648 F. App'x 277, 284-85 (3d Cir. 2016), *cert. denied*, 137 S. Ct. 447 (2016) (quoting *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983) (internal citation omitted).

61. Moreover, in rejecting the Third Circuit's "rare exception" approach, the Supreme Court in *Jevic* noted that the distributions at issue there "more closely resemble[d] proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards," citing the Fifth Circuit's *Braniff Airways* decision. *See Jevic*, 137 S. Ct. at 986 (citing *Braniff*, 700 F.2d at 940) (additional citations omitted).

62. In *Braniff*, the Fifth Circuit reversed the district court's approval of an agreement and a memorandum of understanding between the debtor and various creditors under section 363 of the Code. In particular, the court held that certain parts of the transaction were clearly outside of the scope of section 363(b) because the settlement had the effect of: (i) dictating any future reorganization plan; (ii) disenfranchising creditors from their right to vote on a reorganization plan; and (iii) releasing claims against the debtor. *Braniff*, 700 F.2d at 940.

63. In *EFH*, the Third Circuit quoted *Braniff*'s analysis in reviewing a settlement, thereby making it clear that settlements cannot dictate the terms of any future reorganization plan. *Energy Futures*, 648 F. App'x at 284-85 ("When a transaction or settlement in bankruptcy has the effect of dictating some of the terms of any future reorganization plan, a court deems the

transaction impermissible[.]") (internal and citation omitted).

64. The distribution of the proceeds of the Debtors' assets is being outside of a court-approved Chapter 11 plan. The detailed distribution obligations, which include *limitations* on the payment of administrative and priority claims that are not included within the DIP or wind-down budgets, or included on unfiled schedules to the asset purchase agreement, will not provide any distribution on the DIP or prepetition secured loans held by Citiking, and provide no distribution to holders of "Other Secured Claims," but provide for the same treatment for Noteholders, Kestrel Secured Claims and ONE Aviation General Unsecured Claims as provided by the vacated plan demonstrate that the sale is a *sub rosa* plan, whereby the Debtors have selected some portions of the vacated plan while rejecting others.

65. Accordingly and for all practical purposes, the Sale Motion is a *sub rosa* plan to substitute for a confirmable chapter 11 plan. As a result, it should be denied.

Conclusion

66. Absent a sufficient record that the Debtors will promptly pay all outstanding administrative expense claims and all priority claims, including priority tax claims, that the sale process will not render the estates administratively insolvent, that the proposed sale does not suffer from impermissible terms rendering the process futile, and that there is a sufficient wind-down budget to pay all subsequently incurred administrative expenses, the Motion should be denied.

WHEREFORE, the United States Trustee requests that this Court deny the Motions.

Andrew R. Vara,
United States Trustee, Regions Three and Nine

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